

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस हार्शिए में
नहीं लिखना
चाहिए।
Candidates
must not
write on this
margin

TEST 2

:- International & Growth

SRISHTI MISHRA

Appearing for mains !!!

Space for marks :-

ni
NEXT
DAS

(Please do not write anything except the question number in this space)
कृपया इस स्थान में प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस हाशिए में नहीं लिखना चाहिए।
Candidates must not write on this margin.

Q1a)

The Ricardian model of Trade is based on the idea of comparative advantage which states that if one country can produce a good with a lower opportunity cost than another country, then that country will specialize and export that good.

Assuming there are 2 nations India and Bangladesh trading in wheat and textiles:

	wheat	OC _w	Textiles	OC _t
India	9	$\frac{3}{9} = \frac{1}{3}$	3	$\frac{9}{3} = 3$
Bangladesh	2	2	4	$\frac{2}{4} = \frac{1}{2}$

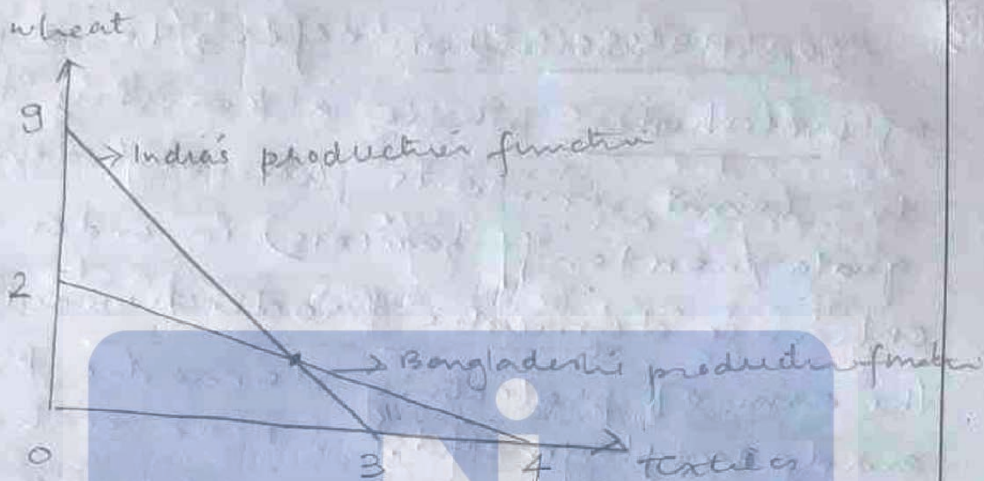
As shown, India has ^{lower} higher OC in production of ^{wheat} textiles while Bangladesh has lower OC in production of textiles.

As a result, Bangladesh specializes in textiles while India specializes in wheat production & export.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस हार्शिए में
नहीं लिखना
चाहिए।
Candidates
must not
write on this
margin



As both specialize and trade through export and import, both end up on a higher Consumption possibility curve than before trade.

Empirical Evidence:

(i) Opportunity cost is definitely a consideration when 2 countries trade.
eg: Bangladesh really does export textiles to India due to lower labour costs than India.

(ii) However, distance between nations, are not accounted for
eg. Brazil and India are too far for trade.

(iii) Trade treaties are not considered.

(iv) Intra-industry trade is more common today.

Evidence is low but theory continues to hold importance.

Please do not write anything except the question number in this space. कृपया इस स्थान में प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

UPSC

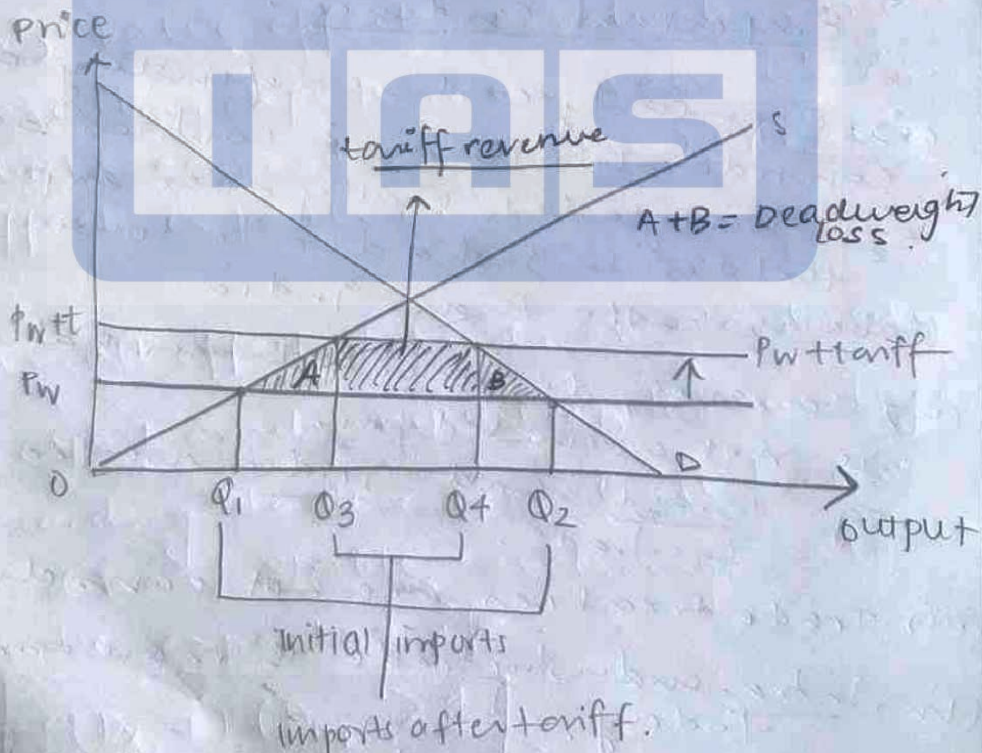
Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस हाशिए में नहीं लिखना चाहिए।
Candidates must not write on this margin.

Q16)

Import Substitution refers to a policy of protectionism where a country tries to limit imports (through tariff/quota/non tariff barriers) in order to enhance domestic production with the aim of protecting domestic producers and employment.

for example, tariff reduces imports and allows domestic production to expand:



UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस शाश्वत में नहीं लिखना चाहिए।
Candidates must not write on this margin.

Benefits of Import-Substitution based industry

- * Allows domestic industries base development
eg: India's PSUs (commanding heights of economy before 1991).
- * protects domestic employment.
- * Allows nascent (sunrise) industries to flourish.
- * Ensures stability no flooding / dumping of foreign goods.
- * Tariff revenue earned → can be spent by govt.

Disadvantages of import substitution

- * leads to a welfare loss shown as shaded triangles

$$A + B$$

↓ efficiency loss
- * domestic producers are inefficient → low quality production hurts consumers.
- * Restricting imports restricts consumer choice
- * Empirical evidence goes against import substitution.
eg: India's 1991 BOP crisis.
- * Restricts technology spillover

Import Substitution no longer constitutes the right development. Instead Atmanirbhar Bharat (self-reliance, not self sufficiency) is the way forward.

Q1c)

Revaluation of currency refers to the "increasing" of value of domestic currency in terms of foreign currency.

There are 2 major impacts of the same :

(i) Volume effect : Revaluation makes domestic goods more expensive and so volume of exports decreases. (Hence volume effect is negative).

(ii) Value effect : Revaluation makes existing exports more valuable (more FOREX earned in return). (Value effect is positive).

Overall effect depends on elasticity of export and import of the country. According to the Marshall Lerner Condition, stable exchange rate can be expected if :

$$PED_x + PED_m > 1$$

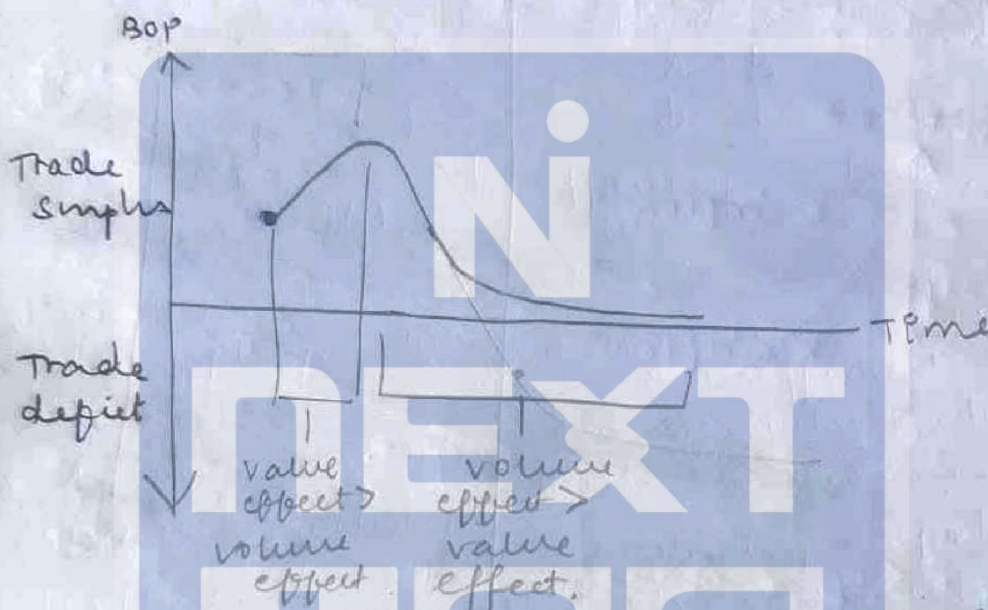
Please do not write anything except the question number in this space. प्रश्न इस स्थान में केवल प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस खाशिए में नहीं लिखना चाहिए।
Candidates must not write on this margin.

If price elasticity of demand for exports and price elasticity of demand for imports is greater than 1, then revaluation of currency will be stable.



If country starts off at high trade surplus, it can revalue its currency such that initially trade surplus increases then reaches stable level ~~reaches~~ trade balance as volume effect dominates value effect.

Thus elasticity of export and import can affect revaluation's impact on currency.

(Please do not write anything except the question number in this space)
कृपया इस स्थान में प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

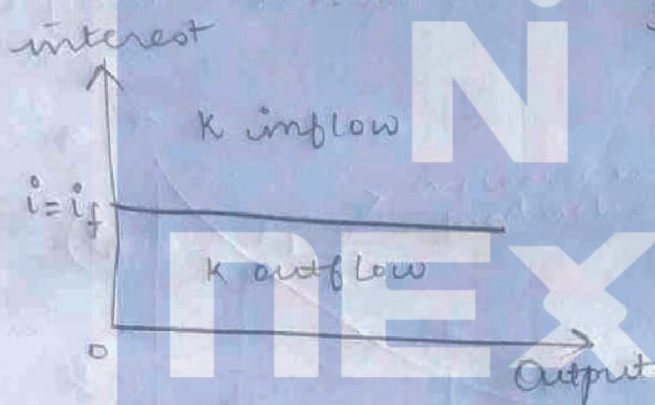
UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस हद्दिए में नहीं लिखना चाहिए।
Candidates must not write on this margin

Q1c)

Convered interest parity refers to a situation in which there is free movement of capital. This is best depicted in the Mundell Fleming model that shows the impossible trinity:



Interest at i_f ensures stability.
If i in Country A rises above i_f , it will become more attractive, and there will be inflow of capital.

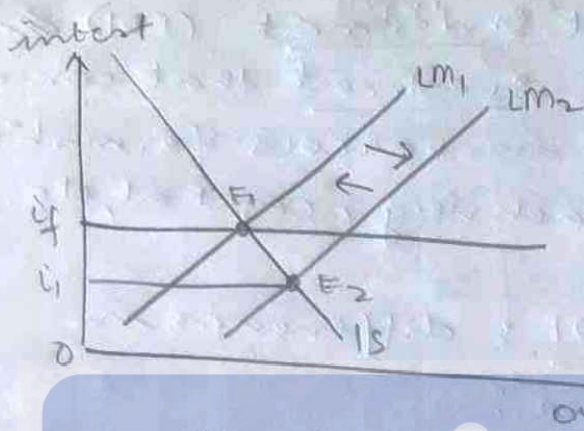
If $i < i_f$, investors will leave so there will be outflow of capital.

According to the Mundell-Fleming model, this leads to a situation in which monetary policy freedom breaks down (in case of fixed exchange rate and perfect K mobility).

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

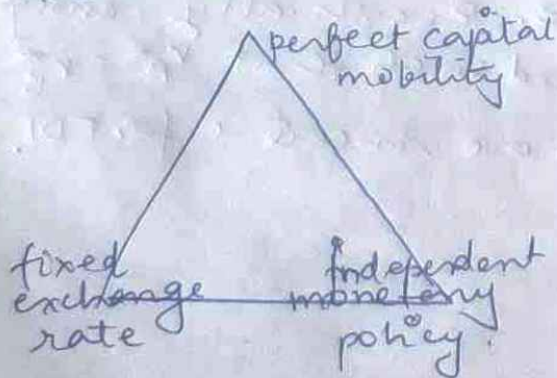
अभ्यर्थी द्वारा को इस शीट पर में नहीं लिखना चाहिए।
Candidates must not write on this margin



As LM shifts right due to expansionary monetary policy ($\frac{\bar{M}}{P} \uparrow$), interests fall to i_1 at E_2 level of equilibrium.

Since $i_1 < i_f$, there is capital outflow. This creates pressure to devalue currency. RBI starts to buy rupee to keep exchange rate fixed at initial level. This reduces money supply such that LM shifts left until initial point of equilibrium E_1 is reached and $i = i_f$.

Thus, Mundell Fleming proves that there is an impossible trinity.



Covered interest parity assumption allows him to reach this conclusion.



Please do not write anything except the question number in this space.
कृपया इस स्थान में प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

UPSC

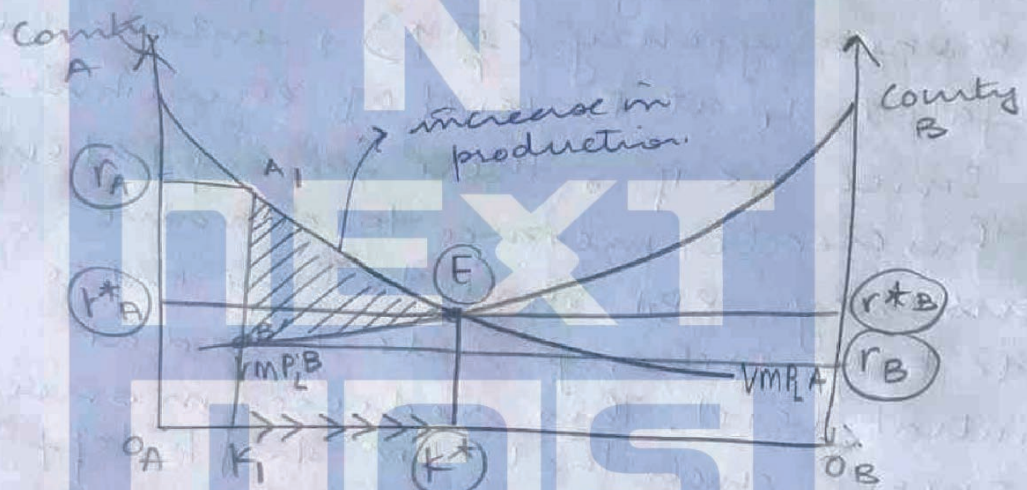
Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस स्थान में नहीं लिखना चाहिए।
Candidates must not write on this margin.

(Q5a)

Foreign Direct Investment (FDI) refers to the investment that comes from abroad in various forms like knowledge, machinery, capital, etc.

Cause of FDI : differences in capital returns :



Since return on capital in Country A (r_A) is greater than that in Country B (r_B), K shifts from A to B. As more K is used in Country A, $VMPL$ falls, while opposite happens in Country B. Eventually, enough capital is transferred such that $r_A^* = r_B^*$ and there is no more incentive for FDI.



UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस कृपिय में
नहीं लिखना
चाहिए।
Candidates
must not
write on this
margin

Gains of FDI :

- (i) Increase in production, depicted as shaded triangle in the figure.
- (ii) movement of technology, skill, techniques of production, knowledge from one country to another.
- (iii) Transfer of production to developing nations (where returns on K are high) leading to social & economic gains eg: development, employment.

Disadvantages of FDI

- (i) It may lead to overexploitation of labour if labour laws are ineffectively defined.
- (ii) may cause pollution if not regulated effectively.
- (iii) Has impact on inflation and exchange rate.

FDI can help a nation grow as long as it doesn't become dependent on it or prey to unfair/unethical practices.

UPSC

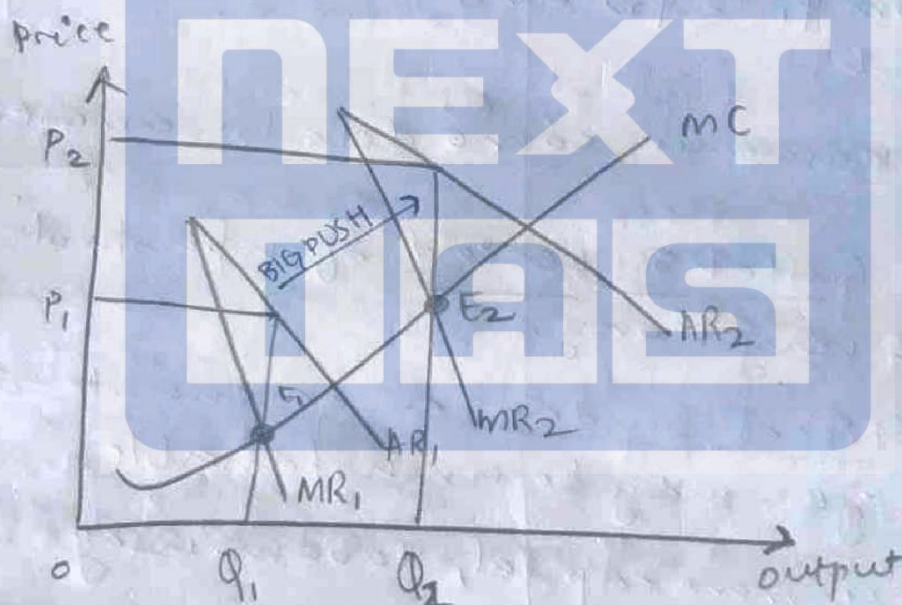
Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस दृष्टि में नहीं लिखना चाहिए।
Candidates must not write on this margin

Q5c)

The Big Push Theory was given by Rosemstein Roden in which he called for the government to provide a "big push" or large lumpsum investment to set the economy on a path of growth.

According to the model, if government creates large investment, it can raise the demand (AR curve) of the economy and create higher output.



As shown in the figure above, government can provide big push in the form of:

- (i) infrastructural development
eg: roads, railways, bridges, ports, etc.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

(ii) Setting up major industries

eg. India set up various PSUs at commanding heights of the economy.
Iron & steel plants,

(iii) Energy generation units at large scale

eg. dams (the Temples of India).

All these push AR came out towards the right leading to higher output (from Q_1 to Q_2) and thus contributing to growth.

However, some details were overlooked.

(i) Gestation period of infrastructure is very long.

(ii) Fiscal burden on government is high - may be unsustainable.

(iii) Human capital, labour usage were overlooked.

Thus, it is important that social overhead capital and directly productive activities are balanced and the big push is sustainable in the long run.

Please do not
write anything
except the
question number
in this space.
कृपया इस स्थान
में प्रश्न संख्या के
अतिरिक्त कुछ
न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस दक्षिण में
गोरे लिखना
चाहिए।
Candidates
must not
write on this
margin

Q5d)

Indicative Planning refers to State-
controlled planning with no role for
private sector. This was followed by
USSR as well as other communist
fringe nations. Decentralized planning is
delegated and multi-sourced.

Indicative
Planning

Decentralized
Planning

① Centralized
state controlled,
all activities
go through the
State.

② Delegated. State
remains at the centre,
but it does not manage
every little detail.

③ Top Down in
approach →
state gives orders
and these are
carried out.

④ Bottom-Up : different
autonomous institutions
define their plan
based on regional
goals.

⑤ One Source :
the State.

⑥ Multi-sourced.
All regions involved.

⑦ Unity above all,
uniformity is key.

⑧ Creates space for
diversity while not
hampering unity.



UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

Indicative

- ① No role of private sector
- ② market economy is completely crushed.
- ③ PPP not allowed.
- ④ Usually followed in communist nations: USSR, Yugoslavia, China (earlier).
- ⑤ Largely unsuccessful due to high burden on government, inefficiency and corruption.

Decentralized

- ① private sector is allowed while government provides distributal justice.
- ② market economy is used for its benefit of efficiency.
- ③ PPP is a way forward.
- ④ Followed in democracies e.g. India, USA.
- ⑤ Largely successful due to delegation of tasks and a feeling of citizenship in all stakeholders.

Indicative Planning can ensure stability but in the long run, grassroots involvement is essential for growth and SDG localization.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस हार्गिफ में
नहीं लिखना
चाहिए
Candidates
must not
write on this
margin

(50)

Gross Domestic Product can be measured in both exchange rate terms and purchasing power parity terms.

Exchange Rate

Purchasing power Parity

① This is the representative of one currency in units of another.

eg: ₹ 80 = \$ 1.

∴ exchange rate between

$$\text{\$ ₹: } \boxed{\frac{1}{80}}$$

② This shows the exchange of currency only.

③ According to this India is the 5th largest economy in the world.

① This is the conversion of value of currency.

eg: If one unit of food (eg: burger) can be bought for ₹ 40 in India but

\$ 1 in USA then

$$\text{PPP is } \boxed{\frac{1}{40}} \text{ and}$$

₹ is worth more in PPP terms than exchange rate terms.

② This shows value of currency or what money can buy.

③ In PPP terms, India is the 3rd largest economy in the world.

Thus, GDP is a relative measure. What money can buy can give a better idea of a nation's progress.

(Please do not write anything except the question number in this space)
कृपया इस स्थान में प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

UPSC

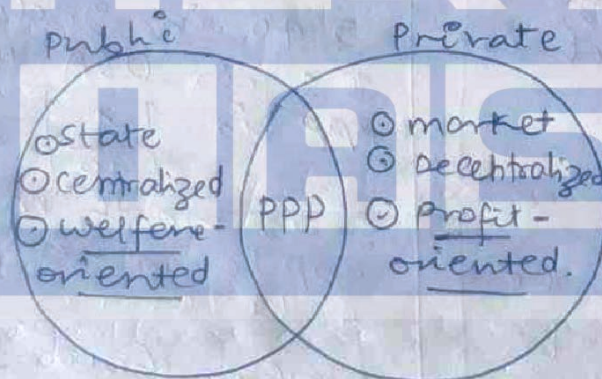
Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवार इस हद्द में नहीं लिख सकते हैं।
Candidates must not write in the margin.

Q.2) a)

Public Private Partnership (PPP)

is a model of growth where the government and the market work together to reach a common goal of development. It seeks to put the benefits of state (communist ideals, along with socialist values) and market (capitalist) ideals together to reach a mutually beneficial arrangement.



There are various forms of PPP:

(i) Build-operate-Transfer model (BOT) :

Here, the government provides permission to a company to build a certain project.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस दृष्टि में
नहीं लिखना
चाहिए
Candidates
must not
write on this
margin

company is allowed to use the project until costs are recovered, after which it transfers the project to the government.

(ii) Hybrid Annuity model (HAM)

Here, the government provides 40% of total resources as upfront payment to a firm. The firm builds the project and hands it over to government. The remaining 60% costs are paid annually by the government to the firm.

(iii) other models include BOOT, cross challenge model, etc.

Benefits of PPP :-

(i) It puts together the good elements of both sectors.

(ii) Welfare goal of state in the form of developing backward regions, financial infrastructure, public goods creation is taken care of.

(Please do not write anything except the question number in this space)
कृपया इस स्थान में प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस हाशिए में नहीं लिखना चाहिए।
Candidates must not write on this margin

(iii) Private objective of profit generation and government support for rapid development is also achieved while ensuring operational efficiency.

(iv) Thus, a partial Pareto optimality is achieved in both production (productive efficiency by the firm) and distribution (allocative efficiency by state) while also safeguarding human & environmental rights.

However, PPP is not without its flaws:

(i) Crony capitalism in the project allocation

eg: there are claims that government has nexus with private firms and project allocation is uneven.

(ii) Corruption - sanctioned by political parties in power.

eg: Money laundering under the guise of PPP can burden the country.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस हार्शिंग में
नहीं लिखना
चाहिए।
Candidates
must not
write on this
margin

(iii) Failure of project midway
resulting in half-done brownfield
projects that become waste of country's
resources.

The aim of PPP, as per the Kelkar
Committee must be to meet social
welfare while ensuring efficiency.
With the aim of Atmanirbhar Bharat,
PPP must be brought to the fore-
front of development.

NEXT
IAS

(Q2b)

Stolper Samuelson Theorem states that as the price of a commodity rises, the returns to that factor of production that is intensively used in the production of that commodity also rise.

Assumption:

- ① There are 2 commodities: X & Y .
- ② 2 factors of production: Labour (paid in wages, w) and capital (paid in rent, r).
- ③ X uses labour intensively, while Y uses capital intensively.

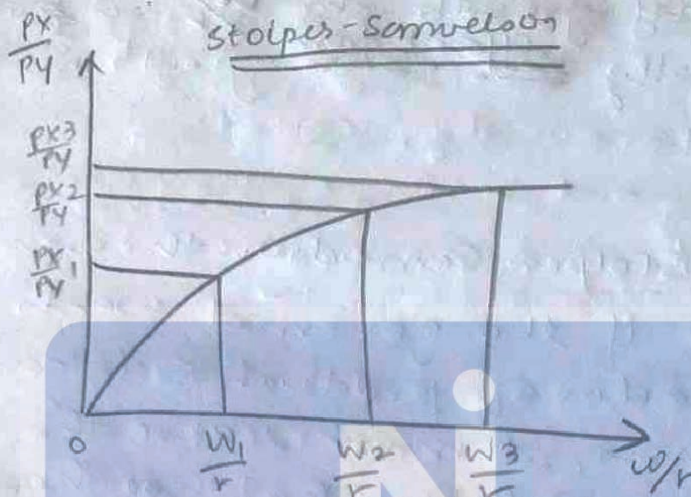
Say a Country A produces both X and Y but is more labour abundant and so produces X in a specialized manner.

If the price of X (P_x) rises, Country A will be likely incentivized to produce even more of X . Since commodity X requires more labour intensity, demand for labour in Country A will rise.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

अमीदवारों को इस दृष्टि में नहीं लिखना चाहिए।
Candidates must not write on this margin.



As soon as demand for labour rises, wages begin to rise because now value of marginal product of labour (VMPL) has risen in Country A. This is depicted in the above figure, showing direct relationship between price ratio of X and Y and returns on factors of production ratio of w and r .

However, this relation is not linear. This is because factors of production are substitutable. Thus, as price of X rises and wages continue to rise, Country A will substitute some labour with capital and continue producing X. This will restrict rise in w and raise r .

(Please do not write anything except the question number in this space)
कृपया इस स्थान पर प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस शीट पर नही लिखना चाहिए।
Candidates must not write on this margin.

this is why growth in $\frac{W}{P}$ is ~~pro~~ proportional to ~~less than~~ ^{different from} growth in $\frac{P_x}{P_y}$.

Hence, Stolper Samuelson theorem proves that if the government wants a certain factor of production to earn higher returns, it must raise the price of commodities that use them intensively. This is the reason for talk on labour-intensive production so that labour can benefit indirectly.

NEXT
IAS

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस दृष्टि में
नहीं लिखना
चाहिए
Candidates
must not
write on this
margin

(20)

As an asset bubble refers to a situation in which the nominal price of an economic asset rises very high above its actual value or real value and thereby creates false animal spirits, leading the economy towards an inevitable crash.

Example : The Sub-Prime Housing Crisis
(2008 Global Recession)

- (i) lenders in the USA were ~~not~~ sending out loans to sub-prime credit borrowers (lacking credit to avail loan due to bad loan history).
- (ii) Booming economy was adding to the positive animal spirits - encouraging loan taking and making banks lenient.
- (iii) Collateral used was housing.
- (iv) When it became clear that economy was in a "bubble", everyone rushed to demand their deposits from banks.

(Please do not write anything except the question number in this space)
कृपया इस स्थान में प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस हाशिए में नहीं लिखना चाहिए।
Candidates must not write on this margin.

(v) Since all ~~loans~~^{deposits} were given out as loans; banks had no money to give.
(vi) simultaneously, collateral was not selling out because they were overpriced and no one could afford them.

(vii) Thus, banks went bankrupt. NPAs rose and collateral prices crashed as demand and supply in money and goods market were hurt → leading to recession.

Methods to Reduce/Remove Asset Bubble

(i) Institutional Responsibility: Banks must check credit history / credit score before lending. No more sub-prime loans can be afforded.

(ii) Reducing Non-Performing Assets through administrative revamping along with Bad Banks like NARCL, IDRCL and legislative means of loan recovery like SARFAESI, IBA, etc.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

(iii) Reducing information asymmetry by spreading awareness on stock market movements, their meanings, formal loan availing mechanisms, etc.

(iv) Active Monetary Committee that can look out for any suspicious bubble formations and support banks in acting against it in gradual steps.

Asset bubbles can result in years or even decades of retrogression. To avoid the same, asset bubbles must be controlled through a cooperative means involving the government, the banks and the people.

Please do not write anything except the question number in this space. कुछ भी लिखना न चाहिए।

UPSC

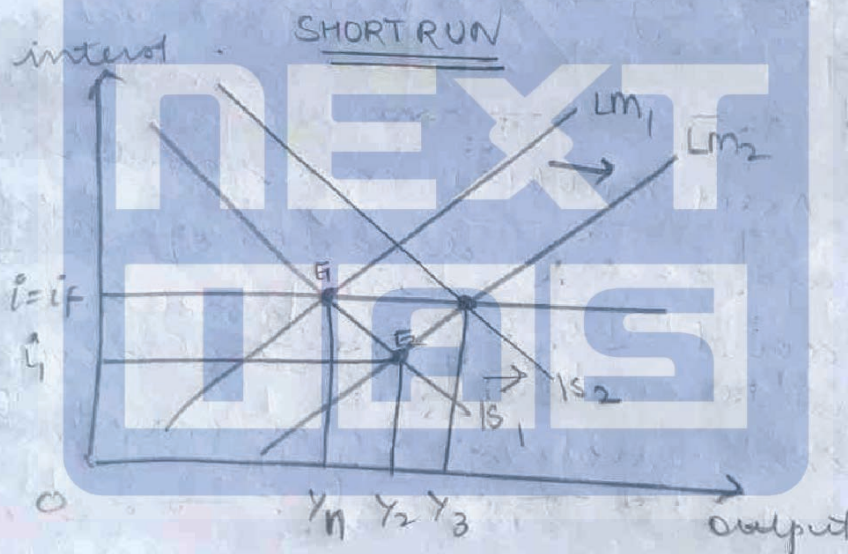
Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस हिसाब से नहीं लिखना चाहिए।
Candidates must not write on this margin.

Q4)

Exchange Rate Overshooting refers to the situation in which ~~a~~ rise in money supply leads to a larger magnitude of depreciation than what is required for long run stability.

This is shown using fixed floating exchange rate and covered interest parity.



Supposing a nation is initially at E_1 at interest $i = i_f$ and output Y_n (natural rate of output). When money supply is raised, LM shifts right from LM_1 to LM_2 . This results in equilibrium shifting to E_2 such that output is at Y_2 and interest is i_1 .

Page



उम्मीदवारों को इस हार्शिए में नहीं लिखना चाहिए।
Candidates must not write on this margin.

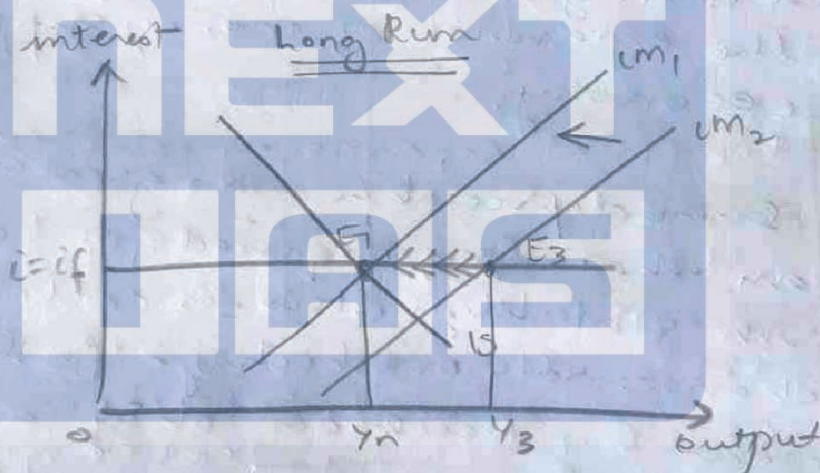
Please do not write anything except the question number in this space. कृपया इस स्थान में केवल प्रश्न संख्या ही लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस हार्शिए में नहीं लिखना चाहिए।
Candidates must not write on this margin.

since $i_1 < i_f$, there is capital outflow. This results in depreciation of the currency. Depreciated currency makes exports of the country more competitive, thereby shifting IS to the right as exports rise. IS shifts until E_3 is reached where $i = i_f$ once more and capital outflow stops. A short run equilibrium is reached at Y_3 which is higher than Y_n .



In the long run, however, since $Y_3 > Y_n$, it puts upward pressure on price in the country. As a result $\frac{M}{P}$ starts to fall, leading to leftward shift of LM . This continues until $Y_n = Y$ such that no more upward pressure on P exists and LM stops falling.

(Please do not
write anything
except the
question number
in this space)
कृपया इस स्थान
में प्रश्न संख्या के
अतिरिक्त कुछ
न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस हद्दिए में
नहीं लिखना
चाहिए
Candidates
must not
write on this
margin

thus, in the long run, 2 things
have happened:

① The country reaches initial
equilibrium at same interest rate
and same output (i_f and Y_n
respectively).

② Prices (nominal) are higher after
the transition and exchange rate
is also higher (depreciated).

These changes occur for adjusting
to the expansion of money supply in
the economy.

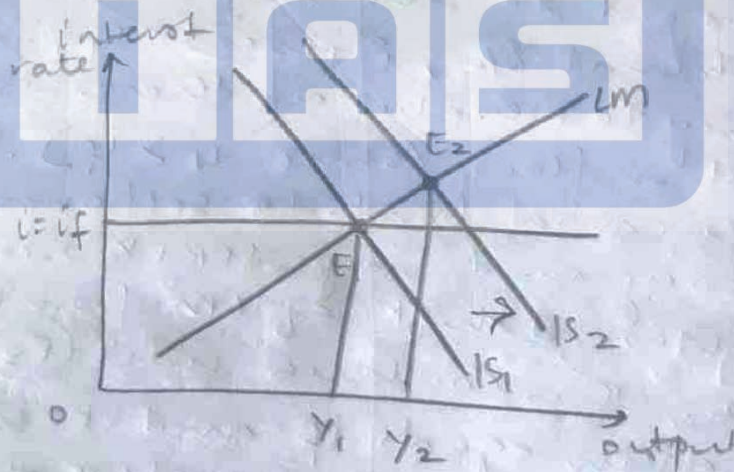
Since depreciation was greater
than what was required for long
run stability, this is called
exchange rate overshooting. In the
Beggar My Neighbor Policy, a
similar mechanism was used to
expand own exports and compete
against a neighbor by depreciating
the currency in the name of
monetary policy.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवादी को इस हाशिए में नहीं लिखना चाहिए।
Candidates must not write on this margin

Q4b) perfect capital mobility occurs when capital (K) is free to move from one nation to another without barriers, based singularly on returns to capital (i). This is shown as perfectly elastic ~~sp~~ curve; such that any $i > i_f$ shows trade inflow and any $i < i_f$ shows trade outflow. Fiscal expansion involves an increase in government spending, resulting in rightward shift of IS curve. Depending on fixed or floating exchange rate, fiscal policy can either be fully effective or fully ineffective.



Expansionary Fiscal Policy
in Perfect Capital Mobility

Please do not write anything except the question number in this space. कृपया इस स्थान में प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

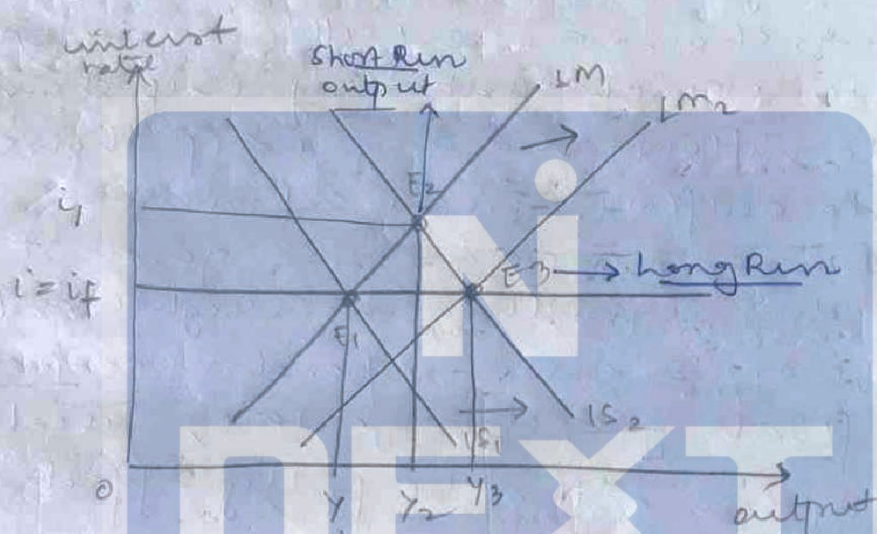
UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस हाशिए में नहीं लिखना चाहिए।
Candidates must not write on this margin.

Case 1 : fixed Exchange Rate

Fiscal Policy is fully effective.

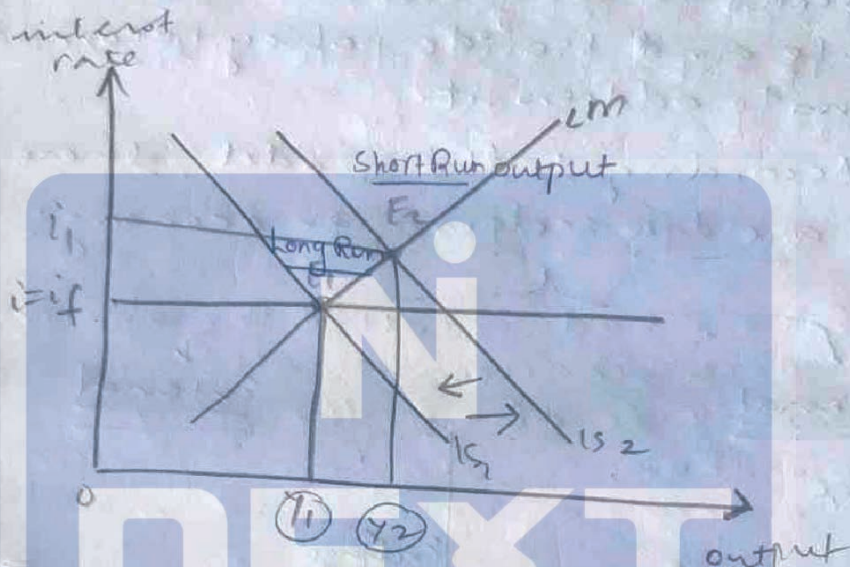


When fiscal expansionary policy shifts IS curve out to the right with new equilibrium at E_2 , i rises to i_1 , forcing currency to revalue as there is capital inflow (since $i_1 > i_f$). This causes central bank to sell own currency and buy FOREX resulting in rightward shift of LM from LM_1 to LM_2 . This continues until E_3 where i once again equals i_f and F -inflow stops and pressure to revalue is finished. Thus fiscal policy is fully effective as output shifts by full value of $\Delta G \cdot \alpha_G$, and output is at Y_3 .

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

Case 2 : Floating Exchange Rate
Fiscal Policy is fully ineffective.



In case of floating exchange rate, rise in IS leads to $i_1 > i_f$, resulting in capital inflow. As a result, currency appreciates. This makes exports of the nation less competitive thereby shifting IS curve back to the left. This shift continues until $i = i_f$ and no more appreciation takes place. Thus, output returns to Y_1 and fiscal policy is fully ineffective.

Thus, fiscal policy impact is dependent on fixed and floating exchange rate. In the short run, both have same impact but in long run, it is drastically different.

(Please do not write anything except the question number in this space)
कृपया इस स्थान में प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

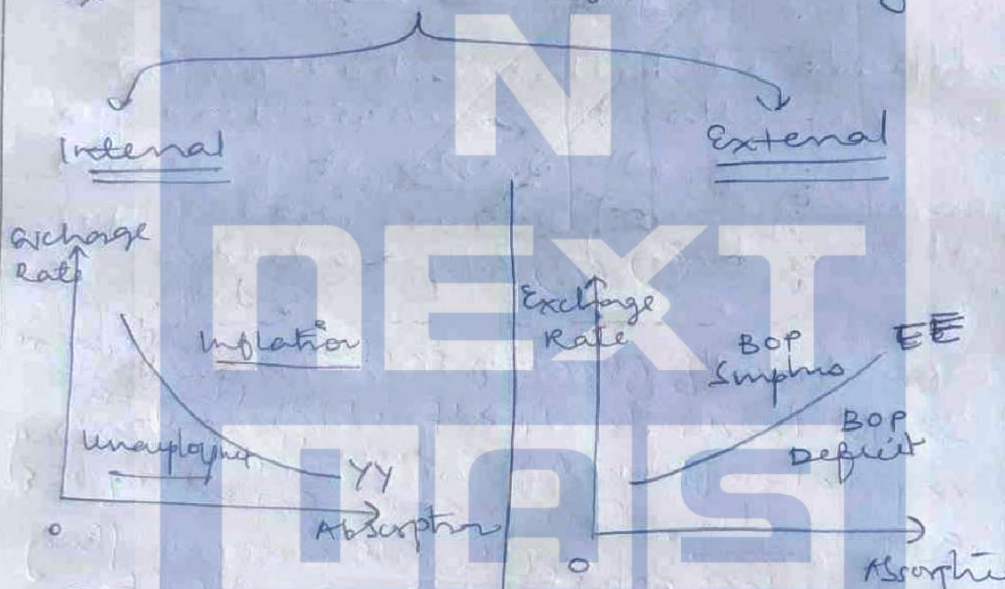
उम्मीदवारों को इस हाशिए में नहीं लिखना चाहिए।
Candidates must not write on this margin.

(Please do not write anything except the question number in this space)
कृपया इस स्थान में प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

Q4c)

Salter Swann Theory is based on internal and external equilibrium. It seeks to diagnose an economy's state and provide policy recommendations to address it.

According to the model, there are two sectors of an economy:



This is downward sloping because as exchange rate falls, income rises and economy absorbs more employment.

Any point above shows inflation, below shows under-employment.

This is upward sloping since higher exchange rate requires greater absorption in external markets to reach equilibrium.

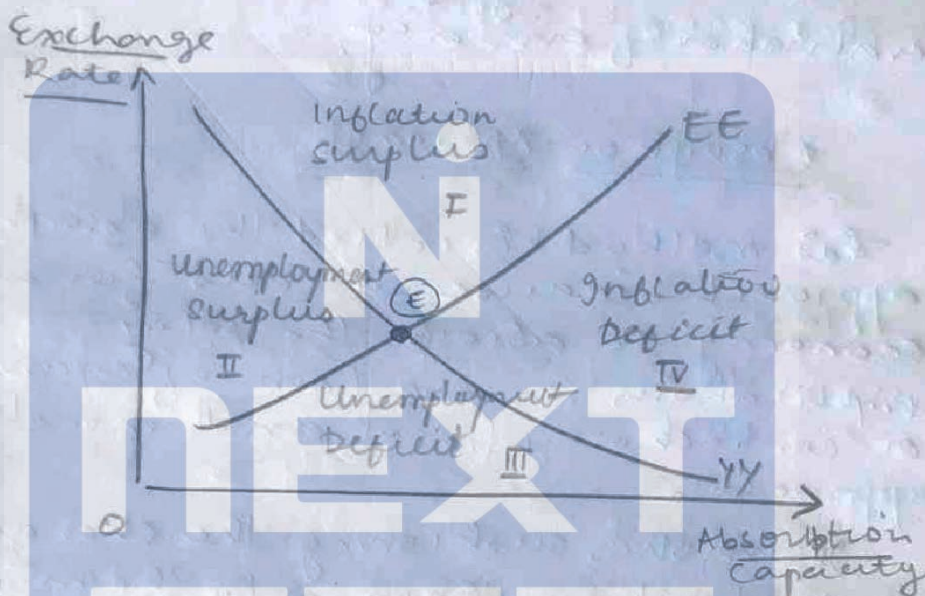
Any point above the EE curve shows BOP surplus. Below shows BOP deficit.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस हाथिए में नहीं लिखना चाहिए।
Candidates must not write on this margin

Putting both internal and external equilibrium together can provide a picture of overall economic equilibrium in the country.



As shown in the above figure, a nation can be at any "quadrant" depending on prevailing conditions in the economy. From there it can use various policy combinations to reach a different stage, closer to 'E' where there is both internal & external equilibrium.

Example : India is currently in quadrant III, facing unemployment and a trade deficit. This is because it lies below both the YY curve (hence unemployment) and the EE curve (hence trade deficit).

Please do not
write anything
except the
question number
in this space
कुछ इस स्थान
में प्रश्न संख्या के
अतिरिक्त कुछ
न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस भाग में
नहीं लिखना
चाहिए।
Candidates
must not
write on this
margin

In such a situation, Salter-Swan suggests expansionary fiscal policy and ~~expansionary~~ ~~contract~~ expansionary monetary policy to reduce unemployment while enhancing growth of trade through devaluation of currency.

Absorption Approach

This method is called the absorption approach because it calls for an economy to absorb the policy implications in the form of expansionary or contractionary fiscal and monetary approach.

It involves cushioning the changes and absorbing them into the model to see long term effects.

Thus, Salter-Swan provides a general equilibrium approach to internal and external equilibrium in an economy.

UPSC

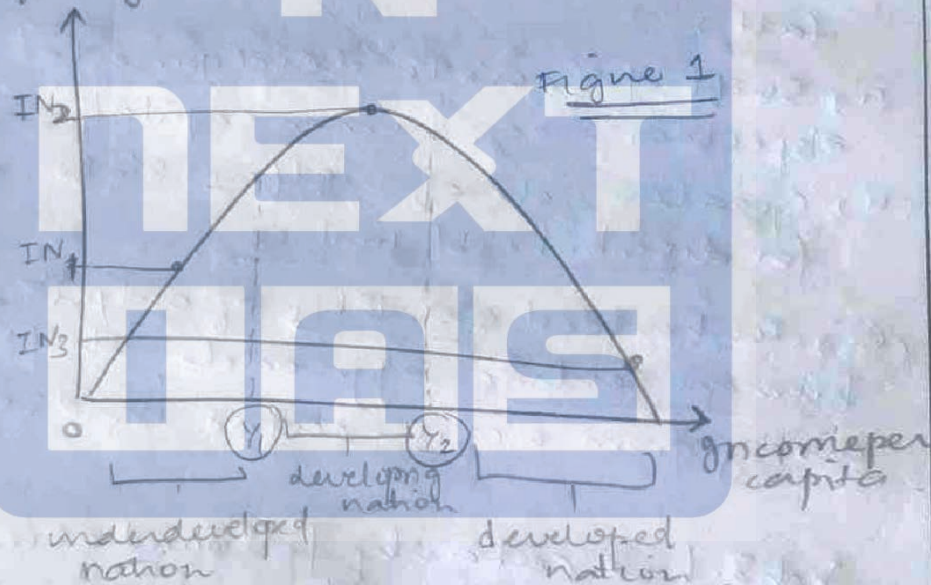
Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस खण्ड में नहीं लिखना चाहिए।
Candidates must not write on this margin

Q7a) According to Kuznets structural Growth Transition, an economy passes from ~~an~~ an underdeveloped to developing to developed nation while having simultaneous impacts on other structural parts of the economy.

Kuznets' Inequality Proposition

Inequality



As shown in Figure 1, as income per capita grows from Y_1 to Y_2 , inequality raises in the nation. This can be seen as:

(is focus on economic growth (size of the pie) instead of distributional justice (pieces of the pie)).

Please do not
write anything
except the
question number
in this space.
कृपया इस स्थान
में प्रश्न संख्या के
अतिरिक्त कुछ
न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस भाग में
नहीं लिखना
चाहिए
Candidates
must not
write on this
margin

Please do not
write anything
except the
question number
in this space.
कृपया इस स्थान
में प्रश्न संख्या के
अतिरिक्त कुछ
न लिखें।

- (i) greater focus on economic growth
instead of economic development.
- (ii) ignoring the socio-cultural
impacts of growth.
- (iii) heavily capitalist economy, unequal
distribution of wealth.

eventually, as country shifts into
developed nation, inequality starts to
fall:

- (i) Shift of focus to developmental
objectives - eg: human capital.
- (ii) Greater role of welfare state giving
for distributive justice.
- (iii) enhanced quality of output,
human centric approach, shift
away from profit-centric mindset.

India has certainly followed a similar
path in its growth:

- (i) from 1947 to around 1980s, there
was much emphasis on growth
eg: PSU's commanding heights of economy,
mahalanobis model focussed on
industry, ignored agriculture.

- (ii) However, with 5th 5 Year Plan, there
was a shift away from unequal

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

growth and towards equality.

eg: End Poverty, Socialist Values
under Jawahar Gandhi.

(iii) Now there is increased focus
on equity:

eg: Healthcare: PMJAY

Agricultural schemes: PMFBY,
Irrigation, Fertilizer subsidy

Education: Sama Shiksha Abhiyan

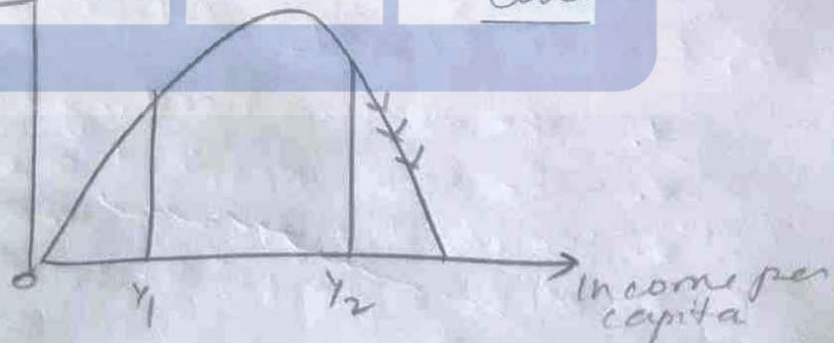
Skilling: PMKVY

Rural & Urban Amenities: SMART
Cities,
PM Awas, etc.

Similarly, Kuznets provided an
environmental perspective:

Environmental
Degradation

Environmental Kuznets
Curve



As income rises, countries become
more wary of their carbon footprint.

As such, India is on the downward
sloping portion of the curve with following
commitments:

(Please do not write anything except the question number in this space)
कृपया इस स्थान में प्रश्न संख्या के अतिरिक्त कुछ न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस दृष्टि से नहीं लिखना चाहिए।
Candidates must not write on this margin

- ① Panchamrit Promises at COP27 Glasgow -
- ② Carbon Neutrality by 2070
- ③ Green technology. (eg: Green Hydrogen)
- ④ Financing greener investments:
eg: Green & Blue Bonds.
- ⑤ International efforts like International Solar Alliance to encourage renewable energy.

Thus, India is on ~~the~~ Kuznets structural growth transition and is aiming to be a global superpower through effective changes in its equity and sustainable development goals impact.

UPSC

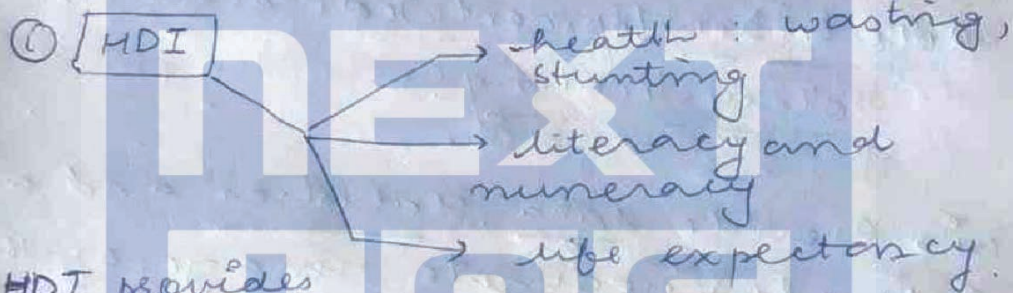
Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस हार्जिए में
नहीं लिखना
चाहिए
Candidates
must not
write on this
margin

Q76)

Development Indicators refer to Human Development Index (HDI) & multidimensional poverty index (MDPI) and other approaches like capabilities approach by Amartya Sen for the purpose of gauging economic development & the utility of government policy decisions.

Various indices to measure development



HDI provides a basic idea of levels of poverty and severity of the same in different regions.

② MDPI → ⑫ indicators including sanitation, access to water, access to electricity, fuel, etc.

This provides a more diverse and comprehensive map of the needs of a region.

③ Capability Approach: According to Amartya Sen, any individual who is deprived of the opportunities that (s)he as a person can avail or that lies within his/her potential, is poor.

Thus, this approach embodies a much larger perspective on poverty and government policy approach.

Role of Development Indicators in Policy-making

(i) Provide data, statistics and a (close to) accurate image of the situation at hand.

(ii) Provide a "map" detailing

1. The regions needing help
2. The resources that are lacking
3. Demand supply mismatches
4. Other important details.

(iii) They help devise a plan of action and allow for targetted approach to development of a region.

Please do not
write anything
except the
question number
in this space
कृपया इस स्थान
पर प्रश्न संख्या के
अतिरिक्त कुछ
न लिखें।

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को
इस हाशिए में
नहीं लिखना
चाहिए।
Candidates
must not
write on this
margin

(iv) Help evaluate policies of government on an output/outcome basis and therefore instruct further action

(v) Help control fiscal deficit as actions taken weed out wasteful policies if indicators show ineffectiveness.

However, development indicators

(i) can be inaccurate

(ii) can be vague

(iii) may not point to direct issues

(iv) are based on unrealistic assumptions.

Thus, development indicators are only a tool (a means to an end). Policy making, implementation and grassroots evaluation can make these indicators more purposeful.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

Q7C)

Gunnar-myrdal's model of growth
is based on 2 effects of growth:

(i) Back Wash effect: refers to the
centripetal force that guides resources
and development to be centred in a
region.



(ii) Spread effect: refers to the
centrifugal force that pushes
development out to outskirts due
to spill over impact.



In an economy like India,
both of these effects are seen in
growth and development in different
regions and versions of the
nation.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

उम्मीदवारों को इस हाशिए में नहीं लिखना चाहिए।
Candidates must not write on this margin

Backwash Effect in India

① Seen in the form of industrialization coupled with urbanization.

eg: development of tier 1 cities like New Delhi & Mumbai.

② Outskirts consist of low levels of development.

eg: Shrines on the outskirts of Mumbai.

③ Inward (centripetal movement) in the form of

- (i) people: migration from rural to urban areas.
- (ii) resources: greater capital development at the centre.

Spread Effect in India

① Seen in the form of RURBAN clusters development

eg: tier 2 and tier 3 cities are emerging as gains from industrial cities are spreading to the rest of India.

② Enhanced facilities and development spreading outwards.

③ Supported by government mechanisms

eg: RURBAN mission, SMART cities, AMRUT programme, National Rural Development mission.

UPSC

Answer Questions in NOT MORE THAN the Word Limit specified for each in the Parenthesis.
(Specimen Answer Booklet - For Practice Purpose Only)

Backwash Effect

① This effect's negative implications are being countered by government action.

eg: Rehabilitation of slum dwellers, Antyodaya programme, support to migrants through e-Shram portal, etc.

② Understanding that rural urban growth is essential but also needs balance with human rights and development.

Spread Effect

① Industrial clusters

eg: PM MITRA, SEZs, mega food park schemes under MoFPI, encouraging agri-preneurship to enhance the overlap of rural agricultural regions and scientific advancements.

② Greater focus on skilling and schemes like One District One Product with introduction of Unity malls in Budget 2023-24 to encourage indigenous products.

Guman Myrdal theory is a reminder to build clusters to expand growth but also aim to enhance the spillover of growth ~~into~~ in the form of spreading development in the nation.