9:40 to 1 PM
Extra time - 20 min

NEXT IAS

(To be filled by candidate)

Name of Candidate : R Sri Rusat

Roll No. : MT24ECOL1021 Contact No. ....

e-mail: ...@gmail.com Date of Examination : 09/07/2024

Exam Centre : Old Rajinder Nagar ☐ Online ☑

CSE (MAINS) TEST SERIES-2024

Test-02	ECONOMICS OPTIONAL
Dated : 07-07-2024	*(International Trade and Development Economics)*

Time Allowed : Three Hours

Maximum Marks: 250

QUESTION PAPER SPECIFIC INSTRUCTIONS

(Please read each of the following instructions carefully before attempting questions)

*There are **EIGHT** questions divided in **Two sections** and printed in **ENGLISH**.*

*Candidate has to attempt **FIVE** questions in all.*

*Question No. **1** and **5** are compulsory and out of the remaining, any **THREE** are to be attempted choosing at least **ONE** question from each section.*

The number of marks carried by a question/part is indicated against it.

Answers must be written in the medium authorized in the Admission. Certificate which must be stated clearly on the cover of this Question-cum- Answer (QCA). Booklet in the space provided.

No marks will be given for answers written in a medium other than the authorized one.

Word limit in questions, wherever specified, should be adhered to.

Attempts of question shall be counted in sequential order. Unless struck off. Attempt of a question shall be counted even if attempted partly. Any page or portion of the page left blank in the Question cum Answer (QCA). Booklet must be clearly struck off.

DELHI CENTRE:
Old Rajinder Nagar: 27-B, Pusa Road, Metro Pillar no. 118, Near Karol Bagh Metro, New Delhi-110060 | Phone: 8081300200
Mukherjee Nagar: 1422, Main Mukherjee Nagar Road, Near Batra Cinema, New Delhi-110009 | Phone: 8081300200
BHOPAL CENTRE: Plot No. 46 Zone - 2, M.P Nagar, Bhopal - 462011 | Phone: 8827664612, 8081300200
JAIPUR CENTRE: Plot No. 6 & 7, 3rd Floor, Sree Gopal Nagar, Gopalpura Bypass, Jaipur - 302015 | Phone: 9358200511
PRAYAGRAJ CENTRE: 31/31 Sardar Patel Marg, Civil Lines, Prayagraj, Uttar Pradesh - 211001 | Phone: 9958857757

(For filling by Examiners only)

Q. No.	Page No.	Max. Marks	Marks	Total	Signature
1. (a)	4	10			
1. (b)	6	10			
1. (c)	8	10			
1. (d)	10	10			
1. (e)	12	10			
2. (a)	14	15			
2. (b)	17	20			
2. (c)	21	15			
3. (a)	24	15			
3. (b)	27	20			
3. (c)	31	15			
4. (a)	34	20			
4. (b)	38	10			
4. (c)	40	20			
5. (a)	44	10			
5. (b)	46	10			
5. (c)	48	10			
5. (d)	50	10			
5. (e)	52	10			
6. (a)	54	20			
6. (b)	58	20			
6. (c)	62	10			
7. (a)	64	15			
7. (b)	67	15			
7. (c)	70	20			
8. (a)	74	20			
8. (b)	78	20			
8. (c)	82	10			
Grand Total					

Remarks

Observations:

SECTION-A

Write notes on the following in about 150 words each: (10 × 5 = 50)

Q.1 (a) Explain using RD-RS curve, the impact of a transfer on importing country. Illustrate all cases.

Q.1 (b) Comment on the empirical evidence of the PPP theory.

PPP theory entails that in the economy where there exists different price levels in the economy leading to the proportionate shifting in the ~~terms of trade~~ basket of goods of different countries (i.e) exchange rate multiplied by price differential.

$$\boxed{\text{Absolute PPP} = e\frac{P}{P^e}}$$

~~Eta~~ $e \rightarrow$ exchange rate
$P \rightarrow$ Price level in domestic economy.
$P^e \rightarrow$ Price level in the foreign economy.

Empirical relevance of PPP theory

Baumol studied the empirical relevance of PPP and he observed the following:-

i) The absolute PPP relation does not exist between 2 countries due to the following:-

(a) Existence of non-tradeable goods in the country.

~~(b)~~ eg:- service Professionals like doctors, barbers etc.

(b) ~~E~~ Presence of tariff barriers like

eg:- Customs duty, Import Quota.

(c) Presence of non-tariff barriers
eg:- Transportation and logistics cost in the economy.

(d) level of income and standard of living in both economies.

(ii) However, he pointed out the relative PPP can exist in both economies over the period of time.

(iii) He shows using the data of 2 countries- UK and US and shows ~~the~~ over the years the relative PPP relation may exist.

Therefore, there is no absolute convergence of price levels in the economy but relative convergence or relative PPP exists in the economies of 2 countries.

Q.1 (c) Explain Rybczynski theorem.

According to the Rybczynski theorem, the trade between two countries happens because of "abandance of factors" employed in the production of those commodities.

Assumptions

1. Perfect factor mobility in the economy.
2. 2 goods - X and Y.
3. 2 countries - A and B.
4. 2 factors of production - Labour and capital.
5. Incomplete specialisation in the economy.

Model

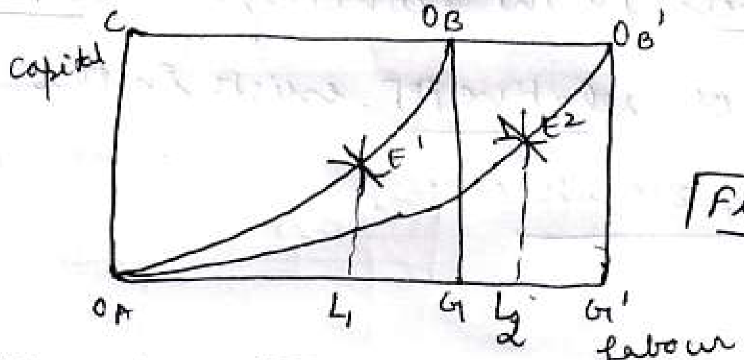


Fig 1

From the above Fig 1 we can see the following:

i) At E_1, the economy A employs L_1 amount of labour in the economy showcasing its labour intensive production in the economy.

(ii) At E_1, it still uses some level of capital in the export of commodities.

(iii) When the factor (i.e.) ~~to~~ labour employed in the production increases from OBG to $OB'G'$, then the production of the export ~~comp~~ commodities increases from E^1 to E^2.

(iv) The above leads to increase in employment of labour from L_1 to L_2.

(v) At E_2, level of production, the capital used in the production is relatively less than capital used in the point E_1.

$\boxed{\text{Criticisms}}$

① The role of technology is absent in the model.

② The "perfect factor mobility" in actual economy is very restricted.

③ It assumes employment for all labour- not taking into consideration the possession of skills and abilities of the labourers.

Q.1 (d) What is Stolper-Samuelson theorem?

Stolper-Samuelson theorem acts as a corollary to the Heckshler-Ohlin model wherein the trade between two countries based on different relative price level leads to the equalisation of price between the economy.

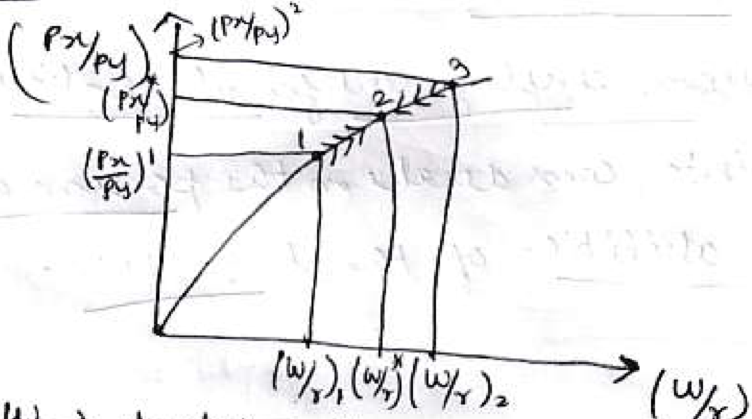
Assumptions

① The factor mobility happens between the countries.

② No significant tariff and non-tariff barriers in the economy.

③ Identical tastes and preferences of the consumers in both countries.

Model



w → factor price for labour → wages

r → factor price for capital → rent

Explanation

(i) At point 1, the relative price for labour and capital is $(w/r)_1$ and the relative price level of the commodities is $(Px/Py)_1$.

(ii) At point 3, the relative price level for labour and capital is $(w/r)_2$ and the relative price level for the commodities is $(Px/Py)_2$.

(iii) When both countries engaging in trade then the domestic country producer imports capital in the economy and exports labour to the foreign country. (At point 1).

(iv) At point 2, the foreign country exports the capital to the domestic country and imports the labour from the domestic country.

(v) This transaction happens till it reaches point 2 where,

$$\boxed{\frac{Px}{Py} = \frac{w}{r}}$$ → No further export and import of factor commodities in the economy.

Q.1 (e) Comment on political economy of policy of protection.

Political economy ~~so~~ of policy of protection uses the non-economic reasons to justify the existence of tariff and non-tariff barriers in the economy.

Political economy of Policy of protection

(i) Infant Industry Argument – The industry/ies at the nascent stage of development would not be able to protect itself from the "cheaper goods" imported by the high developed countries due to their achievement of "Economies of scale" and "technological diffusion" in their respective economies.

(ii) Maximization of Govt. revenue – by levying of customs duty, ~~exp~~ special additional customs duty etc to maximise their development objectives

Eg:- India's budget 2022-23 shows that Customs duties occupied about 8% of total govt. revenue.

(iii) Creation of jobs - Domestic industries would lift surplus labour from the economy to the industrial sector to solve the problem of disguised unemployment.

(IV) National security Argument - Provision of public goods like defense etc act as "sensitive national security issues" which are taken place with the help of govt's policy decisions.

(V) Argument for de-merit goods - Trade of de-merit goods like Tobacco, etc are restricted taking into consideration the health of the domestic population.

Thus, the above arguments are mainly given by the political economists against free trade.

Q.2 (a) Examine the impact of positive external shock on output and interest rate in case of imperfect capital mobility. (15)

Impact of positive external shock takes place in the form of higher foreign investment, invention of new market, products, production technique and raw materials by the domestic economy.

Imperfect capital mobility is due to the capital control restrictions by the Government of the domestic country.

Impact of Positive External shock

(I) When $Y < Y_F$

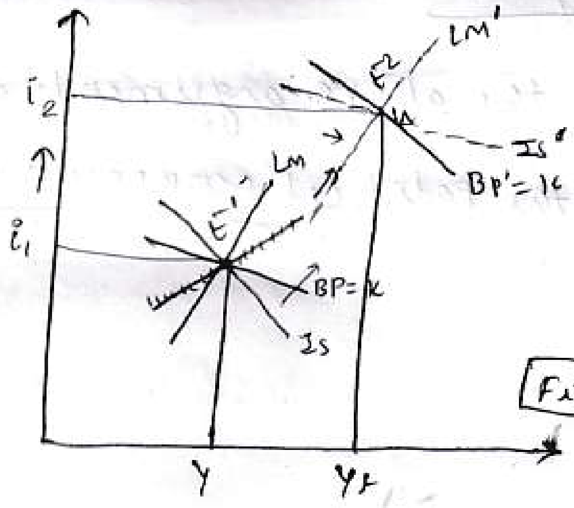


Fig 2

From Fig 1 we can decipher the following:-

(i) The initial equilibrium happens where at E_1 the IS economy is at both external and internal balance.

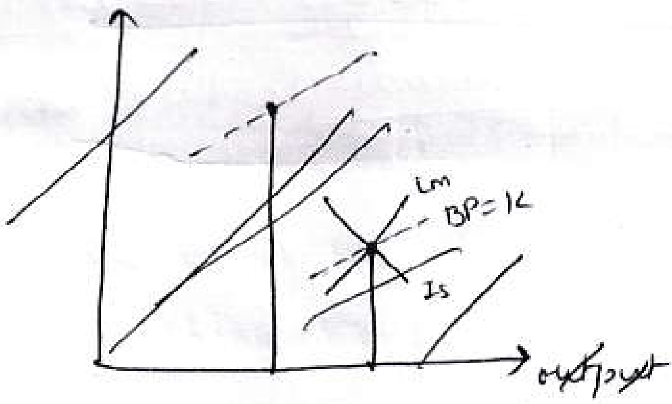
(ii) when sudden positive external shock occurs, then it shifts the BP=K from E_1 to E_2 towards right BP'=K. At this level, BoP records trade surplus.

(iii) This leads to inflow of foreign currency leading to the purchasing of foreign currency and releasing domestic currency by the central bank shifting the LM curve from LM to LM'.

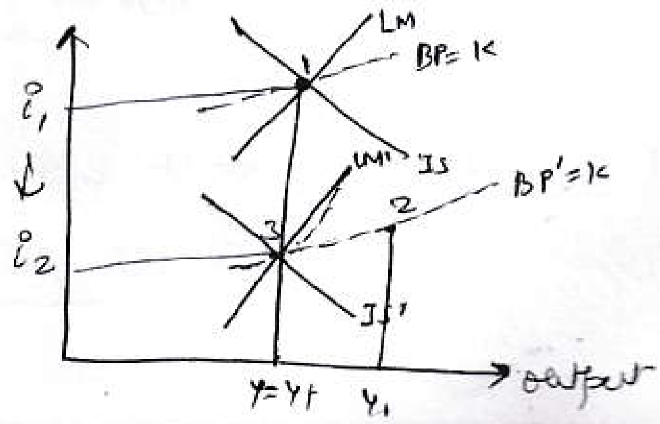
(iv) Now, the rise in exports to the new discovery of an economy shift the IS curve from E' to E_2.

(v) At point E_2, the economy is at both the internal and external balance, & rising the output from $\boxed{Y_1 \text{ to } Y_f}$ and interest from $\boxed{i_1 \text{ to } i_2}$

(II) when $Y > Y_f$



(II) When $\boxed{Y = Y_f}$



↳ When output happens at full employment level of output then positive shock leads to to the point of overemployment at point 2.

↳ This lead to BP=K shifting $\boxed{BP=K'}$ then BoP ~~att~~ gets surplus now the LM curve shifts downwards ~~backward~~ by absorbing the extra cash leading to monetary expansion.

↳ The above is accompanied by fiscal contraction leading to the reduction of interest rate from i_1 to i_2.

Thus, the ~~tax~~ monetary policy and fiscal policy is used to achieve the external and internal balance in the economy.

Q.2 (b) Critically examine H-O model. (20)

According to Hecksher-Ohlin model, A country facing higher labour intensive production or higher capital intensive production would export that commodity which has factor intensification and imports commodities where it is less factor intensive.

Assumption

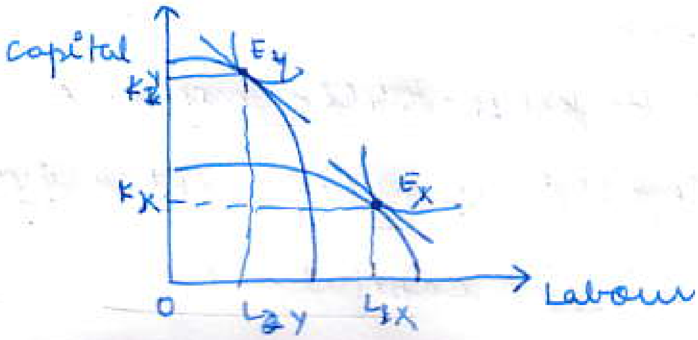
① 2 factors of production - labour and capital.
② 2 country - country X and country Y.
③ Country X uses the labour intensive production technique and country Y uses the capital intensive production technique.
④ (i.e) country X → $\frac{K}{L} < 1$ and country Y → $\frac{K}{L} > 1$

④ Incomplete specialisation occurs in both the countries

⑤ Perfect capital mobility between the factors of production.

Model

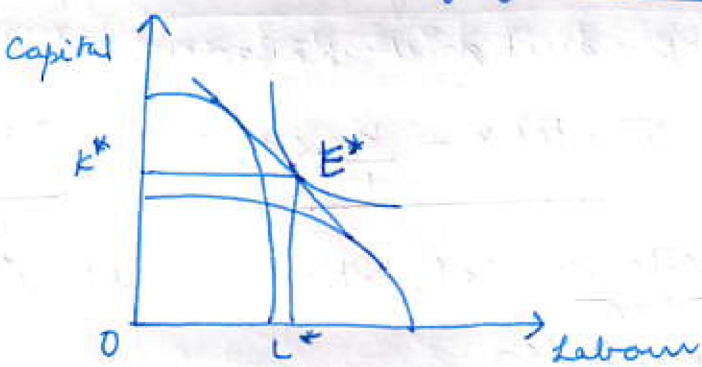
I) When the countries use their factor intensive production method:



↳ Here the country X produces output using L_X labour and K_X capital to produce the optimum level of output whereas country Y produces using L_Z^Y level of labour and K_Z^Y level of output.

↳ The respective economies reach their Optimal points at E_1 and E_2 at Autarky prices

II) When the countries engage in trade:



↳ When the countries opt for trade then they reach the point E^*, with the factor employment of labour at L^* and capital at K^*.

↳ Country X exports labour intensive commodity and imports capital intensive commodity.

(iii) country Y exports capital intensive commodity and imports labour intensive commodity.

Criticism

① The role of technology is ignored in the H-O model.

② The role of foreign investments and foreign capital are neglected.

③ In a real economy, there are more than 2 countries exchanging commodities with each other - complicating the H-O model.

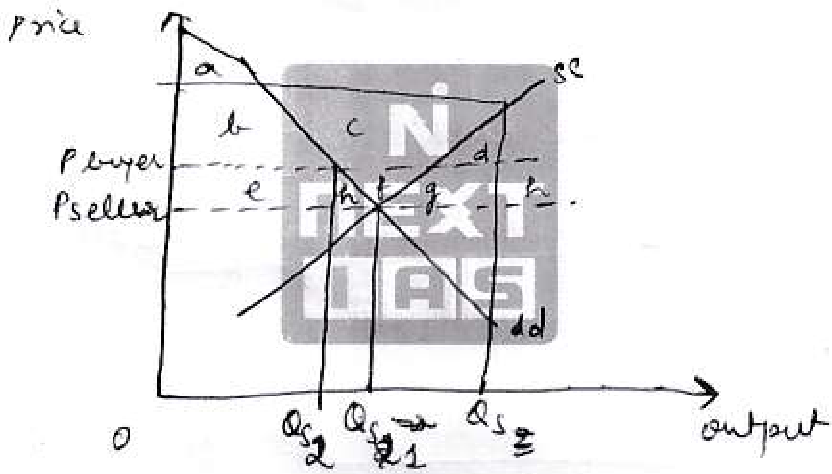
④ The role of Social Overhead Capital and Directly production Activities are ignored.

Candidates must not write on this margin

Q.2 (c) Explain the impact of export subsidy on welfare of the country. (15)

Export subsidy refers to the incentives given by the state to exporters leading to increased supply of goods to the foreign market and reduced supply of goods in the domestic market.

Impact of Export subsidy in large country



components	Before Export subsidy	After Export subsidy
① Consumer surplus	a + b + e + h	a + b
② Producer surplus		


NEXT
IAS

Candidates must not write on this margin

Q.3 (a) Write a note on the evolution of exchange rate mechanism in 20th century. (15)

Candidates must not write on this margin

Candidates must not write on this margin

Q.3 (b) What is the role and impact of speculation in fixed and floating exchange rate? (20)

Candidates must not write on this margin

Q.3 (c) What is the impact of monetary policy under perfect capital mobility and fixed price? (15)

Candidates must not write on this margin

Q.4 (a) What is the impact of a positive real shock on Aggregate Demand, price and output in open economy? (20)

Q.4 (b) Explain the general equilibrium import of tariff levied by small and large country. (10)

Q.4 (c) Describe the classical theory of F.D.I. (20)

Candidates must not write on this margin

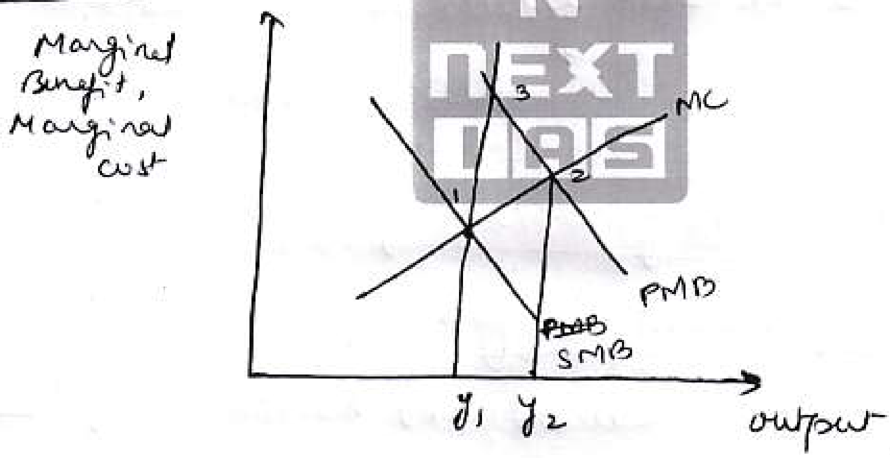
SECTION-B

Write notes on the following in about 150 words each: **(10 × 5 = 50)**

Q.5 (a) Examine the free rider problem in environmental degradation.

Free rider problem refers to the non-excludability of certain users from using the public goods which leads to the problem of over-consumption ~~to~~ due to its non-rivalrous character.

Model

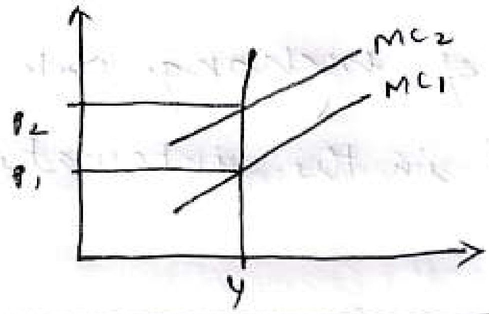


Here, SMB = Social Marginal Benefit and
PMB = Private Marginal Benefit.

(i) The SMB is much less than the PMB leading to the problem of the free rider in the economy.

(ii) The individual using the commodity does not reveal his preference leading to footing of bill by other.

In Public goods provision :-



$\boxed{P_1 + P_2 = \text{Cost of public good}}$

Since the preference of the consumer is not revealed it leads to non-provision of public goods since it cannot be provided for single person.

It happens in the case of provision of public goods like hospitals (public funded), Infrastructure like provision of roads, ports, and airports.

Q.5 (b) Explain the role of Washington Consensus in redefining the role of state

Washington Consensus ~~entails~~ (1945) entails minimum state intervention in the management of exchange rate and currency prices in the international market.

Redefining the role of state

① Usage of fixed exchange rate system-
The domestic currency has to be pegged with dollar prices.

② Unnecessary currency interventions in the form of "Beggar thy neighbour policy" should be avoided.

③ Establishment of IMF and World bank-
To manage the external economy and to act as the ~~exter~~ lender of last resort for countries facing currency crisis.

④ The exchange rates can only be changed when balance of payments faces extreme cases of deficit or surplus.

However, the fixed exchange rate system collapsed in 1977 due to:

(i) Use of "expenditure switching policy" was still prevalent in the economy.

(ii) The Balance of payment of developing countries often faced excessive deficits but could not interfere leading to currency crisis.

(iii) Problem of stagnation affected the economies of the world.

eg:- 1973 — oil price shock

Therefore, the central banks started following floating or managed floating exchange rate to maintain external balance in the economy.

Q.5 (c) What are the core requirements of strategy of agricultural and rural development?

The core requirements of strategy of agriculture and rural development requires solving the problem of lesser productivity in agriculture, to disguised unemployment and lesser capital accumulation in the economy.

Core requirements of strategy of agricultural and rural development.

① Higher investment in modern inputs of agricultural sector.

Deg:- agricultural fertilisers, pesticides, seeds.

② Development of rural infrastructure.

Deg:- Development of feeder roads, cold-storage chains etc.

③ Higher technological infusion

Deg:- Usage of 'Artificial Intelligence, Precision technology in Agri sector.

④ Development of food processing sector

Deg:- It leads to value addition in branding, packaging and storage.

(5) Multiple crop rotations can be practised

Eg:- Inter-cropping of pulses and vegetables.

(6) Integrated pest management

(7) Integrated farm management.

(8) Provision of timely credit to meet the working capital shortage etc.

Eg:- In India, Usage of Kisan credit cards.

Therefore, the above requirements are to be met to ensure sustainable development in agri sector.

Q.5 (d) Analyse the policy of balanced growth.

According to Nurkse, Social Marginal Product of development is greater than the Private Marginal product of development and therefore the govt. must invest in the Social Overhead Capital and Direct Productive Activities to increase the balanced growth.

Demand side → Low employment, low economic growth rate leads to low demand therefore low income in the ~~econ~~ economy. This can be mitigated by investing in Social Overhead Capital (SOC) and Direct Productive Activities (DPA) ~~ac~~ appropriating more external benefit in the economy.

Supply side → Less production, Less investment leads to less ~~emplo~~ productivity and less job creation leading to lower income in the economy.

Horizontal and vertical integration of economy leads to:-

① Balanced development and simultaneous investment of rural and urban sectors of the economy.

(2) ~~Balanced groth~~ Simultaneous investment in the agriculture and industrial sector in the economy.

(3) Simultaneous investment in the external and internal balance of the economy.

Criticism

(1) Higher level of expenditure ~~exists~~ required for the balanced growth.

(2) Developing economies cannot afford higher resources to invest in both SOC and DPA.

(3) Identification and investment based on which sector acts as linkage ~~is no~~ differs from economy to economy.

Candidates must not write on this margin

Q.5 (e) Explain the theory of Solow model with respect to role of saving in development.

According to solow, the creation of additional investment with the help of saving creates no growth effect but leads to level effect in the economy.

Assumptions

① 2 factors of production - Capital and labour.

② Additional saving is completely invested in the economy in the form of investment.

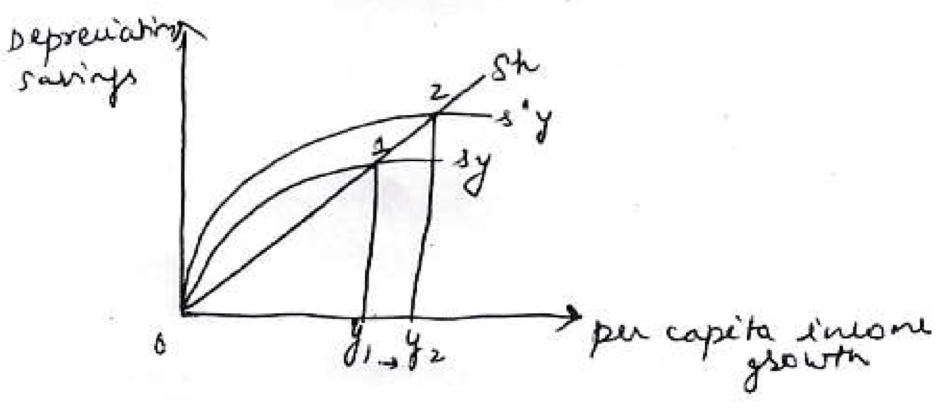
③ The economy operates at Autarky prices (i.e) closed economy.

④ The role of technology growth is exogeneous to the model.

Model

when savings rate increases from s^1 to s^2.

then,



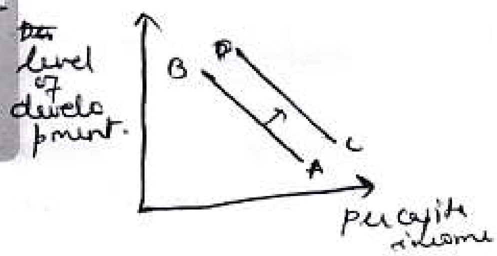
(i) when savings increases from s^1 to s^2 then the level of investment rises faster than the rate of depreciation in the economy.

(ii) At steady state 1, the rate of capital accumulation is higher than the rate of ~~savings~~ depreciation in the economy.

(iii) This leads to higher growth rate & ~~as~~ till it reaches the point from 1 to 2.

(iv) ~~B~~ The output production percapita increases from y_1 to y_2.

(v) There is no growth effect in the economy but level effect



Numerical

$$\Delta k = sy - dk$$

⇒ when s reaches from sy to s'y. then,

⇒ $\Delta k = s'y - dk$

⇒ $\boxed{s'y - dk = 0}$ (No growth rate effect)

⇒ $s'y = dk$

⇒ $\boxed{y = \frac{dk}{s'}}$ or $\boxed{k = \frac{s'y}{d}}$

Q.6 (a) Critically examine the policy options in developing and developed economies for solving environmental issues. (20)

Candidates must not write on this margin

Candidates must not write on this margin

Candidates must not write on this margin

Q.6 (b) Analyse the policy options where there can be positive intervention to reduce inequality and poverty. Substantiate your arguments. (20)

Candidates must not writ on this margi

Q.6 (c) Explain Malthusian trap. (10)

Candidates must not write on this margin

Candidates must not write on this margin

Q.7 (a) Examine the role of Central Bank in development? (15)

The central Bank acts as a monetary policy guardian in the modern economy. It plays crucial role in price stability and maintaining the external balance of the economy.

Role of Central Bank

① Issuer of currency

a) Central bank enjoys the complete monopoly in issuing of currency.

(b) According to the demand and supply of currency in the economy it issues the currency.

② Maintaining stable exchange rate

(a) In fixed Exchange rate, The central bank fixes the exchange rate as per the trade dynamics of the economy.

(b) In floating Exchange rate, the central bank has negligible control over the exchange rate in the ~~econo~~ economy.

(c) In the managed floating exchange rate, The central bank intervenes when the exchange rate breaches the price band set by the economy.

▷ eg:- RBI intervenes when the domestic currency depreciates beyond the price band to stabilise the currency rate.

③ Lender of Last Resort

a) It acts as the lender of last resort by helping the ailing bank to stabilise.

(b) It takesover the management of such banks and makes sure the financial health of the bank is revived.

(c) To the Governments, The central bank lends the money in the crisis situations.

▷ eg:- Deficit financing by the central bank when the government's revenue is minimal in comparison to the government's expenditure.

④ Maintaining stable price level

(a) During the Inflationary and deflationary situations, the govt. uses quantitative and qualitative methods to maintain the price level:-

(i) Quantitative methods

1 - Repo rate - The rate at which Central bank lends to the Commercial bank.

2 - Reverse Repo Rate - The rate at

Candidates must not write on this margin

which the commercial bank can park extra Cash reserves with the central bank.

(5) Banker to the Govt.

a) The central bank maintains the accounts (i.e) Receipts and expenditure of the Govt.

(b) It makes and receives payment on behalf of the govt.

(6) Maintains the Balance of Payments

(a) It records the transactions of the domestic Country with respect to the foreign currency in a systematised manner.

Thus, the Central bank plays a central role in ensuring monetary stability in the economy contributing to the financial stability.

Q.7 (b) Distinguish Romer's model from Solow model in the treatment of technology and savings. (15)

Romer model focuses on the endogeneous technology growth due to the investment and accumulation of capital in the economy whereas Solow focused on exogeneous technological growth placing it outside the ~~model~~ growth model.

$\boxed{\text{Romer Model}}$

$Y = f(K, AL)$

$AL \rightarrow$ Labour augmenting technology

$K \rightarrow$ capital.

Now, $\left(\frac{dL}{dt}\right)\left(\frac{1}{L}\right) = \frac{\dot{L}}{L} = n \rightarrow$ Labour growth @ n rate.

$\left(\frac{dA}{dt}\right) = \dot{A}$ $(A \rightarrow$ ~~creation of knowledge~~ research and development$)$

Now, $\dot{A} = \underline{\delta} L_A^{\lambda} \rightarrow (1)$ (where $L_A \rightarrow$ labour involved in creation of knowledge at 'λ' proportion)

Here, $\underline{\delta} = \delta \cancel{L_A} \delta A^{\phi} \rightarrow (2)$ ($\phi \rightarrow$ creation of knowledge)

Then, $\dot{A} = \delta A^{\phi} L_A^{\lambda} \rightarrow (3)$

Dividing eqn (3) by A we get,

$$\frac{\dot{A}}{A} = \frac{\delta A^{\phi} L_A^{\lambda}}{A}$$

$$\Rightarrow \frac{\dot{A}}{A} = \frac{\delta L_A^{\lambda}}{A^{1-\phi}} \rightarrow (4)$$

Taking log on both sides we get,

$\log \mathring{A} - \log A = \log \delta + \lambda \log L_A - (1-\phi)\log A \rightarrow (5)$

Differentiating (5) with respect to time we get,

$$\frac{\mathring{A}}{A}\left(\frac{d\mathring{A}}{dt}\right)\left(\frac{1}{\mathring{A}}\right) - \left(\frac{dA}{dt}\right)\left(\frac{1}{A}\right) = \lambda\left(\frac{1}{L_A}\right)\left(\frac{dL_A}{dt}\right) - (1-\phi)\left(\frac{1}{A}\right)\left(\frac{dA}{dt}\right)$$

In steady state,

$$\left(\frac{d\mathring{A}}{dt}\right)\left(\frac{1}{\mathring{A}}\right) = \frac{dA}{dt}\left(\frac{1}{A}\right) \text{ then,}$$

$$\Rightarrow \lambda\left(\frac{1}{L_A}\right)\left(\frac{dL_A}{dt}\right) = (1-\phi)\left(\frac{1}{A}\right)\left(\frac{dA}{dt}\right)$$

$$\Rightarrow \lambda n = (1-\phi)(g_A)$$

$\left[\text{Since, } \frac{\mathring{L}_A}{L_A} = n \text{ and } \frac{\mathring{A}}{A} = g_A\right]$

$$\Rightarrow \frac{\lambda n}{1-\phi} = g_A$$

$$\Rightarrow \boxed{g_A = \frac{\lambda n}{1-\phi}} \rightarrow \text{Romer model.}$$

Thus Romer model endogenises the technology growth in the economy.

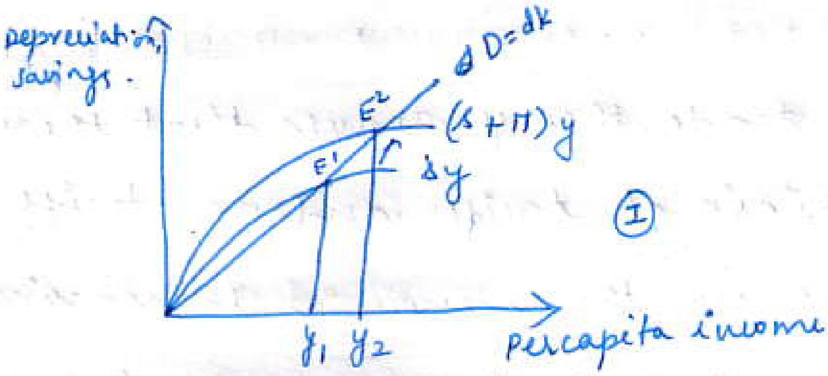
$\boxed{\text{Savings}}$

(1) According to Romer, the Marginal Propensity to save is used in the creation of additional investment in the economy.

$\boxed{\text{Solow Model}}$

$$Y = f(K, L)$$

↳ Technology is exogenous to the solow model and grows at the rate of n.



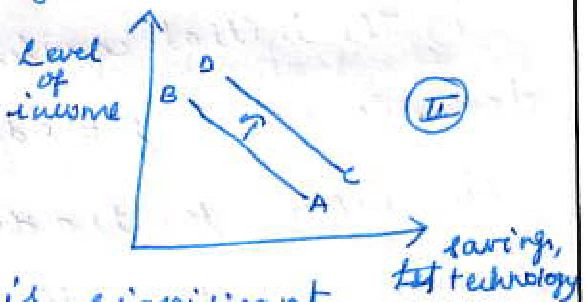
In diagram (I) we get the following,

(1) The exogeneous ~~saving~~ technology grows at the rate of π and shifts the savings curve from sy to $(s+\pi)y$.

(2) The percapita output or income grows from y_1 to y_2.

(3) Higher capital accumulation is taking place from the transition path between y_1 to y_2.

(4) The exogeneous technology growth has stimulated higher level effect as shown in diagram (II)



Thus, the Romer model is significant improvement over the solow model of growth rate.

Q.7 (c) Give a critique of free trade theory in context of developing country experience. (20)

Free trade theory argues that there must be minimal tariff and non-tariff barrier between the economies to maximise the welfare of both the economies to reach higher standards of development.

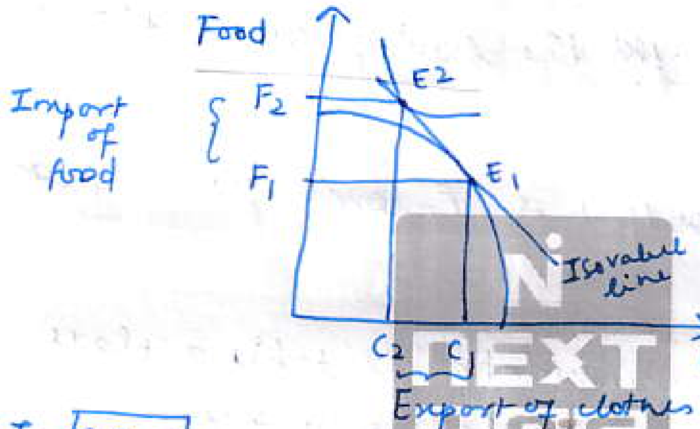


Fig I

In Fig I, Using Ricardo's comparative advantage of free trade theory we can ~~at~~ observe the following:

i) The initial equilibrium ~~line~~ pt at E_1 the domestic economy produces at c_1 and F_1.

(ii) When the trade is allowed between 2 economies, then the IC shifts from E_1 to E_2.

(iii) At E_2 point, The domestic economy consumes at C_2 and F_2.

(iv) Here, $(C_2 - C_1)$ = Exports of clothes to the foreign economy and $(F_2 - F_1)$ = Import of food in the domestic economy.

(v) Therefore, the welfare maximises at E_2 than at E_1.

Critique of free trade theory

i) National security argument - Certain commodities like defence, cyber technologies etc require appropriate policy control and govt. regulation to prevent their misuse and endangering of national security.

(ii) **Infant Industry Argument** - When the developing economy grows at the nascent level of industrial development then during that time opening up of economy would lead to decimation of domestic industries.

Eg:- India, During ~~196~~ late 1960s and early 1970s had licensing policy to control the free trade.

(iii) **Job creation Argument** - In the ~~don~~ developing economies, the Agriculture sector generally has the situation of "disguised unemployment". In order to create better job opportunities in industrial sector, the free trade at the initial stage is restricted.

(iv) Negative terms of trade - when the developing economy enjoys ~~...~~ terms of trade in agriculture sector than in comparison to industries and manufacturing sector this leads to less value exports and more value imports leading to tradedeficit in the economy.

(v) Trade in critical technologies

- Semiconductor
- Artificial Intelligence
- Modern defense technologies
- Quantum technologies

etc are regulated by the govt. to ensure technology supremacy.

(a) It protects the innovation of the entrepreneurs in the national frontiers.

(b) Misuse of such technology by enemy countries are avoided.

However, free trade theory can be practised in the following circumstances.

1. In case of favourable terms of trade.
2. By forging trade partnerships.

Eg:- India UAE CEPA to facilitate better trade.

③ ~~Saving~~ setting the innovation aside and engaging in other common interests of trade and development.

Thus, Free trade theory has to endure and mitigate the above challenges to maintain balanced trade and development and ensure overall growth and development.

Q.8 (a) How is Rostow's stages of growth different from Marxian stages of growth? (20)

Marxian stages of growth is based on "Theory of dialectical ~~ma~~ mercantilism" which is an economic interpretation of history whereas Rostow's stages of growth depends on the gradual development of traditional economy to higher level of mass consumption economy.

$\boxed{\text{Marxian stages of growth}}$

Following 5 stages of growth:

(I) Primitive economy

(a) Balter trade takes place between the economy.

(b) The society has relatively no inequalities.

(c) Subsistence level of production and consumption in the economy.

(II) $\boxed{\text{slave economy}}$

(a) Owing to the control of public resources by few over the others leads to development of few versus the underdevelopment of others.

(b) The slaves here supply free labour to the masters and in return get subsistence wage in the form of grains or other essentials.

(c) Gradually, the ~~no~~ upper class depending on the level of wealth ~~classes~~ become classified amongst themselves.

(d) Few become business persons, others become artisans and remaining supply of agriculture labour → leading to formation of bourgeoisie and labour class.

III **Feudal economy**

(a) From the ruins of slave economy, feudal economy develops sophisticated classification of people based on occupation.

(b) The lower classes experience lower wage for higher labour supply and the higher class experience higher wages for the lower labour supply.

(c) The above leads to the conflict between bourgeoisie and others, rural and urban inhabitants etc.

IV **Capitalistic economy**

(a) In this stage, there is no restriction of production technology and mode of production.

(b) Depending upon the ability of ~~ad~~ merchant class and other market participants proportionate rewards are reaped.

(c) However, the lower rung of society is still underdeveloped which again leads to conflicts.

(V) Socialistic economy - Dictatorship of proletariat class and the wages are depended upon the "ability and adequacy of persons" in the economy.

Rostow stages of growth

(I) Traditional economy

(a) Based on Pre-newtonian technology.

(b) There are tools available in the economy but ~~&~~ the people lack sufficient ability to ~~tot~~ utilise those.

(c) Once the ability is developed then the surplus is created leading to "Pre-conditions of take off".

(II) Pre-conditions to take off

(a) Higher growth rate of saving is maintained - 10% - 15% per ~~ea~~ annum.

(b) Higher growth rate of economy - in double digits.

(c) Higher level of physical investment and intellectual capital.

(III) ~~Cond~~ Take off

(a) Higher Social Overhead Capital (i.e) civic amenities is created.

(b) People enjoy better quality of life.

(c) The level of income in their hands goes up.

(IV) Higher growth maturity - People enjoy higher level of consumption, take up high quality of jobs and the consumption of veblen goods rises.

(V) Higher Mass consumption - Prioritises for leisure than for labour leading to higher growth in the service based economy and the research and development takes centre stage.

Criticisms

① Still the capitalist economy thrives unlike professed by Marx.

② The stages of growth of Rostow may not be sequentially followed.

Eg:- New Zealand and Australia achieved stage IV before stage V.

③ The role of "foreign trade and capital" lacks adequate role in the transformation stages of both Marx and Rostow.

Q.8 (b) Explain Harrod's knife edge equilibrium. (20)

Harrod uses keynesian demand function where in accumulation of savings in an economy leads to creation of additional investments in the economy. The harrodian & equilibrium is the dynamic equilibrium where the actual growth rate (ga) must be equal to warranted growth rate (gw) otherwise it would lead to cumulative inflation and deflation.

Assumption

① The economy operates in a closed economy model.

② The capital-output ratio is constant.

$$\boxed{\frac{\Delta K}{\Delta Y} = C}$$

③ Marginal propensity to save is constant.

$$\boxed{sY = S}$$

④ Investment has dual role in the economy

▷ Demand side = $\frac{\Delta K}{\Delta Y} = C \rightarrow ①$

▷ Supply side = $\frac{\Delta K}{\Delta Y} = Cr \rightarrow ②$

From ①, The investment creates demand in the economy by encouraging consumption and from ② the accelerator coefficient (Cr) creates job opportunities and higher level of income in the economy.

Model

Demand side

$$\frac{\Delta K}{\Delta Y} = c \rightarrow (3)$$

$$sY = S \rightarrow (4)$$

From Assumptions

We know that, $sY = \Delta K$, since savings are re-invested in the economy by creating additional investments in the economy then,

$$\Rightarrow \frac{sY}{\Delta Y} = c$$

$$\Rightarrow \frac{Y}{\cancel{\Delta c}\,\Delta Y} = \frac{c}{s}$$

$$\Rightarrow \boxed{\frac{\Delta Y}{Y} = \frac{s}{c}} \rightarrow (5)$$

Supply side

$$\frac{\Delta K}{\Delta Y} = Cr$$

$$sY = S$$

From Assumptions

$$\Rightarrow \frac{sY}{\Delta Y} = Cr$$

$$\Rightarrow \frac{Y}{\Delta Y} = \frac{Cr}{s}$$

$$\Rightarrow \boxed{\frac{\Delta Y}{Y} = \frac{s}{Cr}} \rightarrow (6)$$

Here, Actual growth rate $(g) = \frac{s}{c}$

Warranted growth rate $(g_w) = \frac{s}{C_r}$

Natural rate of growth $(g_n) = \frac{s}{C_r}$

Knife edge equilibrium

Case I - when $g_n > g_w$ then $g_w > g$ implies the natural rate of growth being higher than the warranted rate of growth ~~is~~ creates the situation of excess demand in the economy unmet by the existing capacity utilisation of supply side.

↳ $\boxed{C > C_r}$ → consumption is higher than the potential consumption level in the economy leading to cumulative inflation.

Case II - when $g_n < g_w$ then $g_w < g$ here the actual output in the economy is less than the warranted level of output in the economy.

↳ $\boxed{C < C_r}$ → Consumption is less than the potential level of consumption leading to ~~higher~~ cumulative deflation in the economy.

Therefore, the Harrodian equilibrium is a knife edge equilibrium where $\boxed{g_w = g_n = g}$ otherwise it would only create cumulative inflation and cumulative deflation in the economy.

Q.8 (c) What is the role of remittances in economic growth? (10)

Remittances refer to the unilateral transfer payments by the inhabitants in the foreign country to the domestic country. According to the World Bank Report (2023), India is the largest international remittances receiver which accounts to more than $100 billion.

Role of Remittances in economic growth

① Increases the money supply in the domestic economy.

② Provides liquidity to domestic banks.
Eg:- Non-Resident Indian deposits.

③ Increases the foreign exchange reserves of the domestic economy.

④ Stimulates demand in the economy.
Eg:- A person sending remittance to their family members in the domestic economy increases their consumption level in the domestic economy.

⑤ Stimulates economic growth due to demand led development.

(6) Increases job creation in the domestic economy.

⇒ eg:- Commercial banks receiving foreign transfers can more branches increases the job opportunities for bank staffs.

(7) Increases the govt. revenue due to higher spending by the family members of the non-resident inhabitants.

Therefore, the remittances act as the "lifeline" for many developing economies providing adequate buffer of forex in case of exigency situations.

Candidates must not write on this margin

SPACE FOR ROUGH WORK