NEXT IAS

(To be filled by candidate)

Name of Candidate : R SRI RUSAT

Roll No. : MTS24ECOL1021 Contact No.....

e-mail:.....com Date of Examination : 02/07/2024

Exam Centre : Old Rajinder Nagar ☐ Online ☑

CSE (MAINS) TEST SERIES-2024

Test-01

Dated : 30-06-2024

ECONOMICS OPTIONAL

(Micro and Macro 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.

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(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	15			
2. (c)	20	20			
3. (a)	24	15			
3. (b)	27	15			
3. (c)	30	20			
4. (a)	34	20			
4. (b)	38	20			
4. (c)	42	10			
5. (a)	44	10			
5. (b)	46	10			
5. (c)	48	10			
5. (d)	50	10			
5. (e)	52	10			
6. (a)	54	15			
6. (b)	57	20			
6. (c)	61	15			
7. (a)	64	15			
7. (b)	67	15			
7. (c)	70	20			
8. (a)	74	20			
8. (b)	78	15			
8. (c)	81	15			
Grand Total					

Remarks

Observations:

SECTION-A

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

Q.1 (a) What are different sources of monopoly power? How can it be controlled?

Monopoly power refers to the degree of control exerted by the individual firm in the market outcomes due to the cross elasticity of product virtually being zero.

Using lerner's index

Degree of monopoly power = $\frac{\Sigma(P - AC)}{Q}$

Sources of monopoly power

- Patents - Granted to innovators allows them to enjoy higher price setting power for considerable period of time.
- Government policy decisions
  - eg:- Atomic energy is solely under govt's control.
  - Non tariff barriers like quota etc leads to higher fixing of prices.
- Nature of service
  - Non-tradable services like professional surgery can fix higher prices.
- Market barriers like transportation reducing the power of arbitrage.

Control of monopoly power

(i) Relaxation of Patent rules

▷ eg:- Allowing the local manufacturers to use the formula of pharma companies to produce generic medicines.

(ii) Investing on infrastructure - Removes the physical barrier for transporting goods.

(iii) Lowering of non-tariff producers like quota and hence making "arbitrage" possible.

(iv) Ensuring smooth labour mobility.

The above solutions can improve the market mechanisms leading to the competitive pricing of products achieving higher consumer surplus.

Q.1 (b) Explain why there are multiple relations possible between price and output in monopoly.

In a Monopoly condition, Supply curve independence does not exist due to the ~~absence~~ of price and output decisions taken by the producer.

multiple relations possible between price and output:

(I) When prices are fixed

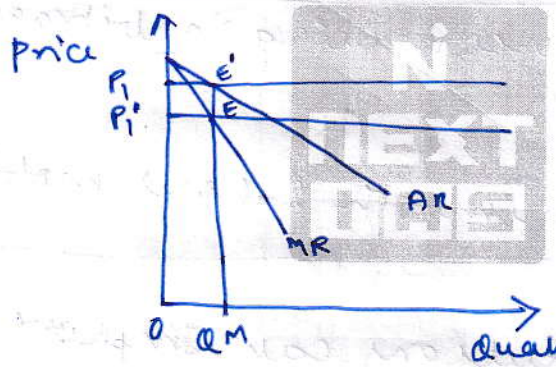

Fig 1

In the above fig 1 when the monopoly fixes the price ~~for~~ P_1 then the firm has to produce OQ_M level of output to maintain the price level at P_1. From E', the line intersects at E producing the monopoly output at Q_M.

(II) When output is fixed

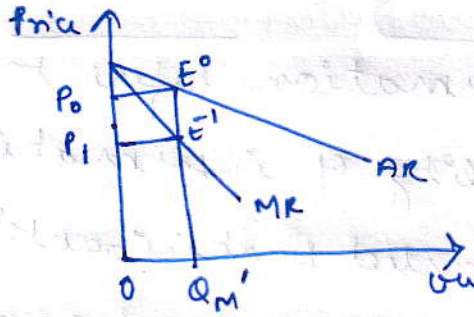

Fig 2

In Fig 2, ~~the~~ when the output level is fixed at OQ_M' then the price at which the level of monopoly output can be produced is OQ_M'.

Since, a monopoly can control either price or output but not both.

Therefore, multiple relations can exist price and output in a monopoly product.

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Q.1 (c) Is it necessary that asymmetric information will have unique equilibrium?

Asymmetric information refers to the higher availability of information to one set of market participants than the other set of market participants.

Existence of unique equilibrium

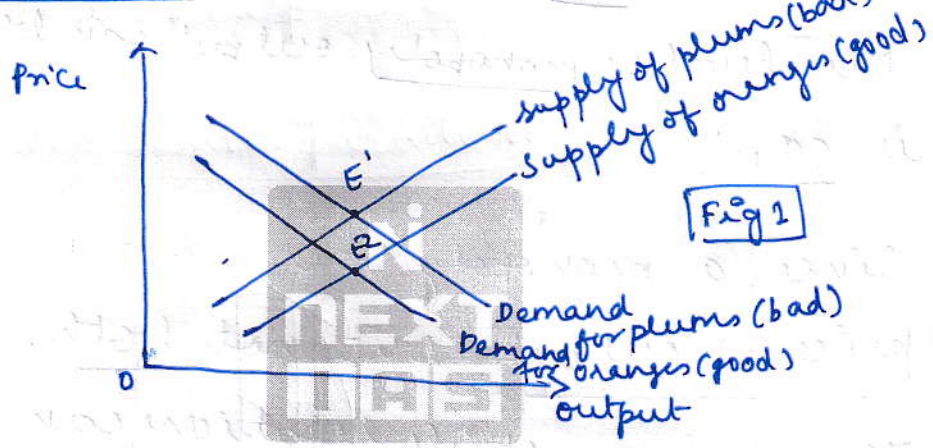

Fig 1

In Fig 1, the market for plums and oranges are segregated and the buyer and seller are perfectly aware about the market conditions.

Hence, the equilibrium is achieved at two points in E^1 and E^2. Hence, Unique equilibrium doesnot exist in this case.

When there are strict actions against bad (say, duplicate equipment) then:

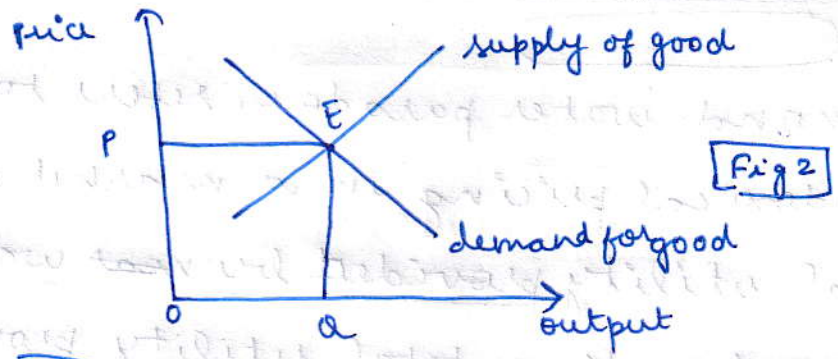

Fig 2

(i) In Fig 2, Due to government's policy decision making, the bads are driven out of the market therefore only the point E as unique equilibrium exists.

Therefore, In Asymmetric information it is not necessary to have a unique equilibrium other factors like govt's policy decisions influence the equilibrium condition in a market.

Q.1 (d) Explain diamond water paradox.

Diamond- water paradox, refers to the paradoxical pricing in a market where total utility provided by water is greater than total utility provided by diamond yet price of diamond is more than the price of water.

Diamond- Water paradox

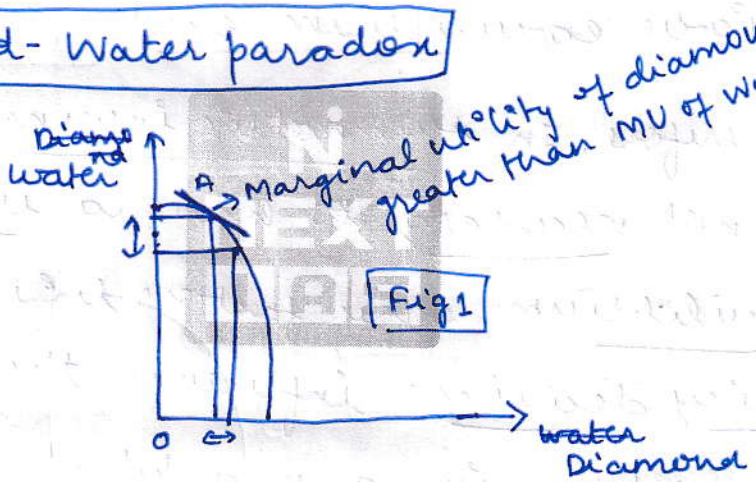

Fig 1

(i) **Marginal utility pricing** - According to the theory, price of diamond is determined not by total utility or total availability but by the marginal utility of the product.

(ii) Therefore, given a fixed amount of income, a rational consumer would make his decisions based

on marginal utility of a product consumption rather than total availability.

(iii) Therefore, In the diamond-water paradox condition, the consumer would purchase more of diamond than more of water.

(iv) In fig 1, the pt A represents the higher trade-off made by the consumer for diamond.

Hence, "diamond-water" paradox acted as an important theoretical example to price a product based on its marginal utility rather than availability.

Q.1 (e) What is Scitovsky solution, explain the entire context.

Candidates must not write on this margin

In the efficiency v/s fair allocation debate, when the competitive market equilibrium allocates output based on its general equilibrium condition and one gets more than other, ~~bundle~~ the bundle can be re-allocated in such a way that fairness in allocation can be achieved.

I Unfair allocation

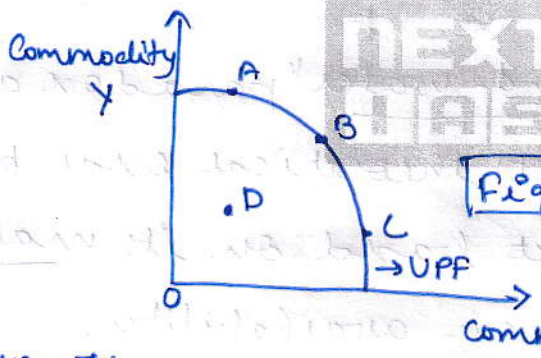

Fig 1

Now, The bundles A, B and C in Fig 1 represents efficient bundle whereas the bundle in D is an inferior solution.

Scitovsky solution

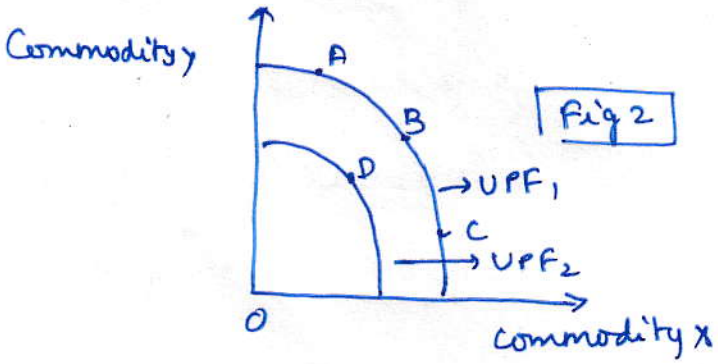

Fig 2

To rectify, the ~~sol~~ ~~conf~~ unfairness in allocation represented in fig 1, Scitovsky provided a solution of re-distribution where some of the income of the consumers purchasing bundles A, B and C can be re-allocated such that it is tangent to the UPF_2.

Now, the Scitovsky provides fairness in market's "invisible hand" mechanism as shown in the fig 2 of the diagram.

Q.2 (a) How is peak load pricing a more efficient solution than normal pricing? 15

Candidates must not write on this margin

Q.2 (b) Show that higher cross price elasticity means flatter compensated demand curve. 15

Q.2 (c) Explain two tier pricing in monopoly discrimination. 20

Q.3 (a) If a utility function is given as $u(x, y) = x+y$ then comment on the shape of indifference curve, equilibrium possibilities and describe various possibilities of income offer curve and engel curve. 15

Q.3 (b) Explain when supply curve is not necessarily upward sloping in perfect competition. 15

Q.3 (c) Explain the derivation of Pareto welfare in a 2×2×2 economy. 20

Candidates must not write on this margin

Q.4 (a) Explain the different concepts of excess capacity, highlighting differences between Chamberlin and Robinson. 20

Excess capacity in a monopoly condition refers the production of individual firm's output below the social optimum level of output.

Normal Excess capacity

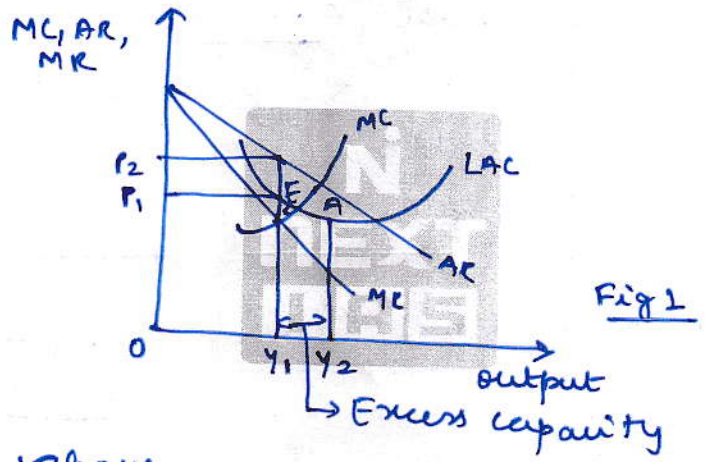

Fig 1

In the above fig 1, the Excess capacity is the difference between the point E, where MC = MR and point A minimum of LAC.

Chamberlin's Excess Capacity

Chamberlin assumes that the excess capacity is due to the difference between output produced because of perceived demand curve and the minimum of LAC.

i) **Perceived demand curve** → when individual firm takes the decision different from the group of firm's decision.

ii) **Proportional demand curve** → when group of firm together takes the pricing decision.

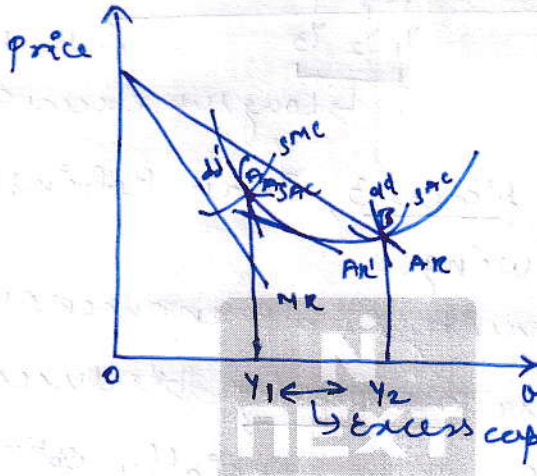

Fig 2

From the above diagram we get the following:-

(i) When individual firm reduces the output to increase its price then dd shifts towards left to dd'.

(ii) At the point A, the output is produced at Y_1.

(iii) But the socially optimum level of output is produced at Y_2 (i.e) minimum of LAC.

(iv) Therefore, the Excess capacity here arises because of difference between Y_1 and Y_2.

(v) Chamberlin often attributes the ~~draught~~ cost of excess capacity to the differentiation cost of the firm.

Joan Robinson's Excess capacity

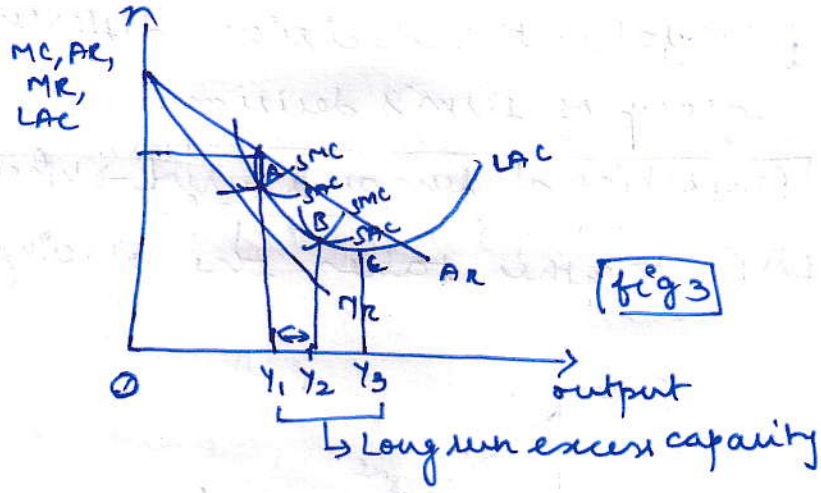

fig 3

In the above figure 3, Joan Robinson contends ~~that~~ the following:-

(i) Excess capacity is a phenomenon of long run when the monopoly produces the output at Y_1 less than socially optimum output at Y_3.

However, later economists pointed out that if Monopolists were to keep their price so high, then it will lead to entry of more firms ~~there~~ thereby reducing the price of the products. Hence, they classified Joan Robinson's excess capacity into short run excess capacity and long run excess capacity.

Chamberlin versus Joan Robinson's Excess capacity

Chamberlin	Joan Robinson
① There is no such classification of short run and long run excess capacity	① There is only long run excess capacity possibility.
② The monopoly firms sell homogeneous products.	② The monopoly firms sell substitute products.
③ The concept of "perceived" and "proportional" demand curve is introduced.	③ No such concept of perceived & proportional demand curve introduced.

Nevertheless, Excess capacity is generally considered as a loss in the output for market as otherwise could be achieved using the perfect competition.

Q.4 (b) "Asymmetric information leads to two important problems in market solutions", examine these problems and provide solutions to them. 20

Asymmetric information refers to the higher availability of information to one set of market participants (buyer or seller) in comparison to other market participants.

▷ eg:- Lemons and Plums market (i.e) Original and duplicate equipment market where the producer is more aware about their products compared to the buyers.

Asymmetric Information leads to 2 important market problems:

① Adverse selection:

(i) It refers to the buyer selecting a particular product assuming that the qualities of its product are in par with the good qualities of the other product.

▷ eg:- In the electronics market, If a buyer purchases laptop with 'brand x' which has lesser quality features in

comparison to 'brand Y' assuming both have equal features then it is referred to as 'problem of adverse selection'.

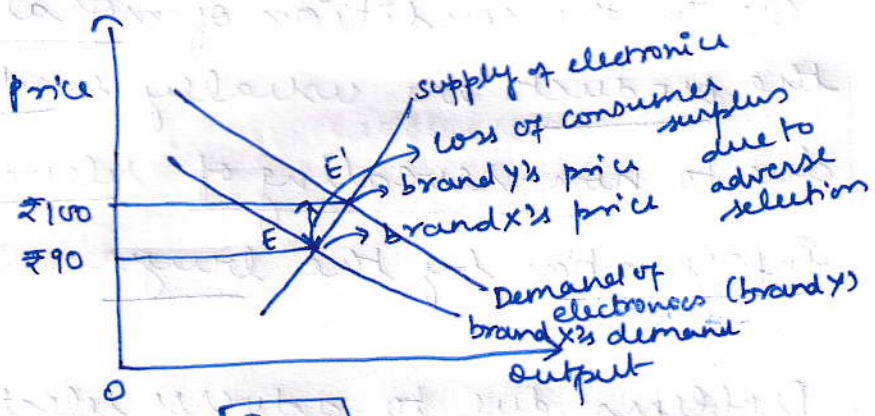

Fig 1

In the above fig 1, the vertical gap between 2 demand curves represents the loss of consumer surplus due to the problem of adverse selection by the consumer.

② Moral hazard

(i) Moral hazard represents the situation wherein the buyer after buying a particular product or availing a partial or service refuses to honour its terms of contract.

▷ eg:- If a consumer "B", purchases a health insurance, agreeing to the terms and

conditions of the contract if does not honour then it refers to the problem of "moral hazard".

(ii) In the condition of moral hazard, the products are usually under-priced due to non-revealing of relevant information by the buyer.

Problems due to adverse selection and moral hazard

① Lack of fair pricing of a product due to irrelevance of market mechanism.

② Loss of consumer or producer surplus.

③ Losing of trust in the "invisible hand" mechanism of the market.

④ Resorting to or development of parallel market

▷ eg:- Black market development due to hoarding or smuggling.

Solutions

① Usage of Trademarks to validate the quality of products.

▷ eg:- ISI mark on electrical and electronical market.

② Free availability of information.

▷ eg:- Use of Aadhar card information to cross verify the details.

③ Strict legal actions

▷ eg:- Penalties or strict law can be enforced for perverse market activities.

Therefore, the above solutions can be used to tackle the problem of "adverse selection" and "moral hazard" arising due to asymmetric information.

Q.4 (c) Explain producer's equilibrium in perfect competition. How is the standard result affected in case of constant return to scale production function. 10

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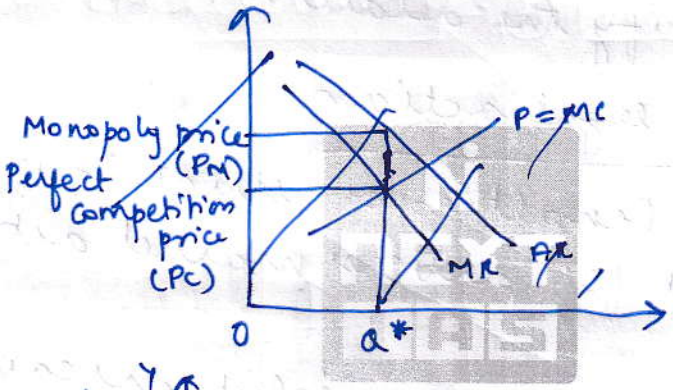
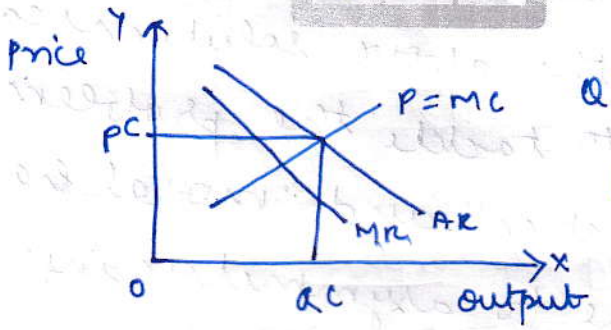
Perfect competition's producer equilibrium takes place when the price is equal to the marginal cost of the product.

Producer's equilibrium in Perfect competition

Price = ~~Marginal~~ Average Revenue ~~Cost~~ approach





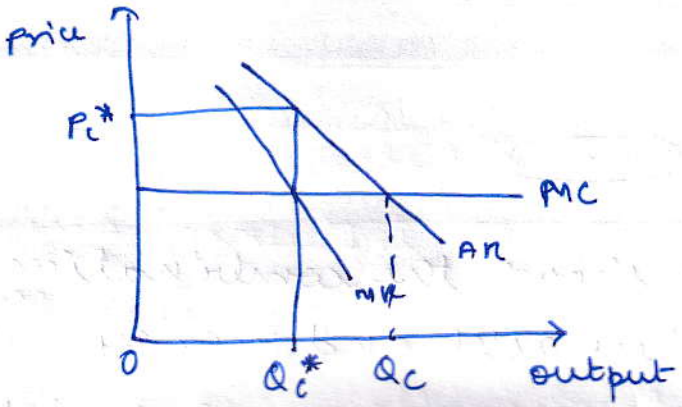
Q^C → Competitive output

P^C → Competitive price

Therfore a producer's equilibrium occurs at (Q^C, P^C) which is the equilibrium of the standard result.

When constant ~~indust~~ returns to scale of production happens in a perfect Competition then:-

Marginal Revenue (MR) = Marginal Cost (MC) approach takes place



Therefore, the difference between $Q_c - Q_c^*$ is the loss of producer's output due to the existence of the constant returns to scale production function.

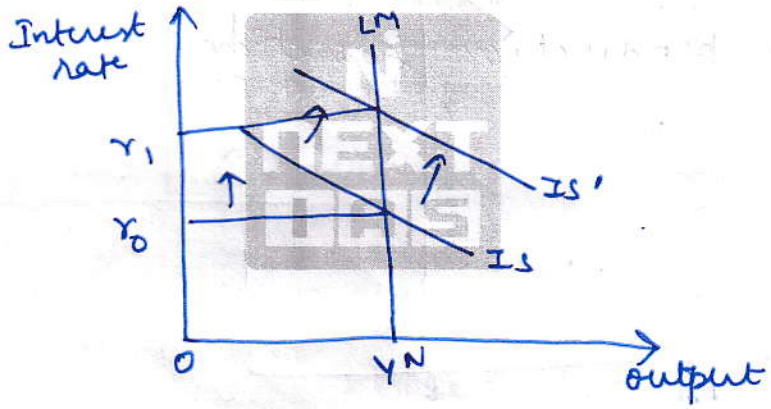
SECTION-B

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

Q.5 (a) What happens if LM is vertical in case of fiscal and monetary expansion. How will your answer change if LM is standard but IS is vertical.

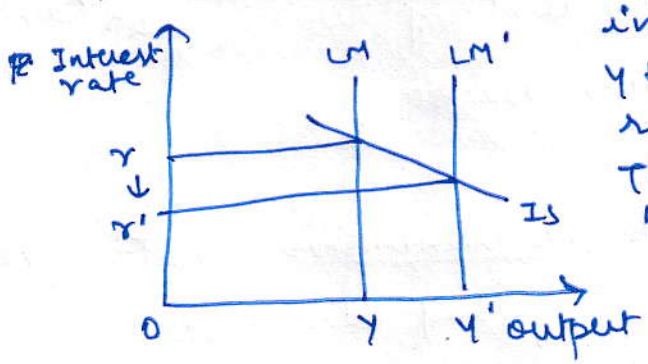
LM curve shows the combination of points where asset and money market are in equilibrium for given interest rate and output.

When LM is vertical → (A) Fiscal Expansion



In (A), The IS curve shifts to the right, in this case, the output is fixed Same, only the interest rate rises from r_0 to r_1 due to ~~money sup~~ "higher income chasing the constant supply of goods".

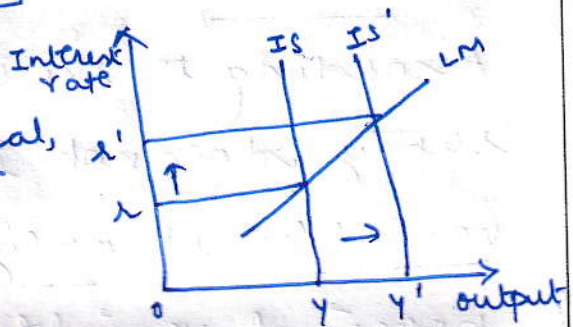
(B) → Monetary Expansion



The output increases from Y to Y' and r reduces to r'. Therefore, monetary policy is effective.

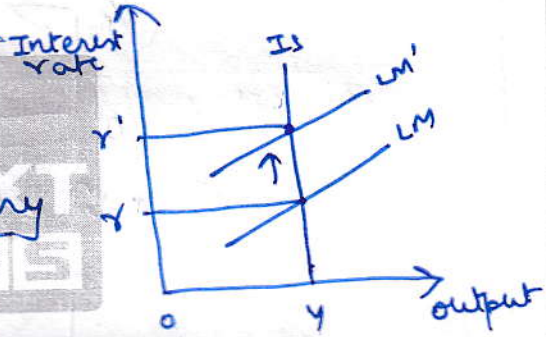
B When IS is vertical

(A) Fiscal expansion



When IS curve is vertical, then fiscal expansion increases the IS to right to IS' increasing output from Y to Y' and interest rate from r to r'. Hence, Fiscal policy is effective.

(B) Monetary Expansion

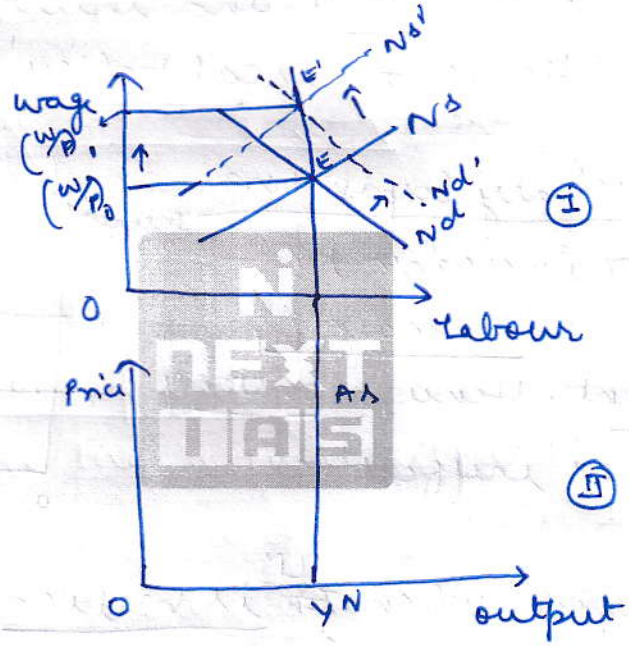


Here, r increases to r' with Y remaining constant. Hence, monetary policy is ineffective.

Therefore, when LM is vertical then the monetary policy is effective but when IS is vertical fiscal policy is effective.

Q.5 (b) Explain the shape of Aggregate Supply (AS) curve in classical model. How does it change with Keynesian approach. What are the policy implications?

According to the classical model, money supply does not influence ~~nominal~~ real variables it only influences the nominal variables. known as "classical Dichotomy."



Policy implications

Classical model

In the long run Aggregate supply curve can be changed by the following real variable:-

(a) Nature of technology

(b) ~~Asss~~ Labour productivity

(c) Marginal productivity of capital

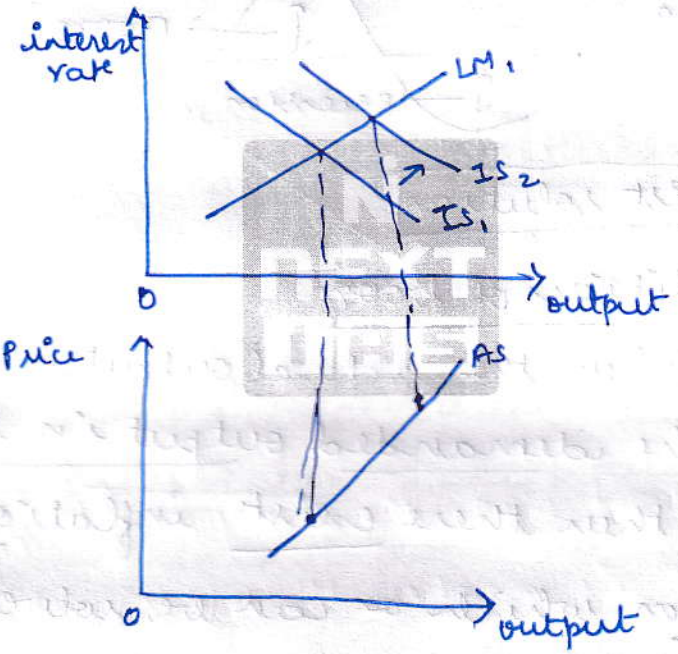
etc.

(ii) Hence, the government in the long run has to make policy decisions on

above factors to ensure the increase in output. (fiscal policy takes prominent role)

Keynesian Approach

Keynes believed that money variables can influence the output decision in the market with the philosophy of 'demand creates its own supply'.



Hence, **Policy implications** → Money supply can be varied to increase or decrease the output in the market (monetary policy is effective.)

Q.5 (c) Monetarist approach cannot give a complete solution to business cycle problems. Discuss.

According to the Monetarist, the money variables can be used to influence the decisions of the real variable - output production, employment creation etc.

Business cycle problems

Monetarist solution

(i) Conditions of boom:

(a) When the actual output is less than the demanded output in the market then there exists inflationary condition which ~~is~~ can be solved by levying new taxes, increasing the interest rate etc to counteract the boom conditions.

(ii) Conditions of Recession

(b) When the actual output is more than the demanded output, there exists excess inventory in the market due to which there exists a deflationary

condition.

(iii) This can be counter-acted by increasing ~~intest~~ government expenditure and reducing the interest rate to ~~expand~~ enforce the monetary expansion.

Cannot give a complete solution to problems

① Rational expectations - In the long run, the workers will figure out the policy variables used to adjust the ↓ business cycle problems.

② Adaptive expectations - The workers in advance would factor in the nominal variable intervention hence would demand price wages accordingly.

Therefore, monetarist cannot give complete solution to the business cycle problems.

Q.5 (d) Explain how Lucas gave a solution to solving disequilibrium through temporary impact.

According to Lucas, Temporary and unanticipated policy decisions can rectify the disequilibrium solution in the labour market.

Temporary impact solving disequilibrium

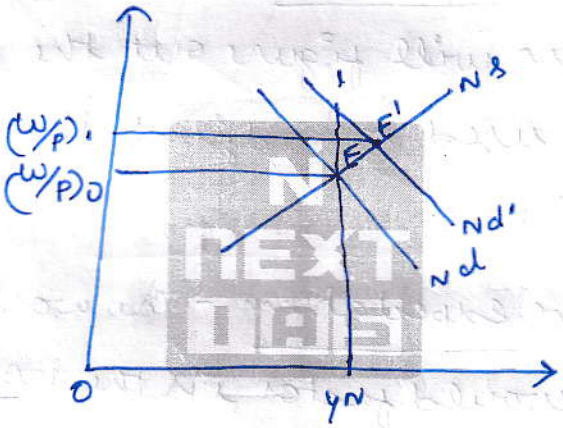
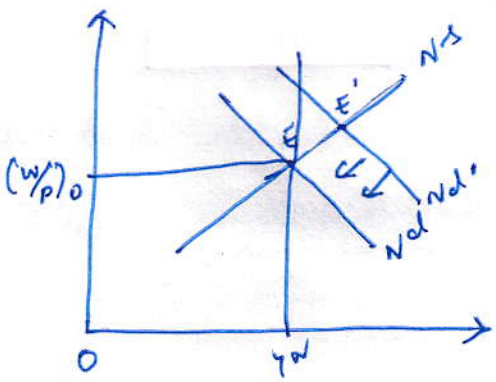


Fig 1

i) In the above fig 1, the temporary $(W/P)_1$ real wage rate is greater than $(W/P)_0$ at E.

(ii) The point E' is again higher than point E.

(iii) Now, levying temporary additional labour tax can lead to:



(iv) Now levying additional labour tax, shifted the labour demand curve to the left at the natural level of output (Y_N).

Thus, Lucas's temporary and unanticipated shock has led to the reaching of equilibrium position again.

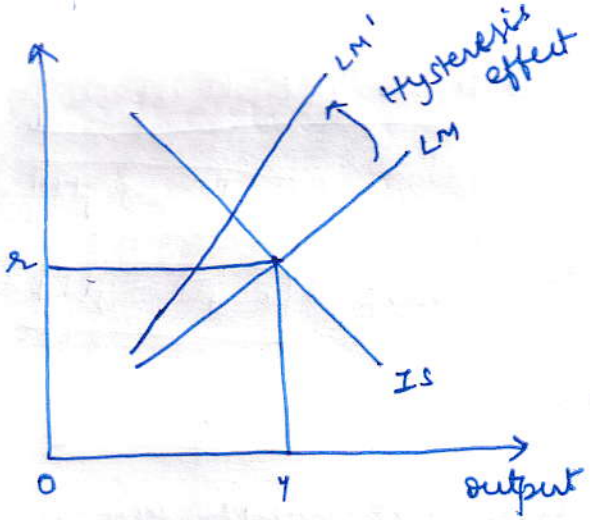
Q.5 (e) What is hysteresis effect? Do you think the pure Keynes model will have more of it than neoclassical?

Hysteresis effect refers to the condition when a variable gets disturbed from the position of equilibrium then it would never reach the $ equilibrium position again.

Pure Keynes model

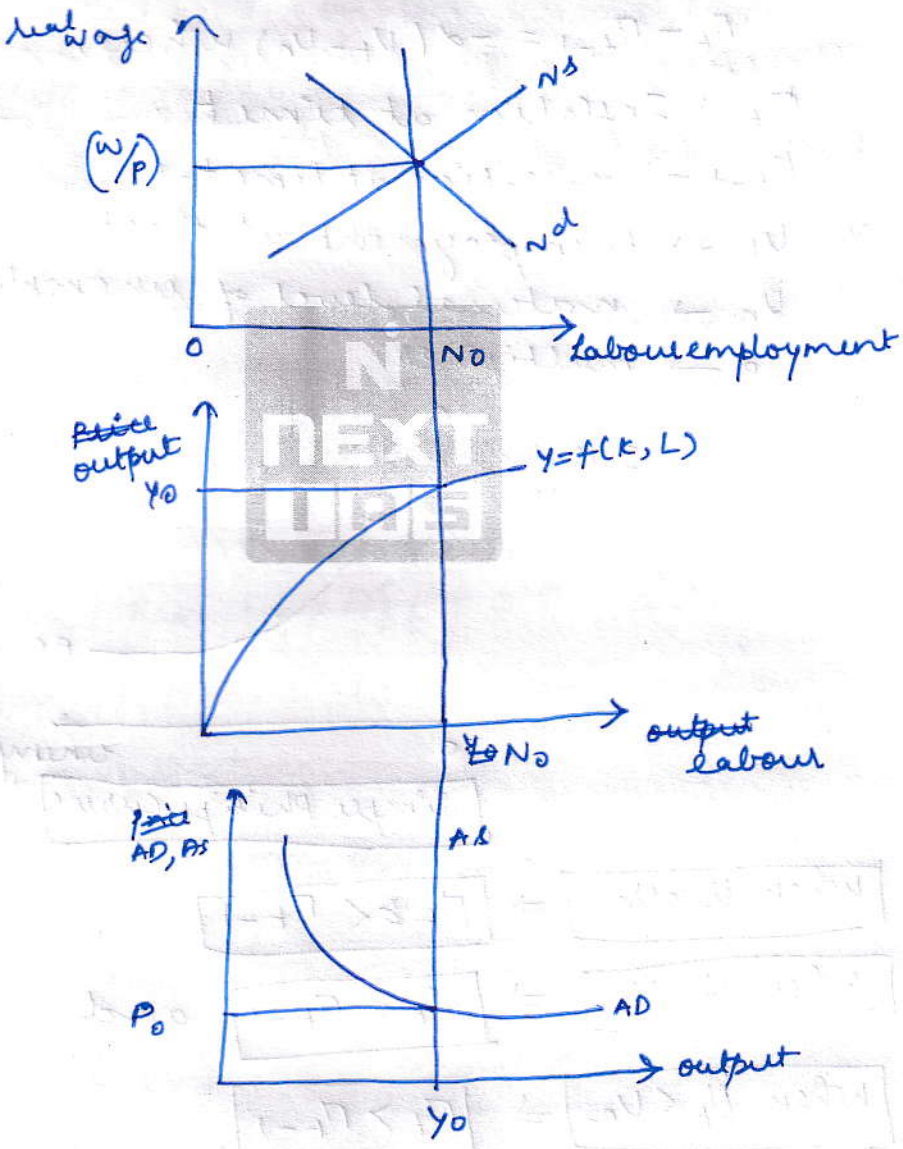
De-stabilizing speculation

(i) Hysteresis effect is much visible in the pure Keynes model due to the effect of nominal money variable effect and the effect because of Speculative demand for money.



Classical model

(i) Long run classical AS curve is vertical because the long run level of output are influenced only real factors. Hence, Hysteresis's effect is minimal.



Hence, Hysteresis effect is much more visible in pure keynes model than the classical model.

Q.6 (a) Explain the evolution of Phillips curve. 15

Philips curves shows the negative relationship between ~~outp~~ unemployment and the rate of inflation.

Mathematically showing:

$\pi_t - \pi_{t-1} = -\alpha(U_t - U_n)$ where,

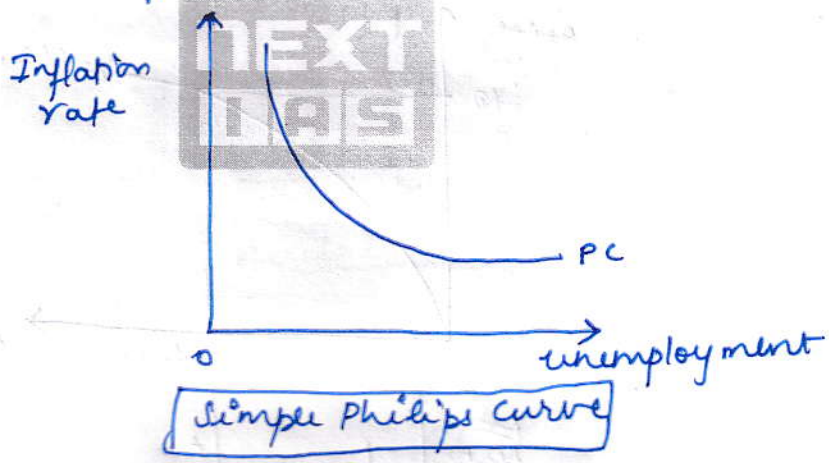
$\pi_t \rightarrow$ Inflation at time t.

$\pi_{t-1} \rightarrow$ Inflation at time t-1

$U_t \rightarrow$ Unemployment at time t

$U_n \rightarrow$ natural level of unemployment

$\alpha \rightarrow$ multiplier



Simple Philips curve

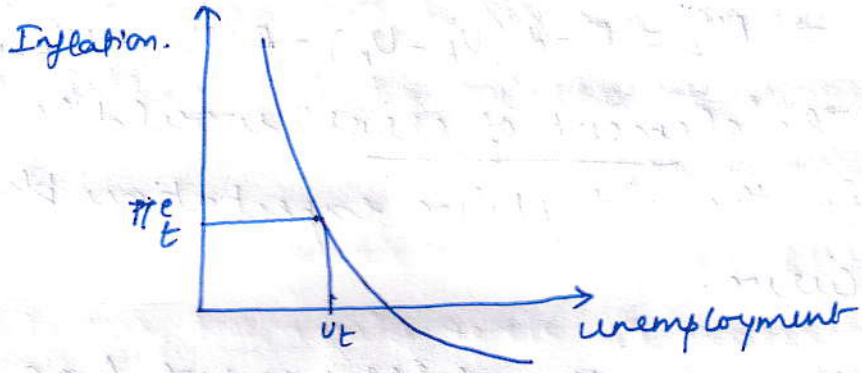
When $U_t > U_n \Rightarrow \pi_t > \pi_{t-1}$

When $U_t = U_n \Rightarrow \pi_t = \pi_{t-1}$ and

When $U_t < U_n \Rightarrow \pi_t < \pi_{t-1}$.

Drawbacks → Did not show the role of "expectations" pointed out by the neoclassicals.

Expectations Augmented Philips Curve



(i) According to the neoclassicals, the workers cannot be fooled continuously they would start to incorporate expectations onto their model.

(ii) Now,

$$\pi_t = \pi^e_t$$

$$\Rightarrow \pi_t - \pi^e_t = -\alpha(U_t - U_n)$$

If $U_t < U_n$ then $\pi_t > \pi^e_t$ ⇒ the actual inflation at time t would be greater than expected inflation.

If $U_t = U_n$ then $\pi_t = \pi^e_t$ and,

If $U_t > U_n$ then, $\pi_t < \pi^e_t$ actual expectations would be less than expected inflation at time t.

~~Adaptat~~ **Adaptive expectation philips curve**

$\Rightarrow \pi^e_t = \pi - \alpha(U_t - U_n) - \beta(\pi_{t-1} - \pi^e_{t-1})$

The "element of error" would be included in the adaptive expectations philips curve.

Therefore, the philips curve has evolved from being a simple philips curve to Expectations augmented Philips curve to Adaptive expectations philips curve.

Q.6 (b) Critically examine Okun's law. Examine the concept of sacrifice ratio. 20

According to okun's law, the increase in growth rate by a percentage point would lead to decrease in unemployment by 2.5%. Okun's used the data from UK's labour market to arrive at the multiplier figure of 2.5%.

Algebraically speaking:

$$U_t - U_{t-1} = -\alpha\beta(g_y - g_n)$$

$U_t \rightarrow$ unemployment rate at t

$U_{t-1} \rightarrow$ Unemployment rate at $t-1$

$\beta \rightarrow$ multiplier value assumed by okun's as 2.5

$g_y \rightarrow$ growth rate of output (actual)

$g_n \rightarrow$ natural growth rate of output.

Assumptions

1. Wage-price is sticky downwards
2. AS curve is upward sloping
3. The natural rate of growth (g_n) is known and defined.
4. Govt. policies are effective when implemented.

Explanation

(i) Okun's used the data from 1916-1950s to arrive at the multiplier value of 2.5.

(ii) The increase in growth rate and decrease in unemployment would lead to rise in inflation. Therefore, Okun points out the inflation-growth trade off.

(iii) & He developed the "sacrificing ratio" to further improve the theory of "growth-inflation trade off".

Sacrifice ratio

(i) Sacrifice ratio refers to the trade-off excess unemployment to the percentage change in inflation rate.

(ii) Mathematically,

$$\text{Sacrifice ratio} = \frac{\text{Point year of excess unemployment}}{\%\text{ change in inflation rate.}}$$

(iii) The above sacrifice ratio can be represented in "1/2".

(iv) 1% increase in unemployment rate leads 2% change in inflation rate and vice-versa.

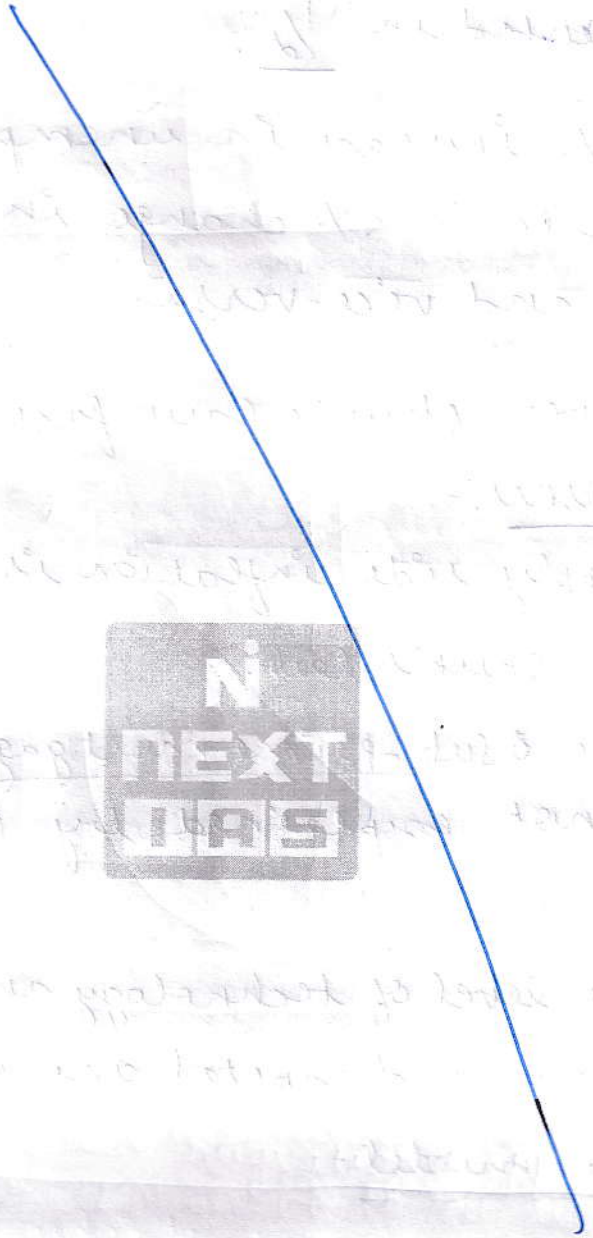
However, Okun's law faces following criticisms:-

(1) Supply side inflation is not explained under Okun's law.

(2) The Sub-prime mortgage crisis (2008) was not explained by the Okun's law.

(3) The level of technology and productivity of labour and capital are not incorporated in the model.

Hence, Okun's law is a significant improvement over the philips curve equation despite having its set of limitations.



Q.6 (c) What is the impact of migration in pure classical model. 15

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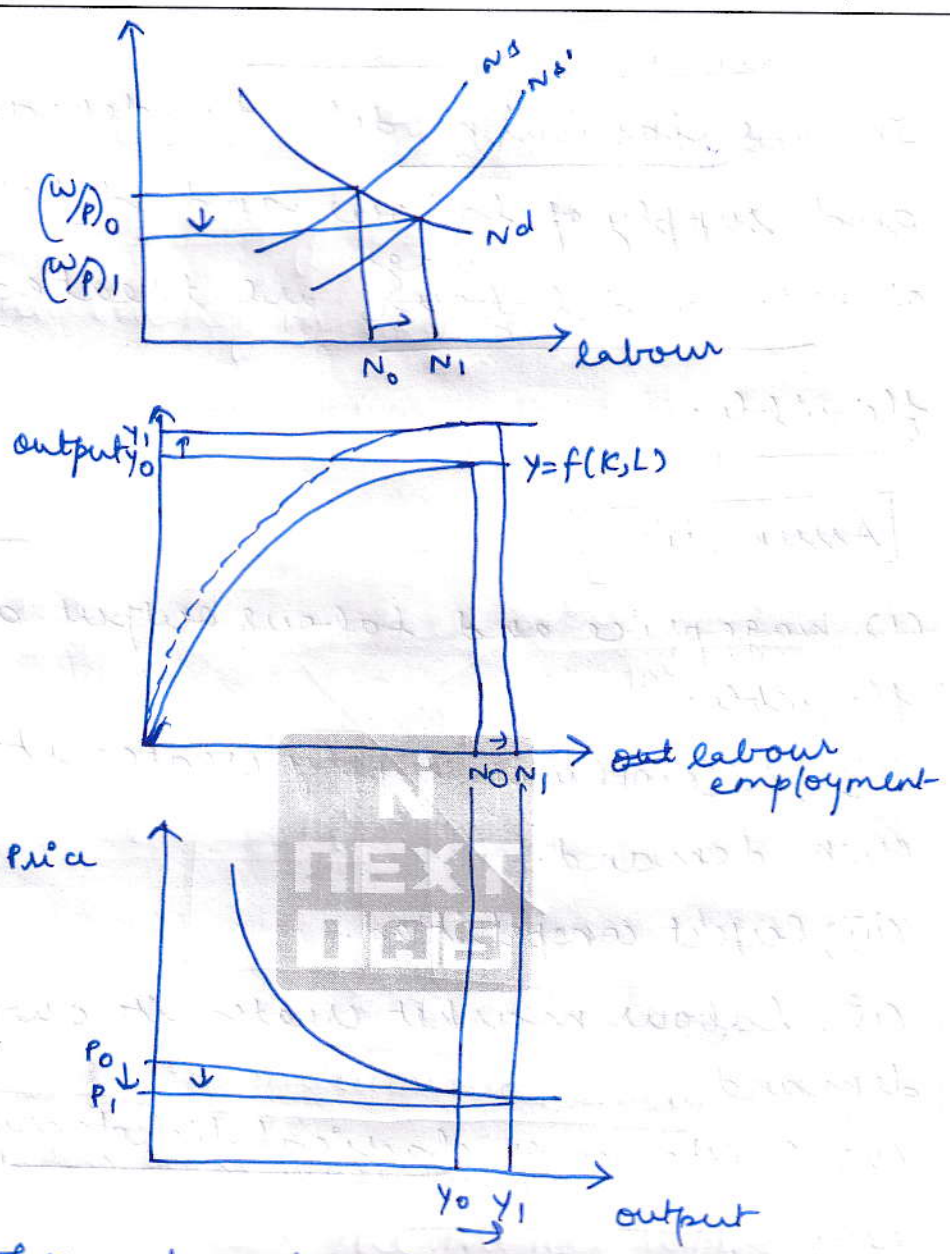
In Pure classical model, the demand and supply of labour and determination of price and ~~labour~~ wage are treated flexible.

Assumption

(i) Wage price and labour output are flexible.
(ii) Philosophy of supply creates its own demand.
(iii) Perfect competition.
(iv) Labour market creates its own demand.
(v) Existence of classical dichotomy.

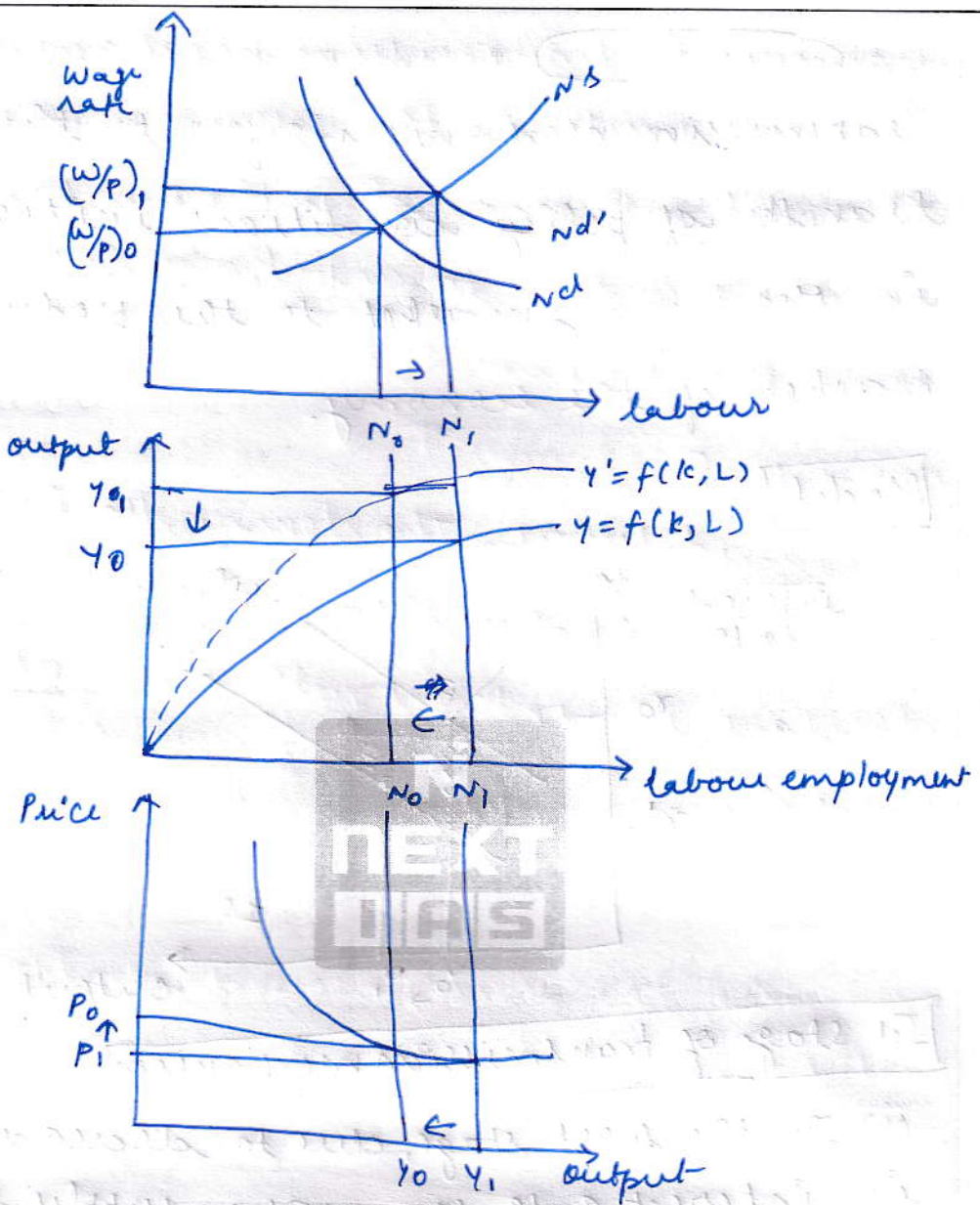
Impact of migration

(i) When inward migration happens then supply of labour is more than the demand of labour. Therefore, the wages fall and output ~~declines~~ rises. leading to reduction in the price level (as shown in fig below):



(ii) When outward migration happens:

(a) The demand of labour is much more than the supply of labour the real wage rate rises, the output declines and leading to the increase in price level.



Therefore, the migration depending upon the inward or outward nature of it lead to the effect of increase/ decrease in level of output and price level changes.

Q.7 (a) Explain transmission mechanism. How do government multiplier, k, b and h affect it. 15

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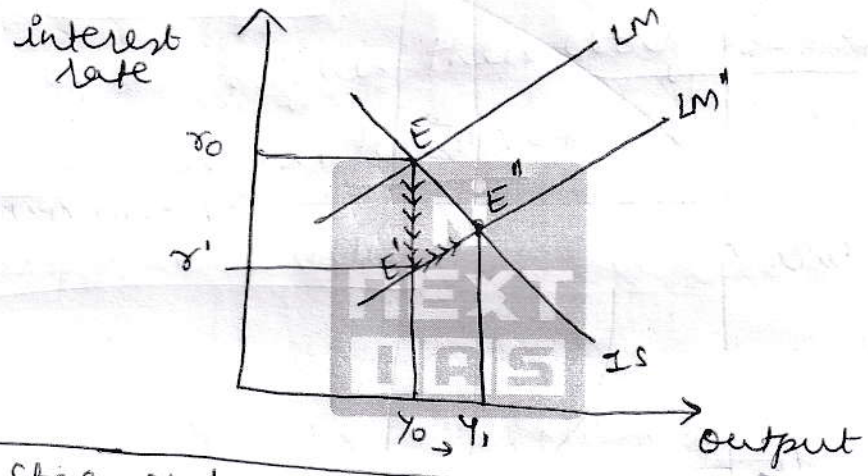
Transmission mechanism refers to the transfer of policy conditions initiated in the money market to the product market of the economy.

Model



Ist stage of transmission mechanism

(i) In the first stage, due to decrease in interest rate the money supply increases and shifts the LM curve to the right to LM'.

(ii) Here, there is excess supply of money and therefore there is excess demand of bonds.

IInd stage of transmission mechanism

(i) The reduction in interest rate

allows the investor to use cheap funds to invest in the market.

(ii) This happen from the point of E' to E'' and increases the output from Y_0 to Y_1.

Government multiplier (α_G) → Higher the govt. multiplier the higher is the effect of transmission mechanism from the money market to the product market.

~~Invest~~ **Income sensitivity** (k) → Higher the income sensitivity the larger the demand of goods in the market and vice versa.

Interest sensitivity (h) → The lesser the interest sensitivity higher is the money demand in the money market and vice versa.

The **larger value of k results** in weaker transmission mechanism and vice versa.

However, the transmission mechanism may not work in the following cases.

① credit rationing - when the banks give out credit to arbitrary firms then the transmission mechanism may fail.

② Liquidity trap - The demand to hold money is higher then every rate of decrease in interest rate the transmission mechanism weakens.

Q.7 (b) Examine Keynesian cross equilibrium. What will be his solution to great depression? Will Keynes suggest monetary solutions? 15

According to Keynes, Aggregate demand or output in the economy is determined by Consumption, Investment and Government expenditure.

Now, when $Y = AD > AD$ (actual)

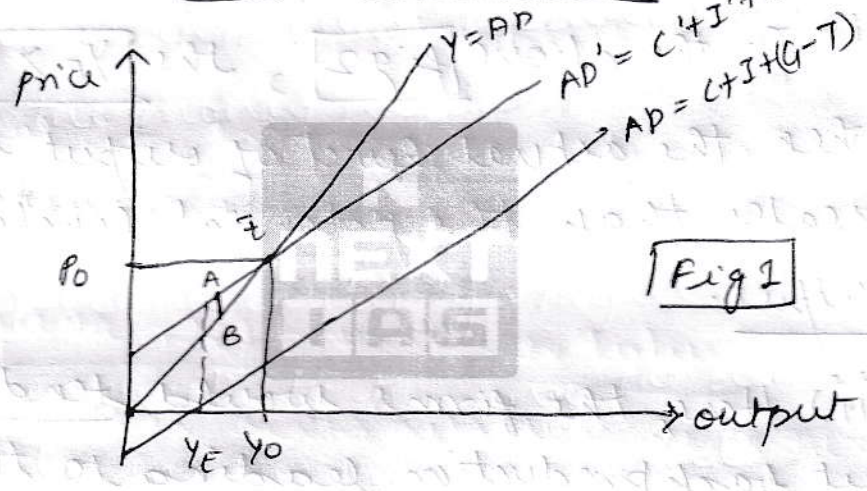


Fig 1

(i) In Fig 1, when $Y_E < Y_0$, then the actual output is much lesser than the potential output demanded in the economy.

(ii) Then the supply gap of AB arises, known as deflationary gap.

(iii) Here, the firm has to increase its production and would reach the point of equilibrium at E.

Inflationary gap

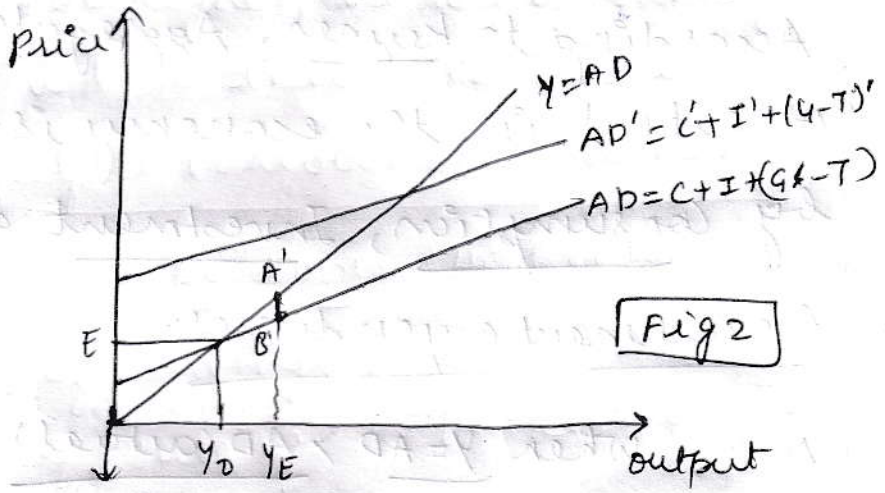


Fig 2

(i) In the above fig 2, the $Y_E > Y_0$ when the actual level of output is greater than the potential level of output.

(ii) Here, the firms would tend to cut back production leading to the reduction of excess inventory and reaching the equilibrium at E.

Keynesian cross equilibrium → therefore shows, the inflationary or deflationary gap prevalent in the economy and appropriate policy decisions to solve those.

Keyne's solution to great depression

(i) Keynes had advocated for increased govt spending during the great depression.

(ii) He advocated the policy of "pump priming" wherein large sum of money were invested in infrastructure construction like roads, railways etc.

Yes, Keynes had suggested ~~a~~ expansionary monetary solution:-

(i) By purchasing the govt bonds → Govt can use deficit financing.

(ii) Reducing the interest rate → the govt can make the firms to ~~fo~~ borrow to invest.

(iii) Credit card culture → consumption using credit was promoted.

Thus, Keynesian study of great depression and its policy recommendation were paradigm altering.

Q.7 (c) "The Keynesian view on role of saving didn't match the classical idea". Discuss. 20

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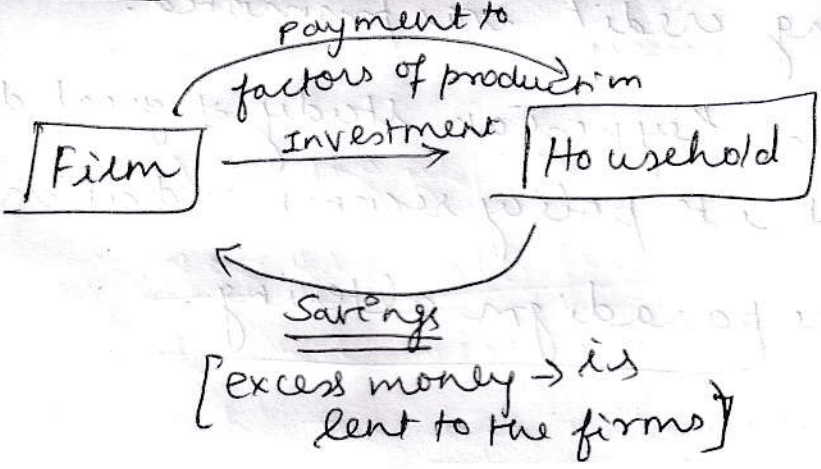
According to Keynes, The role of saving is not just to invest in the economy but to fulfill various other demands:

(i) Transaction purposes - Higher the amount of ~~savings~~ transactions then higher is the amount of savings to be kept by every individual.

(ii) Precautionary purpose - to fulfill the unforseen and unmet circumstances.

(iii) Speculative demand for money - to invest in various other instruments like domestic bonds, foreign bonds etc.

Role of savings by classical

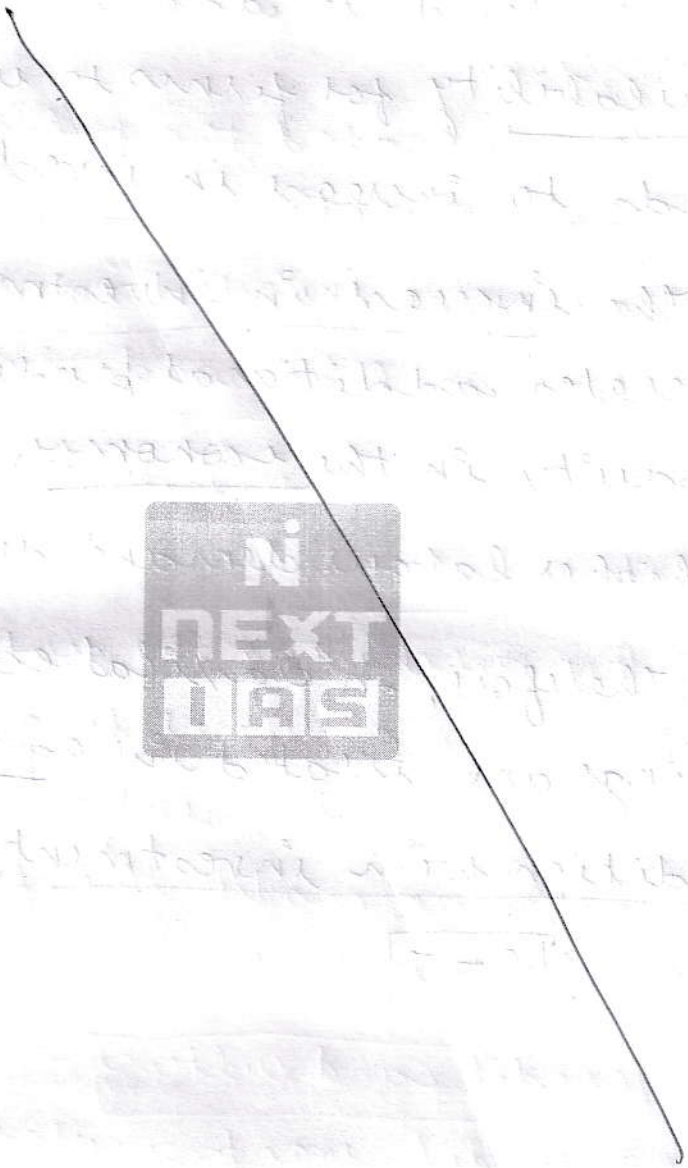


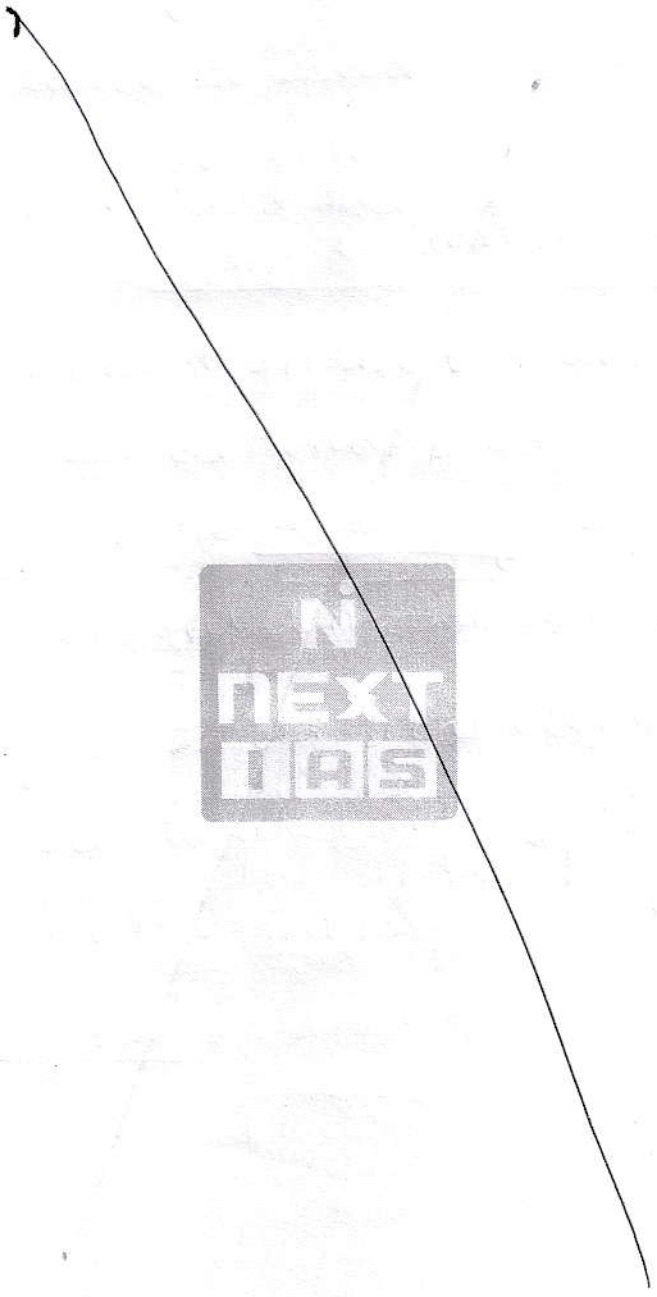
(i) According to the classicals, In the closed economy, when savings increases then it leads to additional money availability for firms to use it leads to increase in investment.

(ii) The increase in investment, generates additional productive capacity in the economy, leading to higher labour demand and so on.

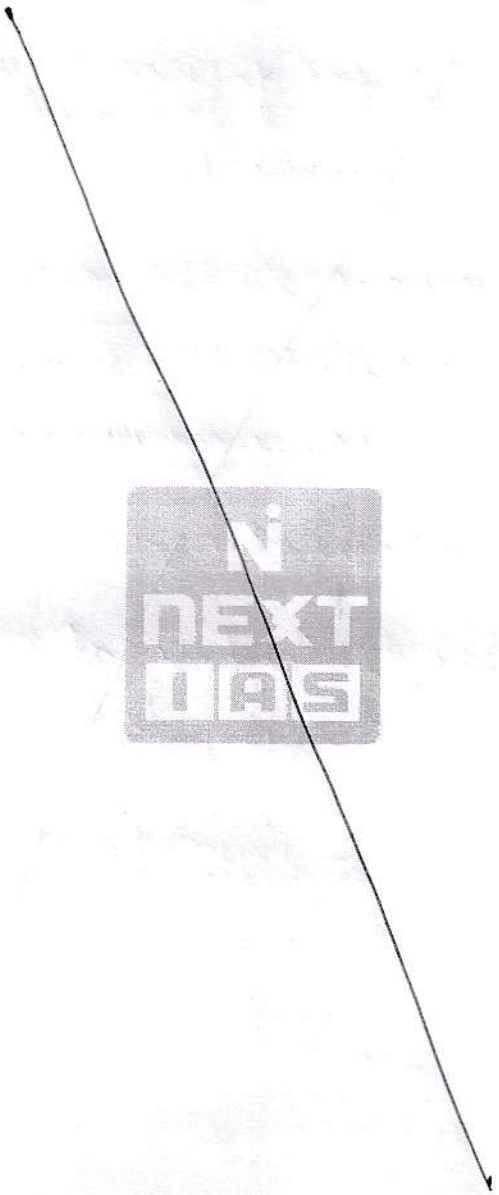
(iii) Therefore, In classical economics, savings are treated in equilibrium condition with investment (i.e),

$$S = I$$





Q.8 (a) "Stagflation couldn't be explained by Keynes, but it could be explained by Neo classical theory."Elaborate. 20



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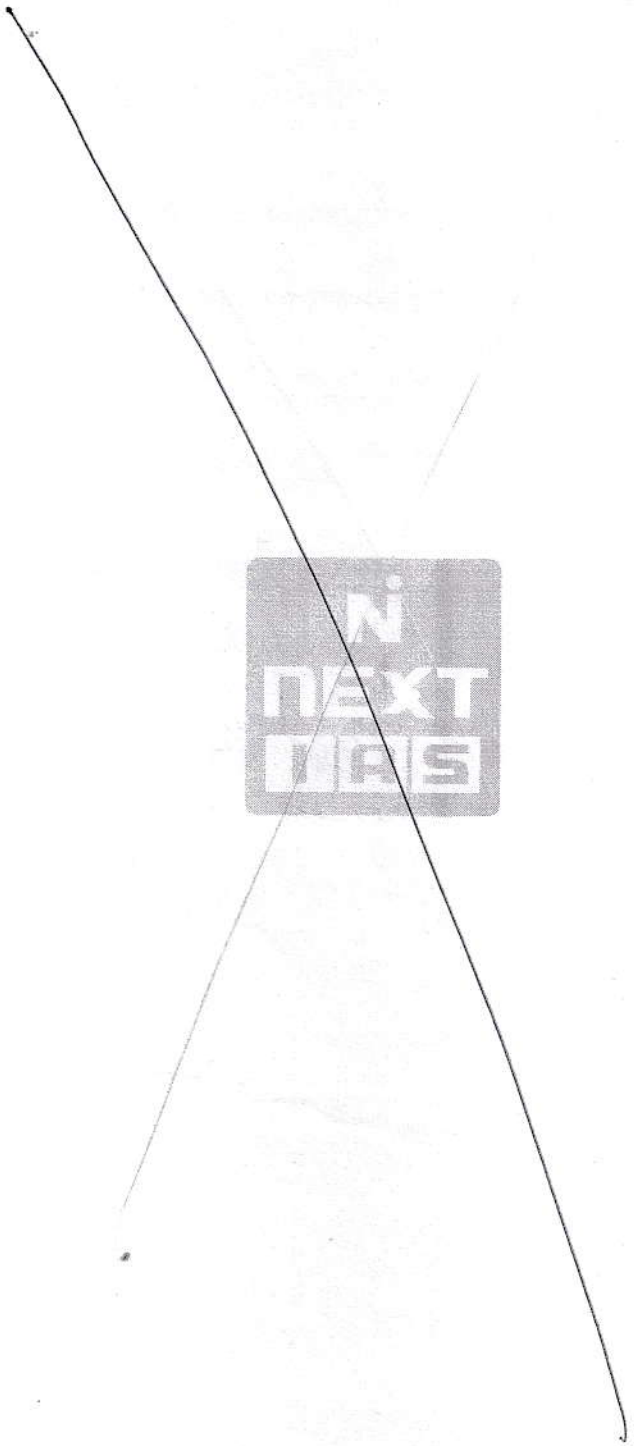
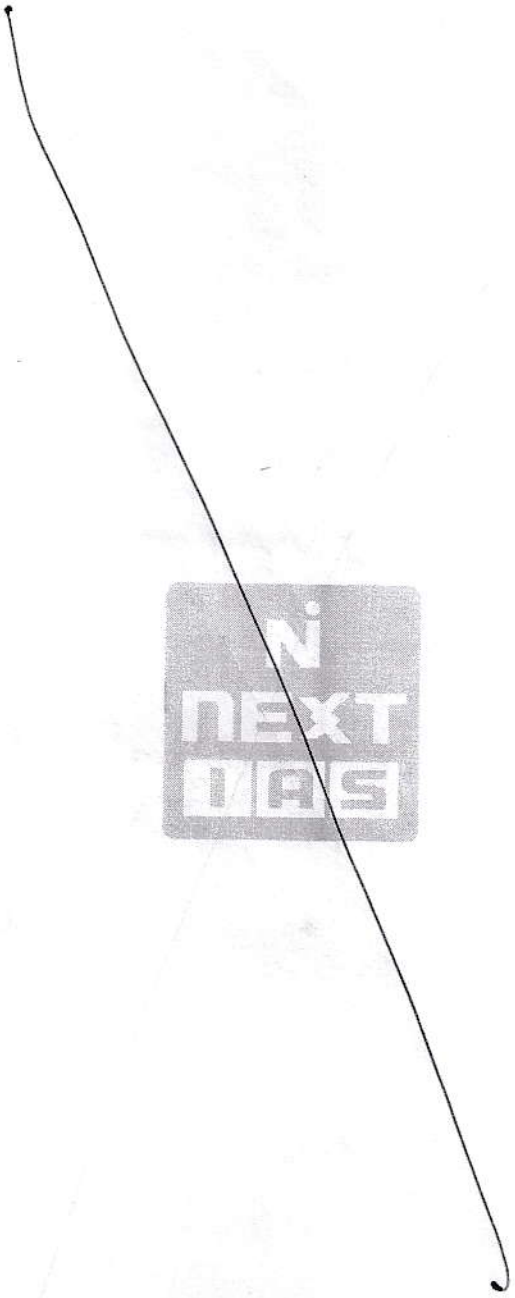
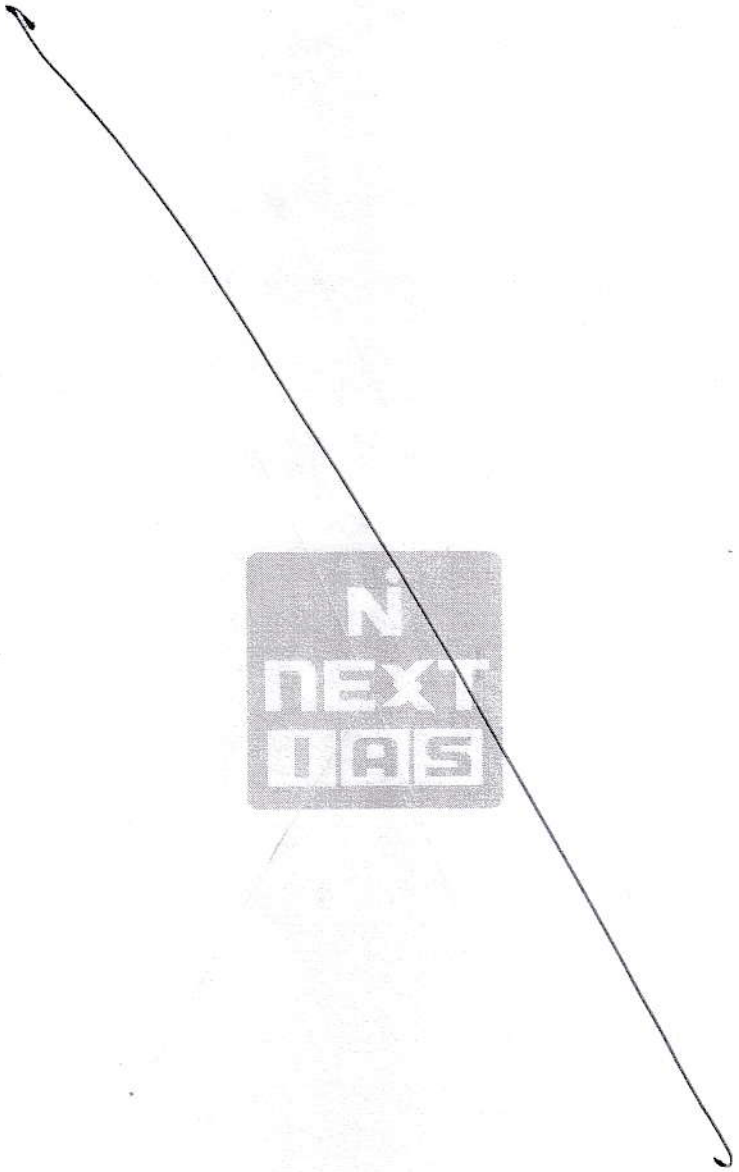
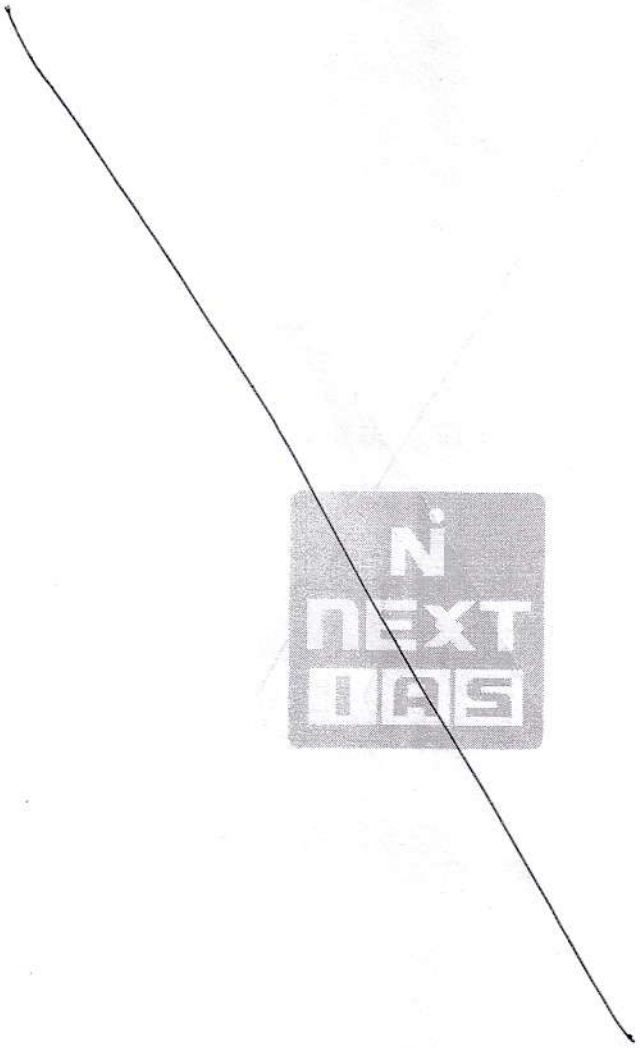
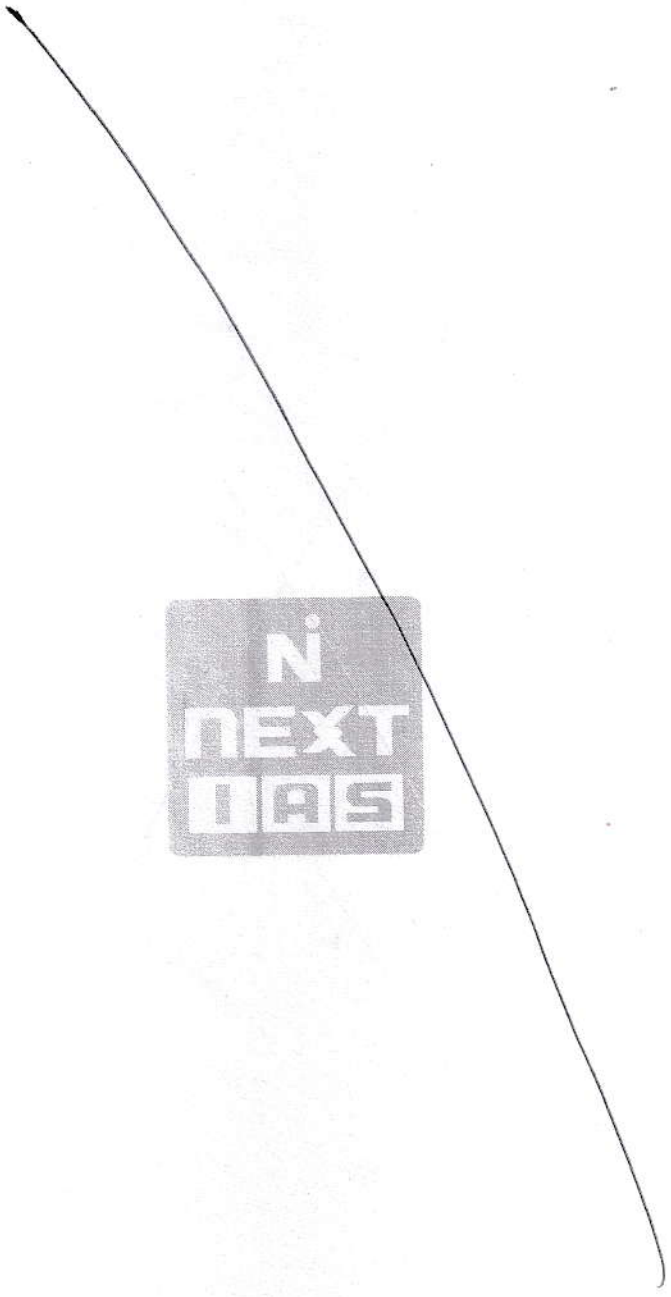


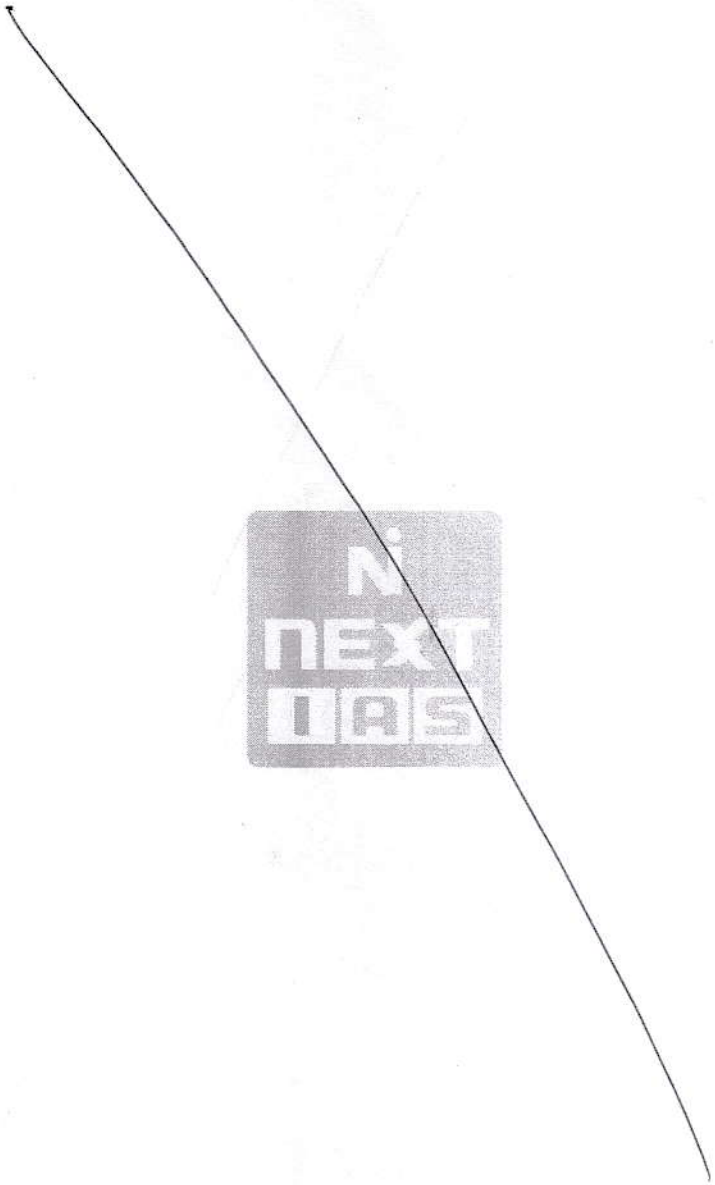




Q.8 (b) What will be the impact of steeper IS on extent of crowding out? What are its policy implications? 15







Q.8 (c) What are demand pull and cost push inflation? What are the policy solutions? 15

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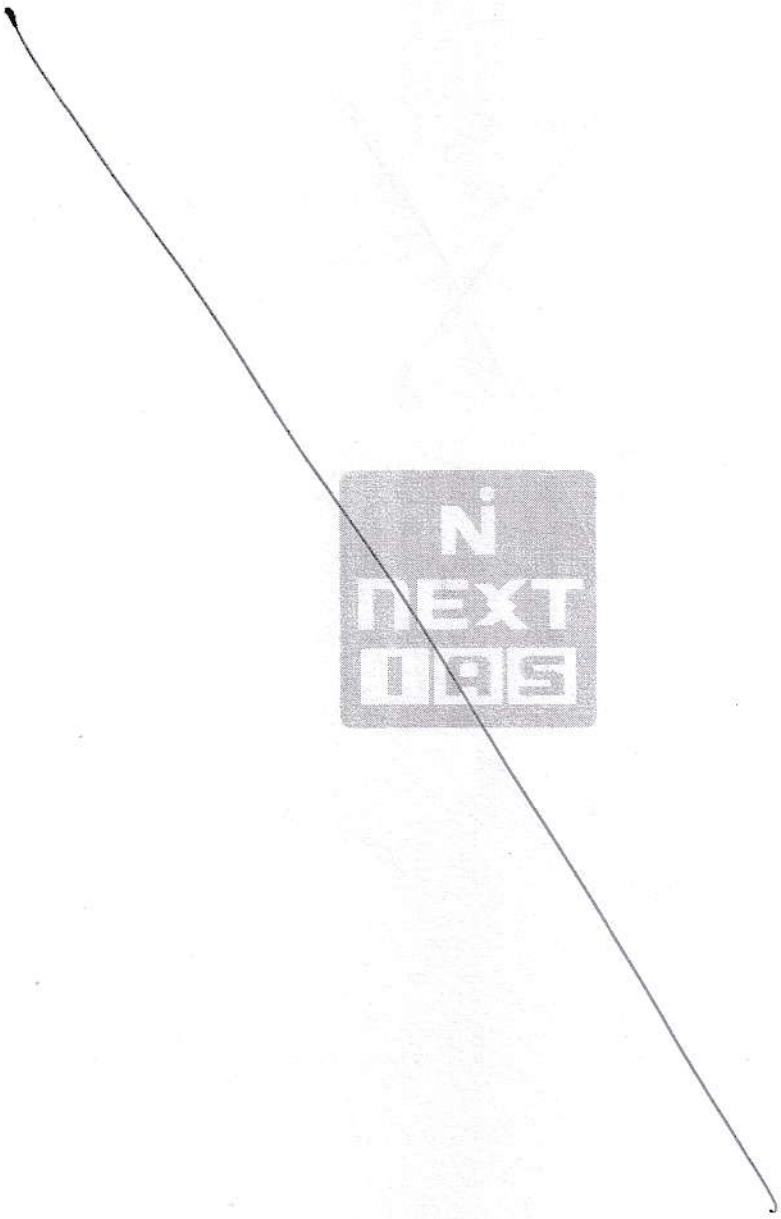

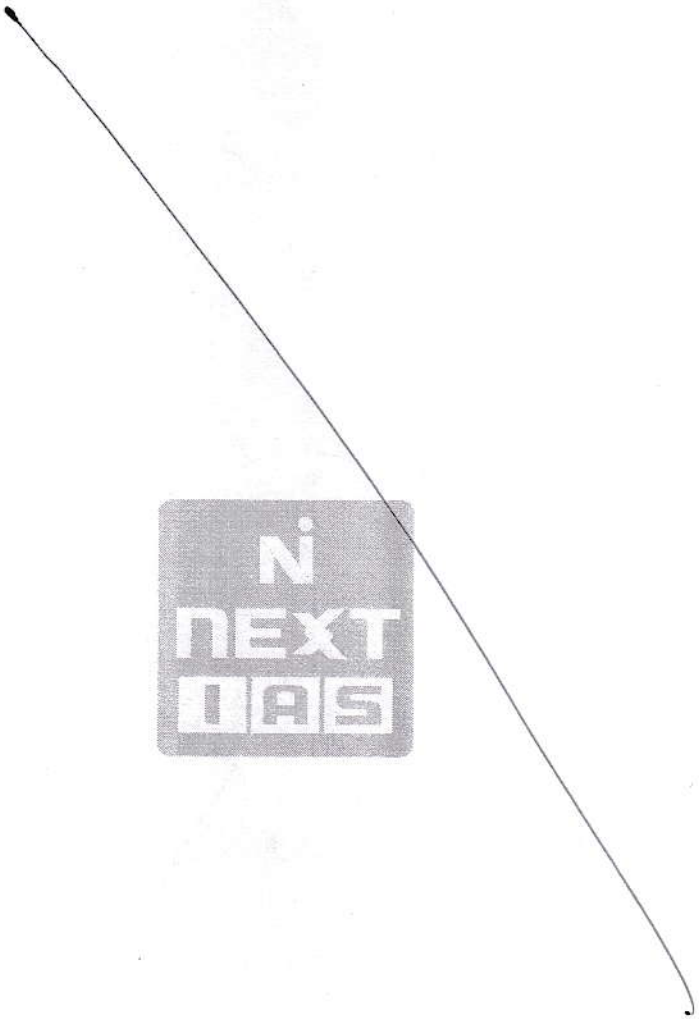

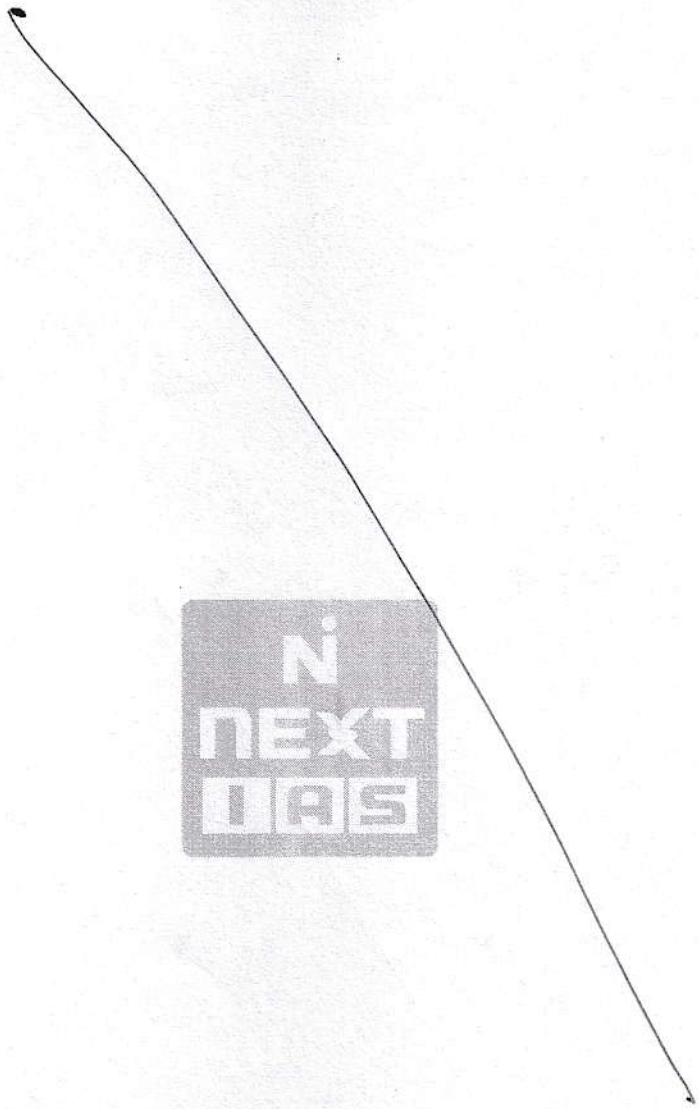

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SPACE FOR ROUGH WORK