ECO401 CURRENT PAPERS Spring 2010 SUBJECTIVE SOLVED BY LAIBA BUTT

Question No: 49 (Marks: 3)

What is meant by exchange rate? Also give example of exchange rate.

Answer:

EXCHANGE RATE:

Rate at which one currency may be converted into another. The exchange rate is used when simply converting one currency to another (such as for the purposes of travel to another country), or for engaging in speculation or trading in the foreign exchange market. There are a wide variety of factors which influence the exchange rate, such as interest rates, inflation, and the state of politics and the economy in each country.**also called** rate of exchange or foreign exchange rate or currency exchange rate.

EXAMPLE:

An exchange rate of 123 Japanese yen (JPY, ¥) to the United States dollar (USD, $) means that JPY 123 is worth the same as USD 1.

Question No: 50 (Marks: 3)

What is the reason of poverty in developing countries according to Prebisch-Singer hypothesis?

ANSWER:

POVERTY means the state of being poor; lack of the means of providing material needs or comforts.

According to Prebisch-Singer hypothesis following are the reason of poverty in developing countries:

- One of the reson for poverty is increasing population.
- Another reason **Lack of precious natural resources (like oil, gold, gas, iron, copper etc.)** was also cited by some as the reason for LICs' continued poverty.

Question No: 51 (Marks: 5)

According to the values given in the following table, calculate the injections at each level of output.

Output (Y)	Saving (S)	Gross Imports (M)	Gross investment (I)	Gross exports (X)	Govt. Expenditures (G)	Taxes (T)
650	80	80	104	97	116	10

700	90	80	119	97	116	10
750	100	80	130	97	116	10
800	110	80	139	97	116	10
900	120	80	146	97	116	10

(Marks: 1 for each)

ANSWER:
We know:

INJECTION=I+X+G

SO,
the injections at each level of output=
1-317

2-332

3-343

4-352

5-359

Question No: 52 (Marks: 5)

What are the major weaknesses of exogenous growth theory? Which theory was developed in against of exogenous growth theory?

ANSWER:
EXOGENOUS GROWTH THEORY:
The Exogenous growth model, also known as the Neo-classical growth model or Solow growth model is a term used to sum up the contributions of various authors to a model of long-run economic growth within the framework of neoclassical economics.
Exogenous growth theory suffered from three major weaknesses:
i. It could not explain why the gap between the poor and rich countries had widened (anticatch up),
ii. It could not explain why some countries in East Asia had apparently grown consistently on the back of higher saving rates, and
iii. It modeled technology as exogenous, and beyond the influence of policy.
PART B SOLUTION:
In economics, **endogenous growth theory** or **new growth theory** was developed in the 1980s as a response to criticism of the neo-classical growth model OR exogenous growth theory

Question No: 53 (Marks: 5)

Discuss the components on the assets and liabilities side of the balance sheet of a central bank.

ANSWER:
Following are the components on the assets and liabilities side of the balance sheet of a

central bank

ASSET SIDE COMPONENTS:

- Loans to Govt Notes
- Forex reserves
- Loans to private sector

LIABILITY SIDE COMPONENTS:

- Notes, coins & currency in circulation
- Govt & commercial bank deposits
- Liquidity paper issued

Question No: 49 (Marks: 3)

Define balance of payment (BOP). How the BOP can be determined?

ANSWER:

THE BALANCE OF PAYMENTS (BOP):

BOP is an accounting record of a country's transactions with the rest of the world.
The balance of payments (or BOP) measures the payments that flow between any individual country and all other countries. It is used to summarize all international economic transactions for that country during a specific time period, usually a year.

PART B SOLUTION:

How the BOP can be determined?

IT CAN BE DETERMINED IN THE FOLLOWING WAY:

The BOP is determined by the country's exports and
imports of goods, services, and financial capital, as well as financial transfers. It reflects all payments and liabilities to foreigners (debits) and all payments and obligations received from foreigners (credits). Balance of payments is one of the major indicators of a country's status in international trade, with net capital outflow.

Question No: 50 (Marks: 3)

Explain the shape of money demand curve with the help of diagram.

Answer:

PERFECT ANSWER ON THIS LINK IS AVAILABLE SEE THIS(PG 9 AND PG 10)
http://www.ssc.wisc.edu/~ldrozd/my_files/102files/slides_9.pdf

Question No: 51 (Marks: 5)

How can a current account, which is in deficit, be restored to balance under fixed exchange rate regimes?

Answer:

There is solution for how can a current account which is in deficit be restored to balance under fixed exchange rate regimes. The answer is **"Economic Deflation"**
Economic Deflation says When a country's national income rises, it spends more; part of that spending falls on imported goods; higher imports cause the current account to worsen.
The reverse is also true for this lower income must reduce import spending and therefore improve the current account spending.
However, economic contraction is not a good idea to restore current account equilibrium the other alternative solution presented by economist is to devaluate or "devaluation".
Devaluation is the phenomena related to exchange rate where exchange rate faces depreciation but in the context of fixed exchange rates. The complement of devaluation is revaluation.
A concept of devaluation is to bring the exchange rate in line with its long-run equilibrium level, i.e. a level consistent with international competitiveness.

Question No: 52 (Marks: 5)

Identify which of the following are stock variables and which are flow variables?
hese are the terms used to differentiate things like "wealth versus income" or "debt versus deficit."

That is, a "stock variable" is a variable measurable at one particular time (wealth); whereas, a "flow variable" is a variable measured after a prolonged amount of time retrospecting spending in the past "x" amount of time (income).

a) **Unemployment**
b) **Redundancies (job lay-offs)**
c) **Profits**
d) **A firm's stock market valuation (share price)**
e) **The value of property after a period of inflation**

(Marks: 1 for each)

ANSWER:
DEFINITION IS JST FOR CONCEPT NOT THE ANSWER.
These are the terms used to differentiate things like "wealth versus income" or "debt versus deficit."
That is, a "stock variable" is a variable measurable at one particular time (wealth); whereas, a "flow variable" is a variable measured after a prolonged amount of time retrospecting spending in the past "x" amount of time (income).

REQUIRED ANSWER:

FOLLOWING ARE THE STOCK VARIABLES:
- Unemployment
- A firm's stock market valuation (share price)
- The value of property after a period of inflation

-

FOLLOWING ARE THE FLOW VARIABLES:

- Redundancies (job lay-offs)
- Profits

Question No: 53 (Marks: 5)

World Bank suggests some structural reform policies for the poor countries to grow. Discuss those policies briefly.
Ans:

World Bank has suggested following policies for the poor countries to grow,

Governance and administrative reforms:
To reduce over employment in public sector, reduce wastes and to improve the quality and reliability of public services. To strengthen the administration of taxes, to eliminate the corruption. To decentralize the control of fiscal policy making. To enrich the legal and regulator framework.

Privatization of state-owned enterprises:
Abbreviated as SOEs. These are influenced by political interference and it is one of the reasons SOEs are considered inefficient. SOEs are also suffering form lack of competition, cost awareness and fear of bankruptcy.

Financial liberalization:
It involves ending of financial repression policies including artificially low interest rates, credit rationing, restrictions on banking competition and government involvement in investment allocation

Deregulation involving dismantling of licensing systems and red-tape

Trade liberalization:
including tariffication of non-tariff-barriers, harmonization of tariffs and an eventual reduction thereof

FDI liberalization:
To create a transparent, predictable environment for foreign investors to operate in.

apital account liberalization:
To remove controls on capital flows

(These policies are suggested by world bank and the successful implementation of these policies depend on the political and economic system of poor countries. In general these policies are expected to provide the poor nation with better understanding and help them to raise their growth.)

Question No: 50 (Marks: 3)

Differentiate between international trade and international finance.
ANSWER:
By **international trade**, we mean the exchange of goods and services between different countries.

International trade is the trade between two or more different countries. It is just the opposite of the trade that takes place within a country i.e. national trade.
Whereas **International finance** is concerned with, among other thing, the mobility of financial capital across
countries, and the problems and opportunities this mobility presents individual countries with. It would not be too inaccurate (in present day context) to say that while international trade deals with the current account, international finance deals with the capital account of the BOPs. That said, issues like the choice of exchange rate regime and of modern-day balance of payments crises also fall firmly within the purview of international finance.

Question No: 51 (Marks: 5)

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ANSWER:

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LIABILITY SIDE COMPONENTS:

- Notes, coins & currency in circulation
- Govt & commercial bank deposits

Liquidity paper issued

Question No: 53 (Marks: 5)

If y = Y / L, where, Y = Total GDP, L = Population, y = Per capita GDP then prove that Growth rate of per capita income = Growth rate of total output - Growth rate of population

ANSWER:

y = Y / L
Where,
• Y = Total GDP
• L = Population
• y = Per capita GDP
Taking log of both sides
• ln y = ln Y – ln L
Taking derivative *w.r.t.* time
• 1/y (dy/dt) = (dY/dt)/Y – (dL/dt)/L
gy = gY – gL

Growth rate of per capita income = Growth rate of total output - Growth rate of population

REFRENCE:
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Question No: 49 (Marks: 3)

Differentiate between inflation and deflation.

ANSWER:

Inflation is a situation in which there is a continuous rise in the general price level.
WHEREAS **Deflation** is the
opposite of inflation and occurs when the general level of prices falls.

Inflation is when the money supply increases by more than the real economy does. This means that one unit of currency will buy less than it could in the past.

Deflation is when the money supply contracts, making a unit of currency able to buy more than it could in the past. This is the exact opposite of inflation, but it is also bad.

Question No: 50 (Marks: 3)

What are the reasons that poor countries remained poor?

Question No: 51 (Marks: 5)

Explain the difference between endogenous growth model and exogenous growth model.

Question No: 52 (Marks: 5)

EXOGENOUS GROWTH THEORY

The Exogenous growth model, also known as the Neo-classical growth model or Solow growth model is a term used to sum up the contributions of various authors to a model of long-run economic growth within the framework of neoclassical economics

ENDOGENOUS GROWTH THEORY

In economics, **endogenous growth theory** or **new growth theory** was developed in the 1980s as a response to criticism of the neo-classical growth model.
In neoclassical growth models, the long-run rate of growth is exogenously determined by assuming a savings rate (the Solow model) or a rate of technical progress. This does not explain the origin of growth, which makes the neo-classical model appear very unrealistic. Endogenous growth theorists see this as an over-simplification

Following table shows different stages of production of cloth. Calculate the value added at each stage of production. What is GDP by this approach?

Stage of production	Money value (Rs)	Value added at each stage (Rs)

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Raw cotton	10.50	**?**
Cotton yarn	25.68	**?**
Coarse cloth	45.82	**?**
Finished cloth	55.66	**?**

ANSWER:

Stage of production	Money value (Rs)	Value added at each stage (Rs)
Raw cotton	10.50	10.50
Cotton yarn	25.68	15.18
Coarse cloth	45.82	20.14
Finished cloth	55.66	9.84

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REFERENCE

METHODS OF MEASURING GDP

There are three equivalent ways of measuring GDP:

i. The product or value added method which sums the value added by all the productive entities in the economy;

ii. The expenditure method which sums up the value of all the "final goods" transactions taking place in the economy;

iii. The factor income method which sums up all the incomes earned by all the factors of production in the economy (rent for land, wages for labour, interest for capital, and equity returns for entrepreneurship).

Value added is the difference between the value of goods produced and the cost of materials and supplies used in producing them. Value added consists of the wages, interest and profit components added to the output by a firm. Value added is the difference between inputs and outputs e-g if a firm spends Rs.500 making a good (inputs) and sells its product (output) for Rs.750, then value added is Rs.250.

Question No: 53 (Marks: 5)

Discuss the equilibrium condition in money market. Explain this equilibrium condition with the help of diagram.

ANSWER= CHP NO 43

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Question No: 49 (Marks: 3)

It is said that growth is an important macroeconomic issue. Why? Discuss.

ANSWER:

Why Growth is an Important Macroeconomic Issue:

It is obvious why growth is an important macroeconomic issue. Every government aspires to deliver a higher growth rate for the country. High growth rates means higher national income which means better living standards on average, which in democracies, means happier electorates and therefore increased chances of re-election for another term in office. However, while all countries might wish to achieve high growth rates, in practice, only a handful have been able to convert the wish into reality.

Question No: 50 (Marks: 3)

What are the different borrowing options available to the government for reducing the fiscal deficit?

By borrowing locally (i.e. issuing bonds), foreign financing (including non-relpayable grants) or printing
money (i.e. borrowing from the central bank). The first of these methods is least inflationary while the last
one is most inflationary.

Question No: 52 (Marks: 5)

Differentiate between fixed exchange rate and floating exchange rate.

ANSWER:

Fixed exchange rate:

.A fixed exchange rate means the amount of currency received is set in advance.
A fixed exchange rate is based upon the government's view of the value of its currency as well as the monetary policy. It has advantages. Stability is one. Another is predictability. Businesses and individuals can plan their activities with the certainty of the value of money. A businessman shipping goods overseas knows the value in advance. A tourist travelling in other countries can budget knowing what his money will buy.

Floating exchange rates:

A floating exchange rate means that the rate is moving and the currency received depends on the time of the exchange
.The floating exchange rate, in its true form, allows the marketplace to set the rate. The forces of supply and demand determine the value of a currency. For example, when the US dollar is considered strong it will take more euros, the currency of most European countries, to buy. When the US dollar is considered weak or in decline the amount of euros needed to buy it will fall.

Question No: 53 (Marks: 5)

Some economists suggest "growth through trade strategy" to tackle the problem of poverty of under developed countries.

a) **What is the basic theme of this strategy?**
b) **Why this strategy is not so much successful?**
c) **What is the proposed solution presented to tackle the drawback of this strategy?**

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Question No: 49 (Marks: 3)

Mention the transactions that cause the demand for dollars to increase in the foreign exchange market.

Pakistani imports of US goods.
Pakistani travelers traveling to the US.
Pakistani students paying for study in US universities.
profits repatriated to
US by US firms operating in Pakistan.

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Question No: 50 (Marks: 3)

Why countries have comparative advantage according to Ricardo?

ANSWER:

Comparative advantage according to Ricardo:

The law of **comparative advantage** refers to the ability of a party (an individual, a firm, or a country) to produce a particular good or service at a lower opportunity cost than another party. There is a source of comparative advantage can be productivity differentials.Ricardo argued that there is mutual benefit from trade (or exchange) even if one party **(e.g. resource rich country, highly-skilled artisan**) is more productive in every possible area than its trading counterpart (e.g. resource-poor country, unskilled laborer), as long as each concentrates on the activities where it has a relative productivity advantage

Question No: 51 (Marks: 5)

A. **"Slope of the consumption function is less than 1".What is meant by this statement?**

ANSWER:
When we drawn in expenditure income space, the consumption function plots as a straight line with positive intercept, and a positive but less than 1 slope. The slope is less than 1 because not all the income is consumed some part of the income is saved.

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B. What are the major macroeconomic variables involved in the determination of national income?

(Marks: 2+3)

Following are the major macroeconomic variables involved in the determination of national income :

C, I, G, X, M, T, S, prices, exchange rate, interest rate and money supply.

Question No: 52 (Marks: 5)

What are the conditions in which foreign exchange market exists? Also give some examples of foreign exchange markets.

In a market there are buyers and sellers who negotiate and agree on the price for the or price for the commodity being exchanged. The foreign exchange market is no different. whatever, here the commodity being traded is foreign exchange and the price is the foreign exchange rate. Specifically, a foreign currency is being traded for the Pakistani Ruppee at a particular rate of exchange.

The sellers and buyers of foreign exchange are not mutually exclusive. The sellers of today, may be the buyers of tomorrow, or even of today.

CONDITION:

Foreign exchange market exists when **buyers and sellers** exit and ready to sell and buy.

The **main driving force** for foreign exchange market is the law of supply and demand.

EXAMPLE:

US $-PAK RS Foregin exchange market

US $ - UK POUND Foregin exchange market

Question No: 53 (Marks: 5)

What thing determines comparative advantage among countries according to Hechshcer-Ohlin? What is the criticism against their argument?

According to Hechshcer-Ohlin suppose we are given two countries one abundant in labour and one abundant in capital and a labour-intensive good and a capital intensive good, the labour abundant country will have comparative advantage in the production of the labour-intensive good while the capital abundant country will have comparative advantage in the capital-intensive good.

So the determinants of comparative advantage among countries according to Hechshcer-Ohlin is capital goods and labour intensive goods.

Critics argued that comparative advantage can and should be viewed in a dynamic (time-varying) sense, and that it was not wise to rule out the possibility of Pakistan developing comparative advantage in cars at some future point in time.

Consequent:

The major criticism leveled against Hechscher-Ohlin type trade theories are that they views comparative advantage in an essentially static sense; i.e. if Pakistan is better at producing cotton and Japan better at producing, then this situation will always prevail.

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Question No: 49 (Marks: 3)

Differentiate between inflation and deflation.

ANSWER:

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WHEREAS **Deflation** is the
opposite of inflation and occurs when the general level of prices falls.

Inflation is when the money supply increases by more than the real economy does. This means that one unit of currency will buy less than it could in the past.

Deflation is when the money supply contracts, making a unit of currency able to buy more than it could in the past. This is the exact opposite of inflation, but it is also bad.

(Marks: 5)

What is meant by Philips Curve? Explain the shape of this curve with the help of diagram.

Philips Curve

W.A.Philips gave the idea of Keynes a formalized shape and draws the Philips curve stating inverse relationship between unemployment and inflation rate.
Philips's views were consistent with the Keynesian views. The cost of reducing inflation is unemployment and the cost of reducing unemployment is inflation

DIAGRAM

For diagram take a look on chp#34 page no 149.

(I DON,T HV MICROSOFT WORD IN MY PC THATS Y GRPAH CAN,T BE DRAW HERE)

Question No: 53 (Marks: 5)

How crowding out of investment demand occur due to expansionary fiscal policy?

ANSWER CAN BE:

In economics, **crowding out** is any reduction in private consumption or investment that occurs because of an increase in government spending. If the increase in government spending is financed by a tax increase, the tax increase would tend to reduce private consumption. If instead the increase in government spending is not accompanied by a tax increase, government

borrowing to finance the increased government spending would increase interest rates, leading to a reduction in private investment, although there is no empirical evidence that supports such interest rate effect on investment

1. Comments of current account in balance of payment 3 marks

ANSWER:

THE CURRENT ACCOUNT

The current account balance is essentially the trade balance (exports minus imports), but with net factor receipts from abroad added.

If the exchange rate is fixed, then changes in reserves must mirror the combined balance on the current and capital accounts in order to bring the overall BOPs to zero. If the exchange rate is floating, then changes to reserves can remain zero, as the adjustment burden is borne by the exchange rate which appreciates (depreciates) in response to a joint surplus (deficit) on the current and capital accounts.

REFRENCE FOR COMPLETE CONCEPT:

PARTS OF BOP

The BOPs can be divided into three parts:

i. Current account,

ii. Capital account and

iii. Changes to reserves

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2. **The reason of poverty in developing countries according Perbisch-Singer Hypothesis**

(3 marks)

ANSWER:

POVERTY means the state of being poor; lack of the means of providing material needs or comforts.

According to Prebisch-Singer hypothesis following are the reason of poverty in developing countries:

- One of the reson for poverty is increasing population.
- Another reason **Lack of precious natural resources (like oil, gold, gas, iron, copper etc.)** was also cited by some as the reason for LICs' continued poverty.

3. Pull demand inflation, cost push inflation (5 marks)

ANSWER:

DEMAND PULL INFLATION:

The inflation resulting from an increase in aggregate demand is called **demand-pull inflation**. Such an inflation may arise from any individual factor that increases aggregate demand, but the main ones that generate *ongoing* increases in aggregate demand are :

Increases in the money supply

Increases in government purchases

Increases in the price level in the rest of the world

COST PUSH INFLATION:

Inflation can result from a decrease in aggregate supply. The two main sources of decrease in aggregate supply are

- An increase in wage rates
- An increase in the prices of raw materials

These sources of a decrease in aggregate supply operate by increasing costs, and the resulting inflation is called **cost-push inflation.**

4. What are the comparative advantages between countries according Hechshcer-Ohlin? And criticisms against it.

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ANSWER:

According to Hechshcer-Ohlin suppose we are given two countries one abundant in labour and one abundant in capital and a labour-intensive good and a capital intensive good, the labour abundant country will have comparative advantage in the production of the labour-intensive good while the capital abundant country will have comparative advantage in the capital-intensive good.

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1.components of current account of BOPS:

ANSWER:

Following are the components:

1.GOODS
2.SERVICES
3.INCOME
4.CURRENT ACCOUNT.

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(FOR COMPLETE UNDERSTANDING AND MORE COMPONANTS VISIT THIS LINK)
http://www.investopedia.com/articles/03/061803.asp

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1**. Difference between capital deepening and capital widening(5 MARKS)**
ANSWER:

Capital deepening

is a term used in economics to describe an economy where capital per worker is increasing. It is an increase in the
capital intensity. Capital deepening is often measured by the capital stock per labour hour.Overall, the economy will expand, and productivity per worker will increase. However, economic expansion will not continue indefinitely through capital deepening alone. This is partly due to diminishing returns and wear & tear

capital widening:

is a term used to describe the situation where capital stock is increasing at the
same rate as the labour force, thus capital per worker remains constant. The economy will expand in terms of aggregate output, but productivity per worker will remain constant

2 .Difference between GNP and NNP:(5 MARKS)
ANSWER:

Gross National Product (GNP):
Gross national product (GNP) is the value, at current market prices, of all final goods and services produced during a year by the factors owned by the citizens of a country. Thus the income earned by Pakistani citizens working in the US would be included in Pakistan's GNP but excluded from Pakistan's GDP. Conversely, the income earned by a US citizen (individual or corporate) in Pakistan would be included in Pakistan's GDP but excluded from Pakistan's GNP. Generally, GNP = GDP + net factor income from abroad. The abbreviation for gross national product, which is the total market value of all goods and services produced by the citizens of an economy during a given period of time, usually one year. Gross national product often was once the federal government's official measure of how much output our economy produces.
GNP = GDP + Net factor incomes from abroad
Net National Product (NNP):
Mathematically, national income is net national product (NNP). It is GNP adjusted for depreciation. In words, it is the net output of commodities and services flowing during the year from the country's production system in the hands of ultimate consumers. The total market value of all final goods and services produced by citizens of an economy during a given period of time, usually a year, after adjusting for the depreciation of capital. Net national product, abbreviated NNP, has the same relation to net domestic product (NDP) as gross national product (GNP) has to gross domestic product (GDP). Net national product also has the same relation to gross national product that net domestic product has to gross domestic product. Like NDP, NNP is a measure of the net production in the economy.
NNP = GNP – Depreciation allowance

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3. Explain Comparative advantage among contries according to Hechshcer-Ohlin. And criricism on it?

ANSWER:

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Q # 1 Difference between inflation and deflation? Marks 3

ANSWER:

Inflation is a situation in which there is a continuous rise in the general price level. WHEREAS **Deflation** is the opposite of inflation and occurs when the general level of prices falls.

Inflation is when the money supply increases by more than the real economy does. This means that one unit of currency will buy less than it could in the past.

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Q # 2 How the central banks plays its important role in order to control the activities of commercial banks? Marks 3

central bank, **reserve bank**, or **monetary authority** is a banking institution granted the exclusive privilege to lend a government its currency. Like a normal commercial bank, a central bank charges interest on the loans made to borrowers, primarily the government of whichever country the bank exists for, and to other commercial banks, typically as a 'lender of last resort'. However, a central bank is distinguished from a normal commercial bank because it has a monopoly on creating the currency of that nation, which is loaned to the government in the form

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of legal tender. It is a bank that can lend money to other banks in times of need. Its primary function is to provide the nation's money supply,

Q # 3 Difference between depreciation and appreciation of currency? Marks 5

ANSWER:

Depreciation:

This is a more or less permanent decrease in value or price. "More or less permanent" doesn't include temporary, short-term drops in price that are common in many markets. It's only those price declines that reflect a reduction in consumer satisfaction.While all sorts of stuff can depreciate in value, some of the more common ones are capital, real estate, corporate stock, and money

APPRECIATION

This is a more or less permanent increase in value or price. "More or less permanent" doesn't include temporary, short-term jumps in price that are common in many markets. Appreciation is only those price increases that reflect greater consumer satisfaction and thus value. While all sorts of stuff can appreciate in value, some of the more common ones are real estate, works of art, corporate stock, and money.

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Q # 4 what is meant by laffer curve? Also explain the shape of this curve? Marks 5

ANSWER:

The graphical inverted-U relation between tax rates and total tax collections by government is known as **Laffer curve**. This curve is developed by economist Arthur Laffer; the Laffer curve formed a key theoretical foundation for supply-side economics of President Reagan during the 1980s. It is based on the notion that government collects zero revenue if the tax rate is 0% and if the tax rate is 100%. At a 100% tax rate no one has the incentive to work, produce, and earn income, so there is no income to tax. As such, the optimum tax rate, in which government revenue is maximized, lies somewhere between 0% and 100%. This generates a curve shaped like an inverted U, rising from zero to a peak, and then falling back to zero. If the economy is operating to the right of the peak, then government revenue can be increased by decreasing the tax rate.

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A slope of consumption function is less than 1." What is meant by this statement?

ANSWER:

When we drawn in expenditure income space, the consumption function plots as a straight line with

positive intercept, and a positive but less than 1 slope. The slope is less than 1 because not all the income is consumed some part of the income is saved.

Differentiate between Inflation and deflation. Marks3

ANSWER:

Inflation is a situation in which there is a continuous rise in the general price level.
WHEREAS **Deflation** is the
opposite of inflation and occurs when the general level of prices falls.

Inflation is when the money supply increases by more than the real economy does. This means that one unit of currency will buy less than it could in the past.

Deflation is when the money supply contracts, making a unit of currency able to buy more than it could in the past. This is the exact opposite of inflation, but it is also bad

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