Semester II

ECOIDC- 151

Foundation of Economics – II

Total Credits: 3

Unit 1: Introduction

Nature and scope of Macro Economics, importance and limitations of Macro Economics Macro variables, stock and flow concept, Concept of - two sector, three sector and four sector economy.

Unit 2: National income,

Concept of GNP, GDP, NNP, NDP, Private income Personal income, per capita income, real and nominal national income, Methods of measuring national income, Difficulties of Estimating National Income, National income and economics welfare, circular flow of income in two sector, three sector and Four sector economy.

Unit 3: The Classical System

Basic ideas of Classical Macroeconomics, Classical theory of income and employment, Say's law market, wage – price flexibility and Classical Full Employment Model, Quantity theory of money- Classical approach

Unit 4: Keynesian economics,

Keynes' objections to classical theory, The Keynesian Approach – Keynesian Consumption Function, Saving, Investment Functions, Basics of Aggregate Demand and Aggregate Supply, The Principle of Effective Demand; Income Determination in a Simple two Sector Model; Investment Multiplier, Keynesian theory of demand for money.

Unit 5: Money and Banking,

Money – Definition, types, and functions, determination of money supply and demand, Measurement of money supply, functions of Commercial bank, credit creation, role of central bank, Credit control- tools of monetary policy

UNIT – 1

One-Mark Questions and Answers:

1. **What is Macro Economics?**
   Macro Economics studies the economy as a whole, focusing on large-scale issues like national income, inflation, and unemployment.
2. **Who is considered the father of Macro Economics?**
   John Maynard Keynes is known as the father of Macro Economics.
3. **What is the main focus of Macro Economics?**
   The main focus is on aggregate variables such as GDP, inflation, and unemployment.
4. **What does the term 'macro' mean in Macro Economics?**
   'Macro' means large or overall.
5. **What is the importance of Macro Economics?**
   Macro Economics helps understand how an economy functions and provides tools for policy-making.
6. **What is a stock variable?**
   A stock variable refers to a quantity measured at a specific point in time, like wealth or capital.
7. **What is a flow variable?**
   A flow variable is measured over a period of time, like income or expenditure.
8. **What is a two-sector economy?**
   A two-sector economy includes households and firms.
9. **What is a three-sector economy?**
   A three-sector economy includes households, firms, and the government.
10. **What is a four-sector economy?**
    A four-sector economy includes households, firms, government, and the foreign sector.
11. **Give one limitation of Macro Economics.**
    It assumes that all individuals behave the same, which is unrealistic.
12. **What is the scope of Macro Economics?**
    It includes national income, aggregate demand and supply, inflation, and unemployment.
13. **Define Macro variables.**
    Macro variables are large-scale economic factors like GDP, inflation, and unemployment.
14. **What is the difference between stock and flow?**
    Stock is measured at a specific time, while flow is measured over time.
15. **What is national income?**
    National income is the total value of goods and services produced by a country in a year.
16. **Why is Macro Economics important for policymakers?**
    It helps in understanding and solving problems like inflation, unemployment, and economic growth.

17. **What does GDP stand for?**
    GDP stands for Gross Domestic Product.

18. **What is aggregate demand?**
    Aggregate demand is the total demand for goods and services in an economy.

19. **What is aggregate supply?**
    Aggregate supply is the total supply of goods and services available in an economy.

20. **What is the limitation of using aggregate data in Macro Economics?**
    Aggregates may hide important details of individual components.

Two-Mark Questions and Answers:

1. **What is the nature of Macro Economics?**
   The nature of Macro Economics is aggregative, as it studies the economy as a whole by focusing on aggregate variables like national income, inflation, and employment.

2. **Explain the scope of Macro Economics.**
   The scope of Macro Economics includes:
   - National income and its distribution
   - Aggregate demand and aggregate supply
   - Economic policies (monetary and fiscal)
   - Problems like inflation, unemployment, and growth.

3. **Why is Macro Economics important?**
   Macro Economics is important because:
   - It helps analyze the overall performance of the economy.
   - It provides tools to solve issues like inflation, unemployment, and recession.
   - It assists policymakers in framing economic policies.

4. **What are the limitations of Macro Economics?**
   Limitations include:
   - It ignores individual differences by focusing only on aggregates.
   - It assumes a uniform behavior of all individuals.
   - It may lead to incorrect conclusions when micro-level variations are significant.

5. **What is the difference between stock and flow variables?**
   - Stock variables are measured at a specific point in time (e.g., wealth).
   - Flow variables are measured over a period of time (e.g., income).

6. **What is a two-sector economy? Explain with examples.**
   A two-sector economy consists of households and firms. For example:
   - Households provide labor to firms.
   - Firms produce goods and services for households.

7. **What is a three-sector economy?**
A three-sector economy includes households, firms, and the government.
    - The government regulates the economy, collects taxes, and spends on public services.
8. **What is a four-sector economy?**
A four-sector economy includes households, firms, government, and the foreign sector. The foreign sector deals with international trade and investment.
9. **What are Macro variables? Give examples.**
Macro variables are large-scale economic factors that affect the whole economy. Examples include GDP, inflation, national income, and employment rates.
10. **What is the significance of studying Macro Economics?**
Studying Macro Economics is significant because it helps:
    - Understand the functioning of the economy.
    - Formulate economic policies for stability and growth.
    - Solve national problems like unemployment and inflation.

Ten-Mark Questions and Answers:

1. **Explain the nature and scope of Macro Economics.**
Answer:
Nature of Macro Economics:
Macro Economics focuses on studying the economy as a whole rather than individual units. Its nature is aggregative, meaning it deals with aggregate variables such as total production, national income, aggregate demand, and aggregate supply. The study includes how these variables interact and influence the overall functioning of an economy. Macro Economics relies on general equilibrium analysis, considering interdependence among different economic sectors.

Key Features of Macro Economics:

- It deals with aggregates like national income, consumption, and savings.
- It studies economic phenomena at a broad level, like inflation, unemployment, and economic growth.
- It involves formulating economic policies to achieve national objectives.

Scope of Macro Economics:
The scope of Macro Economics includes:

- **National Income Analysis:** Understanding national income, its measurement, and distribution is essential to gauge the performance of an economy.
- **Economic Growth:** Macro Economics studies factors influencing economic growth and development over time.
- **Unemployment and Employment:** It examines the causes and solutions to unemployment and employment generation.

- **Inflation and Deflation:** Macro Economics studies the general price level, its rise (inflation), and fall (deflation).
- **International Trade:** It also deals with foreign trade, exchange rates, and balance of payments.
- **Economic Policies:** It provides the basis for monetary, fiscal, and trade policies to stabilize the economy and achieve growth.

2. **Discuss the importance and limitations of Macro Economics.**
Answer:
Importance of Macro Economics:

- **Understanding the Economy:** Macro Economics helps analyze how the economy functions at the national and global levels.
- **Policy Formulation:** It provides tools and data for governments to formulate policies like monetary and fiscal policies.
- **Solving National Problems:** Issues like inflation, unemployment, and economic growth can be addressed using macroeconomic theories.
- **Economic Development:** It studies the factors that lead to the economic development of a nation.
- **Global Perspective:** Macro Economics is essential in understanding global economic trends, international trade, and globalization.

Limitations of Macro Economics:

- **Focus on Aggregates:** Macro Economics ignores individual behavior and differences, which might lead to inaccurate conclusions.
- **Assumption of Uniformity:** It assumes that all individuals or groups behave uniformly, which is unrealistic.
- **Difficulty in Measuring Aggregates:** Measuring aggregates like national income accurately can be challenging due to data limitations.
- **Overgeneralization:** Macro Economics may overlook micro-level details, which are crucial for understanding specific economic problems.
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3. **Define and explain the concepts of stock and flow variables with examples.**
Answer:
Definition:
Stock variables are quantities measured at a specific point in time, whereas flow variables are measured over a period of time.

Explanation:

- **Stock Variables:** These represent the total amount of a quantity available at a given time. For example, capital, wealth, and foreign exchange reserves are stock variables.
Example: The wealth of a household on 31st December 2024 is ₹10 lakh.

- **Flow Variables:** These represent the rate of change in a quantity over a period of time. For example, income, savings, and investments are flow variables.
  Example: A person earns ₹50,000 per month (flow) during 2024.

Differences between Stock and Flow Variables:

- Stock is static, while flow is dynamic.
- Stock is a snapshot at a point in time; flow represents changes over time.
- Stock influences flow, and flow impacts stock.

Interrelation:
Stock and flow are interdependent. For instance, the total wealth (stock) of a household depends on its income (flow) and savings (flow).

4. **What is a four-sector economy? Explain the concept with examples.**
   Answer:
   A four-sector economy includes households, firms, the government, and the foreign sector. Each sector plays a unique role in the economy, contributing to its functioning.

Key Features:

- **Households:** They provide labor and other resources to firms in exchange for wages, rent, interest, and profits. They are consumers of goods and services.
- **Firms:** These are producers of goods and services. They hire resources from households to produce and sell goods and services.
- **Government:** The government regulates the economy by implementing policies, collecting taxes, and spending on public services and infrastructure.
- **Foreign Sector:** This sector represents trade and financial transactions with other countries. It includes exports, imports, and foreign investments.

Example:

- A household buys goods (consumption) from a firm.
- Firms pay wages and salaries to households for labor.
- The government collects taxes from both households and firms and provides public goods like roads and schools.
- The foreign sector imports raw materials for firms and exports finished goods.

Importance of the Four-Sector Economy:
The inclusion of the foreign sector highlights the interconnectedness of economies in the globalized world. It helps understand international trade's impact on domestic economic growth.

5. **What are Macro variables? Explain their significance with examples.**
   Answer:
   Definition:
   Macro variables are economic factors that represent the performance and trends of the economy as a whole.

Examples of Macro Variables:

- **Gross Domestic Product (GDP):** Measures the total value of goods and services produced in a country.
- **Inflation Rate:** Represents the general increase in prices over time.
- **Unemployment Rate:** Indicates the percentage of the labor force that is unemployed.
- **National Income:** Total income earned by a nation's residents.
- **Aggregate Demand and Aggregate Supply:** Represent the total demand for and supply of goods and services.

Significance:

- **Economic Analysis:** Macro variables help analyze the overall performance of the economy.
- **Policy Formulation:** Policymakers use these variables to design policies to stabilize the economy.
- **Comparative Analysis:** They allow comparison of economic performance between countries or time periods.
- **Predicting Trends:** Macro variables are used to predict future trends like growth, inflation, or recession.

UNIT – 2

One-Mark Questions and Answers

1. **What is GDP?**
   Answer: Gross Domestic Product (GDP) is the total monetary value of all final goods and services produced within a country's borders in a given period.

2. **What does GNP stand for?**
   Answer: GNP stands for Gross National Product, which includes GDP and net factor income from abroad.

3. **What is the formula for GDP?**
   Answer: GDP = C + I + G + (X - M), where C = Consumption, I = Investment, G = Government Spending, X = Exports, and M = Imports.

4. **What is NDP?**
   Answer: Net Domestic Product (NDP) is GDP minus depreciation of capital assets.

5. **What is NNP?**
   Answer: Net National Product (NNP) is GNP minus depreciation.

6. **What is private income?**
   Answer: Private income is the total income received by private individuals or enterprises, including wages, profits, rent, and interest.

7. **What is personal income?**
   Answer: Personal income is the total income earned by individuals before paying personal taxes.

8. **What is per capita income?**
   Answer: Per capita income is the average income of a person in a country, calculated as national income divided by the population.

9. **What is real national income?**
   Answer: Real national income is the national income adjusted for inflation to reflect the actual purchasing power.

10. **What is nominal national income?**
    Answer: Nominal national income is the national income measured at current market prices without adjusting for inflation.

11. **What is the circular flow of income?**
    Answer: The circular flow of income represents the movement of goods, services, and income between households and firms in an economy.

12. **What is the two-sector economy?**
    Answer: A two-sector economy includes households and firms, without involving government or foreign trade.

13. **What is the three-sector economy?**
    Answer: A three-sector economy includes households, firms, and the government.

14. **What is the four-sector economy?**
    Answer: A four-sector economy includes households, firms, the government, and the foreign sector.

15. **What are the methods of measuring national income?**
    Answer: The three methods are the production method, income method, and expenditure method.
16. **What is the production method of national income measurement?**
    Answer: The production method calculates national income as the total value of goods and services produced in an economy.
17. **What is the income method of national income measurement?**
    Answer: The income method calculates national income by summing up all incomes earned by individuals and firms.
18. **What is the expenditure method of national income measurement?**
    Answer: The expenditure method calculates national income by summing up all expenditures made in an economy.
19. **What is economic welfare?**
    Answer: Economic welfare refers to the overall well-being and standard of living of individuals in an economy.
20. **What are the difficulties in estimating national income?**
    Answer: Difficulties include the informal economy, lack of accurate data, and valuation of non-monetary transactions.

Two-Mark Questions and Answers

1. **Differentiate between GDP and GNP.**
   Answer:
   - **GDP (Gross Domestic Product):** Measures the total value of goods and services produced within a country's boundaries during a specific period.
   - **GNP (Gross National Product):** Measures the total value of goods and services produced by the residents of a country, including net factor income from abroad.
     Formula:
   - GDP = C + I + G + (X - M)
   - GNP = GDP + Net Factor Income from Abroad (NFIA).
2. **What is the difference between nominal and real national income?**
   Answer:
   - **Nominal National Income:** Measured at current market prices without adjusting for inflation.
   - **Real National Income:** Adjusted for inflation, reflecting the actual purchasing power.
     Formula: Real National Income = Nominal National Income ÷ Price Index × 100
3. **What is private income, and how is it calculated?**
   Answer:
   Private income is the total income received by individuals and private enterprises. It is calculated as:

Private Income = National Income + Transfer Payments + Net Factor Income from Abroad - Income from Government/Public Enterprises.

4. **Explain personal income and its calculation.**
   Answer:
   Personal income is the total income received by individuals before personal taxes are deducted.
   Formula:
   Personal Income = Private Income - Corporate Taxes - Retained Earnings + Transfer Payments.

5. **What are the three methods of measuring national income?**
   Answer:
   - **Production Method:** Total value of goods and services produced in the economy.
   - **Income Method:** Total income earned by factors of production (wages, rent, interest, profit).
   - **Expenditure Method:** Total expenditure on goods and services in the economy.

6. **What is the circular flow of income in a two-sector economy?**
   Answer:
   In a two-sector economy, income flows between households and firms. Households provide factors of production (labor, land, capital) to firms, and firms produce goods and services consumed by households. Payments (wages, rent, interest, profit) complete the circular flow.

7. **What is the significance of per capita income?**
   Answer:
   Per capita income measures the average income of individuals in a country, reflecting the standard of living and economic performance.
   Formula:
   Per Capita Income = National Income ÷ Population

8. **What are the difficulties in estimating national income?**
   Answer:
   - Valuation of non-monetary transactions (e.g., domestic work).
   - Informal and unorganized sector activities.
   - Lack of reliable data, especially in developing economies.

9. **How does national income contribute to economic welfare?**
   Answer:
   National income helps assess a country's economic performance, availability of resources, and standard of living. Higher national income often indicates better economic welfare, though disparities and environmental concerns must also be considered.

10. **Explain the difference between stock and flow variables in economics.**
    Answer:
    - **Stock Variables:** Measured at a specific point in time (e.g., capital, wealth).
    - **Flow Variables:** Measured over a period of time (e.g., income, expenditure).

Ten-Mark Questions and Answers

1. **Explain the concepts of GNP, GDP, NNP, and NDP in detail.**
   Answer:
   Gross National Product (GNP), Gross Domestic Product (GDP), Net National Product (NNP), and Net Domestic Product (NDP) are critical economic indicators used to measure the performance of an economy.

- **Gross Domestic Product (GDP):**
  GDP is the total monetary value of all final goods and services produced within a country's borders in a specific period, regardless of the ownership of the resources. It includes consumption, investment, government spending, and net exports.
  Formula: GDP = C + I + G + (X - M)
  Example: If India produces goods and services worth ₹100 lakh within its borders, the GDP is ₹100 lakh.

- **Gross National Product (GNP):**
  GNP includes GDP and net factor income from abroad (NFIA). It measures the total output produced by the residents of a country, including their income from overseas investments.
  Formula: GNP = GDP + NFIA
  Example: If India's NFIA is ₹10 lakh, and its GDP is ₹100 lakh, the GNP is ₹110 lakh.

- **Net Domestic Product (NDP):**
  NDP accounts for depreciation (wear and tear) of capital assets from the GDP.
  Formula: NDP = GDP - Depreciation
  Example: If India's depreciation is ₹5 lakh, and GDP is ₹100 lakh, the NDP is ₹95 lakh.

- **Net National Product (NNP):**
  NNP is the GNP after deducting depreciation.
  Formula: NNP = GNP - Depreciation
  Example: If India's depreciation is ₹5 lakh, and GNP is ₹110 lakh, the NNP is ₹105 lakh.

These concepts help economists assess the overall economic performance, policy effectiveness, and resource utilization in an economy.

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2. **Describe the methods of measuring national income in detail.**
   Answer:
   National income can be measured using the following three methods:

- **Production Method (Value Added Method):**
  This method calculates the total value of goods and services produced in an economy. It involves summing up the value added at each stage of production.
  Steps:
  1. Classify the economy into sectors (primary, secondary, tertiary).
  2. Calculate the value of output for each sector.
  3. Subtract the intermediate consumption to get the value added.
     Formula: National Income = Value of Output - Intermediate Consumption

- **Income Method:**
  This method calculates national income by summing up all incomes earned by factors of

production (land, labor, capital, and entrepreneurship).
Components:

1. Wages and salaries (compensation of employees).
2. Rent (income from land).
3. Interest (income from capital).
4. Profit (income from entrepreneurship).
   Formula: National Income = Wages + Rent + Interest + Profit

- **Expenditure Method:**
  This method calculates national income by summing up all expenditures in the economy.
  Components:
  1. Consumption expenditure by households.
  2. Investment expenditure by firms.
  3. Government spending on goods and services.
  4. Net exports (exports - imports).
     Formula: National Income = C + I + G + (X - M)

Each method highlights different aspects of the economy and provides insights into its functioning.

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3. **What are the difficulties in estimating national income? Explain in detail.**
   Answer:
   Estimating national income involves several challenges, especially in developing countries.

- **Non-Monetary Transactions:**
  Activities like subsistence farming, household services, and barter transactions are difficult to value in monetary terms.
- **Unorganized Sector:**
  A large portion of the economy operates informally, with little or no record-keeping.
- **Double Counting:**
  Including the value of intermediate goods along with final goods leads to overestimation of national income.
- **Valuation of Services:**
  Services such as healthcare, education, and defense are challenging to value accurately.
- **Income from Illegal Activities:**
  Income from activities like smuggling and gambling is not reported, leading to underestimation.
- **Price Level Changes:**
  Fluctuations in prices over time complicate comparisons of national income.
- **Lack of Reliable Data:**
  Developing countries often lack robust statistical systems to collect and analyze data effectively.

- **Net Factor Income from Abroad (NFIA):**
  Determining accurate income flows between countries is challenging due to lack of transparency in international transactions.

Efforts to address these difficulties involve improving statistical methods, enhancing data collection, and using advanced technology for accurate estimation.

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4. **Explain the circular flow of income in a four-sector economy.**
   Answer:
   The circular flow of income explains how income and expenditure move through different sectors of the economy. In a four-sector model, the economy includes households, firms, government, and the foreign sector.

- **Households:**
  Households provide factors of production (labor, land, capital) to firms and receive wages, rent, interest, and profit. They spend their income on goods and services produced by firms.
- **Firms:**
  Firms use factors of production to produce goods and services. They pay income to households and receive revenue from selling goods and services.
- **Government:**
  The government collects taxes from households and firms and uses the revenue for public goods and services, subsidies, and transfers.
- **Foreign Sector:**
  This sector includes exports and imports. Households and firms purchase imports, while firms export goods to foreign countries, generating income.

Circular Flow Stages:

1. Households supply factors of production to firms.
2. Firms produce goods and services for households.
3. Government regulates the flow through taxation and spending.
4. The foreign sector adds international trade, involving imports and exports.

UNIT – 3