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COMMERCE & LAW
PROGRAM DIVISION (CLPD)

FDG

Roll. No. ……………………………

Total No. of Question -04 **Maximum Marks : 40**

Test Paper with Solutions

ECONOMICS FOR FINANCE

CA-Intermediate (May 2023)

Examination

Disclaimer Clause :

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- Views and Answers provided may differ from **ICAI** due to difference in assumptions taken in support of the answers .
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PART– II

Section - B

Question No. 7 is compulsory.

Answer any Three questions from the rest.

Working notes should form part of the respective answers.

7. **(a)** The following information relating to a particular financial year of a country is given below:

Particulars	**Amount (₹ in crore)**
Private final consumption expenditure	1620
Government final consumption expenditure	750
Net domestic fixed expenditure	500
Export	400
Import	440
Net Factor Income from Abroad	20
Net Indirect Taxes	100

You are required to compute the National Income of the country by using Expenditure Method.

(3 Marks)

Sol. **(a)** Calculation of NDP From expenditure Method = C + I + G + x – m

Private Final consumption expenditure	(C)	= 1620
+		
Net Domestic Fixed Investment =	(I)	= 500
+		
Government Final Consumption = expenditure	(G)	= 750
+		
(–) Net export / (x – m)		(–) 40
NDP_{MP}	=	2830
Calculation NDP_{FC} =		2830
(NDP_{MP} – NIT)		(–)100
NDP_{FC}	=	2730
Calculation of N.I.	=	
(NDP_{FC} + NFIA)	=	2730
		+ 20
National Income	=	2750

Ans. 2750 N.I from expenditure Method

7. **(b)** Compute the Reserve Money from the following data relating to 31st March, 2023:

Particulars	**(₹ in crore)**
Currency in Circumstances	28637
Bank Deposits with RBI	5673
Post Office Deposits	400
Other Deposits with RBI	210

(2 Marks)

Sol. Reserve money = CC + BD + OD

Reserve Money = Currency in circulation = 28637

\+

Bank Deposit with RBI = (+) 5673

\+

Other Deposit with RBI (+) 210

34520

Ans. ₹34520

7. **(c)** Explain the differences between Foreign Direct Investment (FDI) and Foreign Portfolio Investment (FPI).

(3 Marks)

Ans (c) Basis of Difference FDI Vs FPI

Basis of Difference	**FDI**	**FPI**
Meaning	FDI refers to investment by foreign investors to obtain a Substantial interest in enterprise located in different country	FPI refers to investing in the financial assets of a foreign country, such as stock or bonds available on exchange
Degree of control	High control	Very low control
Entry and exist	Difficulty	Relatively easy.
Risk involved	Stable	Volatile
Term	Long-term investment	Short-term investment
Type	Direct investment	Indirect investment

7. **(d)** Describe the name and salient features of the fiscal policy for combating inflationary pressures in the economy.

(2 Marks)

Sol. **(d)** Contractionary Fiscal Policy aim at eliminating an inflationary rate

— Decarese in govt Spending

— Increase in personal income tax reduce disposable income

— A combination of decrease in govt spending and increase in personal tax/business tax.

This is achieved by adopting policy measures that would result in the aggregate demand curve (AD) shifting to the left so the equilibrium may be established at the full employment level or real GDP. This can be achieved either by :

1. Decrease in government spending : With decrease in government spending the total amount of money available in the economy is reduced which in turn trim down the aggregate demand.
2. Increase in personal income taxes and/or business taxes: An increase in personal income taxes reduces disposable incomes leading to fall in consumption spending and aggregate demand. An increase in taxes on business profits reduces the surpluses available to businesses, and as a result, firms' investments shrink causing aggregate demand to fall. Increased taxes also dampen the prospects of profits of potential entrants who will respond by holding back fresh investments.
3. A combination of decrease in government spending and increase in personal income taxes and / or business taxes.

8. (a) (i) Following information is related to an economy :

Autonomous consumption	₹ 1,000 crore
Marginal propensity to consume	0.8
Equilibrium level of income	₹ 10,000 crore

You are required to calculate the investment expenditure and consumption expenditure of the economy.

(3 Marks)

Sol. (a) (i) Given (i) C = 1000 crore

MPC = 0.8

Equilibrium level of income (Y) = 10,000 crore

We know Y = C + I, and given C = 1,000 + 0.8 Y + I

Y = C + I

10,000 = 1,000 + 0.8 Y + I

10,000 = 1,000 + 0.8 (10,000) + I

10,000 = 1,000 + 8,000 + I

10,000 = 9,000 + I

I = 10,000 – 9,000

I = 1,000

C = 9,000

8. **(a)** **(ii)** Explain the government interventions for combating the market failures due to information problem.

(2 Marks)

Sol. **(ii)** Government intervention for correcting information failure

For contribution the problem of market failure due to information problems and considering the importance of information in making rational choices, the following interventions are resorted to :

- Government makes it mandatory to have accurate labelling and content disclosures by producers. E.g. Labelling on cigarette packets and nutritional information in food packages.
- Mandatory disclosure of information For example : SEBI requires that accurate information be provided to prospective buyers of new stocks.
- Public dissemination of information to improve knowledge and subsidizing of initiatives in that direction.

Regulation of advertising and setting of advertising standard to make advertising more responsible informative and less persuasive.

8. **(b)** **(i)** Compute M1 and M4 from the following data relating to 31st March, 2023 :

Notes in circulation	3,01,78,670
Circulation of rupee coins	6,48,902
Demand deposits with banks	1,41,31,650
Time Deposits with Banks	31,24,276
Cash in hand with banks	7,64,130
Other Deposits with RBI	3,98,048
Post Office Savings Deposits	2,02,684
Post Office National Savings Certificates (NSCs)	820

(3 Marks)

Sol. **(b)** **(i)** M1 = CU + DD

(30178670 + 648902 + 14131650 + 398048)

M1 = 45357270

M2 = M1 + Saving deposit with post office

(M2 = 45357270 + 202684)

M2 = 45559954

M3 = M1 + Net time Deposit of Commercial Bank

(M3 = 45357270 + 3124276)

M3 = 48481546

M4 = M3 + Total deposit with P.O Savings (excluding NSC)

(M4 = 48481546 + 202684)

M4 = 48684230

Ans. M1 = 45357270, M4 = 48684230

8. **(b)** **(ii)** Describe the exchange rate regime that is commonly used by the countries in real world.

(2 Marks)

Sol. **(ii)** Exchange rate regime that is commonly use by the countries in real world ware often misled to think that it is common for countries to adopt the flexible exchange rate system. In the real world, there is a spectrum of 'intermediate exchange rate regimes' which are either inflexible or have varying degrees of flexibility that lie in between these two extremes (fixed and flexible). For example, a central bank can implement soft peg and hard peg policies. A soft peg refers to an exchange rate policy under which the exchange rate is generally determined by the market, but in case the exchange rate tends to be move speedily in one direction, the central bank will intervene in the market. With a hard peg exchange rate policy, the central bank sets a fixed and unchanging value of the exchange rate. Both soft peg and hard peg policy require that the central bank intervenes in the foreign exchange market.

9. (a) (i) Two countries G and H are producing Sugar and Steel. The table given below shows the number of labour hours required to produce Sugar and Steel :

Commodity	Country G	Country H
One Unit of Sugar	6.0	2.0
One Unit of Steel	2.5	5.0

(A) Compute the Productivity of labour in both countries in respect of both commodities.

(B) Which country has absolute advantage of production of Steel?

(C) Which country has absolute advantage of production of Sugar?

(3 Marks)

Ans (a) (i) Productivity of labour calculation in both country

Country	One unit of Sugar	One unit of Steel
Country G –	$\frac{1}{6}=0.166\text{ units/hour}$	$\frac{1}{2}=0.5\text{ units/hour}$
Country H –	$\frac{1}{2.5}=0.4\text{ units/hour}$	$\frac{1}{5}=0.24\text{ units/hour}$

(ii) Since 0.5 > 0.2 **country G** has absolute advantage of production of Steel.

(iii) Also, 0.4 > 0.166 **country H** has absolute advantage of production of Sugar.

9. (a) (ii) In a economy investments have been increased by ₹5,000 crore.

The Marginal Propensity to Consume (MPC) is 0.82.

You are required to compute the total increase in income and saving in the economy.

(2 Marks)

Ans (a) (ii) Given Investment increase by ₹5,000 crore

MPC = 0.82

Calculation of Total increase in income

We known Investment Multiplier $=\frac{1}{1-\text{MPC}}=\frac{1}{1-0.82}$

$$K=\frac{1}{1-0.82}=5.5\text{ times}$$

Also K = $\Delta I/\Delta Y$

Substituting equation

$$\Delta I=5.5\times\frac{\Delta Y}{5000}$$

$$\Delta Y=27500$$

We know that MPS = $\frac{\Delta S}{\Delta Y}$ or $(1-\text{MPC}=0.18)$

MPS = 0.18

$$MPS = \frac{\Delta S}{\Delta Y}$$

$$0.18 = \frac{\Delta S}{27500}$$

$$\Delta S = 4950$$

Ans. ΔY **= 27500 and** ΔS **= 4950**

9. (b) (i) Discuss the similarities between Fisher's Transaction approach and Cambridge Cash Balance approach

(3 Marks)

Sol. Similarities between Fisher's Transaction Approach and Cambridge cash balance Approach:

The fisherian and Cambridge versions lead to the same conclusion that there is direct and Proportional relationship between the quantity of money and the price level and an inverse proportionate relationship between quantity of money and the value of money.

9. (b) (ii) Explain the following terms :

- Stagflation
- Contagion Effect

(2 Marks)

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Sol. (a) **Stagflation :** The combination of recession or stagnation and Increasing prices or inflation.

(b) **Contagion effect :** In economics and finance, a contagion can be explained as a situation where a shock in a particular economy or region spreads out and affects others by way, say, Price movements The contagion effect explains the possibility of spread of economic crisis or boon across countries or regions.

10. (a) (i) Following information relating to a developing country is available to you :

Investment (I)	₹140 crore
Government Expenditure(G)	₹90 crore
Export (X)	₹100 crore
Consumption Function (C) =	80 + 0.8 Yd (Disposable Income)
Import (M) =	50 + 0.09 Y (Income)
Tax (T)	0.2 Y (Income)

You are required to :

(A) Find out equilibrium level of income (Y)

(B) Calculate foreign trade multiplier.

(C) Calculate net export if investment is increased by ₹30 crore.

(3 Marks)

Sol. **(A)** Given

Investment (I) = 140 Cr. **Consumption Function = 80 + 0.8Yd**

Export (X) = 100 cr. **Tax = 0.2 Y (income)**

Import (M) = 50 +0.09Y **Govt expenditure = 90 crore**

In 4 sector Economy Y = C + I + G + (X – M)

Y = [80 + 0.8 Yd] + 140 + 90 + [100 – (50 + 0.9Y)

Y = [80 + 0.8 (Y – 0.2Y) + 140 + 90 + [100 – (50 + 0.9Y)

Equation 1. Y = 80 + 0.8Y – 0.16Y + 330 – 50 – 0.9Y

Equation 2. Y = 360

Substituting equation 1 and 2

Y – 0.8Y + 0.16Y + 0.9Y = 360

1.26Y = 360

OR $y = \frac{360}{1.26}$

(a) Equilibrium Level of Income (Y) = 286

Disposable income = (Y – Tax) = (286 – 0.02Y)

Yd = Y – Tax = 286 – 0.2 (286)

Yd = 286 – 57 = 229.

(B) Foreign Trade Multiplier $\frac{1}{1-b+v}$

F.T. M = $\frac{1}{1-b+v}$ where b = MPC, V = Propensity to Import

Here b = MPC = 0.8 (from C function)

and V = Propensity to import = 0.09 (from M function)

Substituting in the equation

We have Foreign trade Multiplier = $\frac{1}{1-b+v}$

Foreign Trade Multiplier = $\frac{1}{1+0.8+0.09} = \frac{1}{0.29}$

FTM = 3.44 times

(C) Net Export (X – M)

Net Export = (100 – 50 + 0.09Y)

Net Export = (100 – 50 + 0.09(286)

Net Export = 50 + 27 = 77

Calculation of Net Export if Investment is increase by ₹30 crore

In 4 sector Economy Y = C + **I +** ΔI + G + (X – M)

$Y = [80 + 0.8\ Yd] + I\ 140 + 30 + 90 + [100 – (50 + 0.9Y)$

$Y = [80 + 0.8\ (Y – 0.2Y) + 140 + 30 + 90 + [100 – (50 + 0.9Y)$

Equation 1. $Y = 80 + 0.8Y – 0.16Y + 360 + 30 – 0.9Y$

Equation 2. $Y = 390$

Substituting equation 1 and 2

$Y – 0.8Y + 0.16Y + 0.9Y = 390$

$1.26Y = 390$

OR $y = \frac{390}{1.26} = 309$

If investment increase by 30 in that case Net Export = 50 + 0.09 (309)

Net exporter = 100 – 77 = 33

10. (a) (ii) A customer of a bank deposits ₹50,000 in his bank. The bank is required to keep a cash reserve of 20 percent to meet the demand for cash by its depositors.
Calculate the amount of bank deposits the banking system as a whole would generate on the basis of such deposits by the customer.

Sol. (a) Initial Deposit X $\frac{1}{CDR\%}$

50,000 = Bank Deposits

CDR = 20/100

$5000 \times \frac{1}{20/100}$

$5000 \times \frac{1}{1/5}$

$5000 \times 5 = 25000$

Ans. 25000 Amount of Bank deposit the balancing System as a whole

10. (b) (i) Is World Trade Organisation (WTO) better than General Agreement on Tariffs and Trade (GATT)? Explain with reasons.

(3 Marks)

Ans The GATT was international treaty with a temporary international existence, where as WTO is a permanent body whose authority has been satisfied by its Member nations.
GATT dispute settlement was generally slower and less effective than dispute settlement under the WTO. Hence WTO is better the GATT.

10. (b) (ii) Write down the name of the terms used in the analysis of the effect of externalities in the following conditions :

(A) The change in the cost of parties other than the producer or buyer of a good or service due to an additional unit of the good or service.

(B) The change in society's total benefits associated with an additional unit of good or service.

(C) The change in the benefit to parties other than the producer or buyer of a good or service due to an additional unit of the good or service.

(D) The change in society's total cost brought about by an additional unit of a good or service.

(2 Marks)

Sol. (ii) Type of externalities

(A) Marginal External Cost

(B) Marginal social Benefits

(C) Marginal External Benefit

(D) Marginal Social Cost