

NEXT IAS

(To be filled by candidate)

Name of Candidate : <u>RUHANI</u>	<u>T-S/470</u>	
Roll No. : <u>PTTP 22 0870 (IGP-2022 Student, writing CSE 2023 Mains)</u>		
Registration Number :	Date of Examination : <u>21 18-08-2023</u>	
Exam Centre : Old Rajinder Nagar <input type="checkbox"/>	Bhopal <input type="checkbox"/>	Online <input checked="" type="checkbox"/>

CSE (MAINS) TEST SERIES - 2023

Test-05	ECONOMICS OPTIONAL
Dated : 13-08-2023	Full Syllabus (Paper-I)

Time Allowed : Three Hours

Maximum Marks: 250

QUESTION PAPER SPECIFIC INSTRUCTIONS

(Please read each of the following instructions carefully before attempting questions)

There are **EIGHT** questions divided in **Two sections** and printed in **ENGLISH**.

Candidate has to attempt **FIVE** questions in all.

Question No. 1 and 5 are compulsory and out of the remaining, any **THREE** are to be attempted choosing at least **ONE** question from each section.

The number of marks carried by a question/part is indicated against it.

Answers must be written in the medium authorized in the Admission Certificate which must be stated clearly on the cover of this Question-cum- Answer (QCA). Booklet in the space provided.

No marks will be given for answers written in a medium other than the authorized one.

Word limit in questions, wherever specified, should be adhered to.

Attempts of question shall be counted in sequential order. Unless struck off. Attempt of a question shall be counted even if attempted partly. Any page or portion of the page left blank in the Question cum Answer (QCA). Booklet must be clearly struck off.

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(For filling by Examiners only)

Q. No.	Page No.	Max. Marks	Marks	Total	Signature
1. (a)	4	10			
1. (b)	6	10			
1. (c)	8	10			
1. (d)	10	10			
1. (e)	12	10			
2. (a)	14	15			
2. (b)	17	20			
2. (c)	21	15			
3. (a)	24	15			
3. (b)	27	15			
3. (c)	30	20			
4. (a)	34	15			
4. (b)	37	20			
4. (c)	41	15			
5. (a)	44	10			
5. (b)	46	10			
5. (c)	48	10			
5. (d)	50	10			
5. (e)	52	10			
6. (a)	54	15			
6. (b)	57	15			
6. (c)	60	20			
7. (a)	64	15			
7. (b)	67	15			
7. (c)	70	20			
8. (a)	74	15			
8. (b)	77	15			
8. (c)	80	20			
Grand Total					

Remarks

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Observations:



SECTION-A

Write notes on the following in about 150 words each:

(10 × 5 = 50)

Q.1

(a) "Excess capacity meant different things for different people", Explain the statement in context of monopolistic competition and imperfect competition.

Monopolistic competition is a system in which there are large number of buyers and sellers, differentiated products and free entry and exit of firms.

It is a type of imperfect competition as the producer is able to charge a price higher than the perfectly marginal cost.

Excess capacity is the amount by which the ~~equilibrium~~ actual ~~of~~ output in the monopolistic competition falls short of the socially optimum level of output (OQ).

Thus, $PQ = \text{Excess Capacity}$.

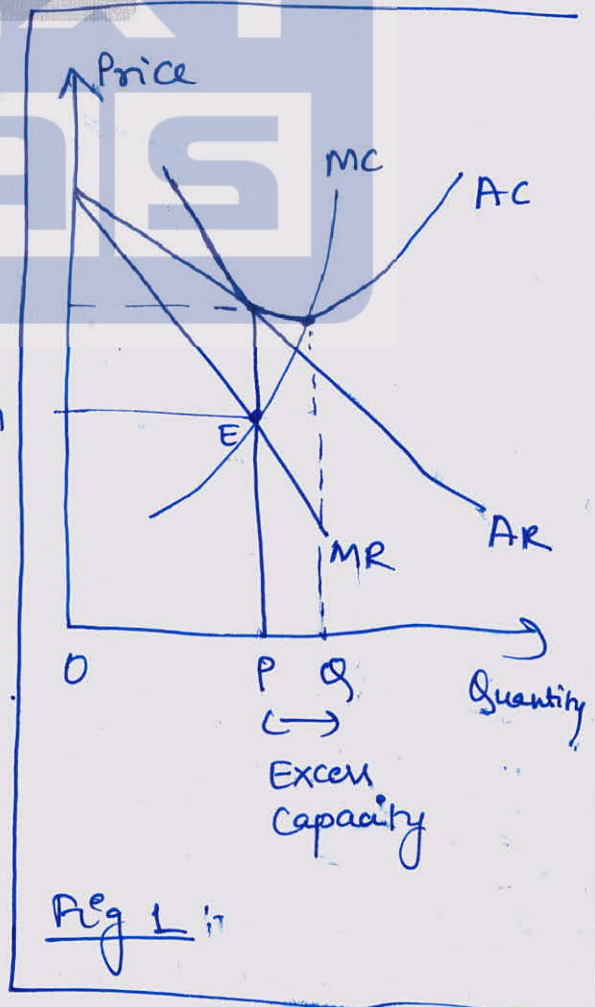


Fig 1.ii

However, Chamberlin explains that OQ should not be considered as the ideal output.

→ He argued that OP should be the ideal output as ~~some~~ consumers benefit from the product differentiation in the system of monopolistic competition.

→ Thus, for Chamberlin, OP output is the ideal output and there was no excess capacity as long as there was price competition and free entry ~~of~~ and exit of firms.

Q.1

(b) "Rent is the result of indestructible capacity of soil". Discuss

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Ricardo's model stated that land is fixed in supply and hence, return on land constituted the rent.

Land can neither be decreased nor increased and rent is the result of indestructible capacity of soil.

ASSUMPTIONS :-

- Diminishing returns to land
- Malthusian law of population :- As wage rate increases, population increases which leads to reduction in wage rate such that in long run, $\boxed{\text{wage rate} = \text{subsistence wage}}$
- Profits are necessary for capital accumulation and growth.

MODEL :-

- let subsistence wage rate be \bar{w} .
- $\text{Rent} = (AP_L - MP_L) \times L = \text{Area } abdc$

where $AP_L =$ Average product of labour

$MP_L =$ Marginal product of labour

$L =$ labour

- Thus, wages = $0f\bar{w}$

∴ Profit = Residual
 = Total output - Rent - wage
 Profit = Area $\bar{w} e d c$

→ This profit is reinvested and thus, demand for labour increases.

→ This keeps on happening until labour becomes equal to Oh .

→ Here, Rent = ig per unit

→ Wage = ow gh and profits become zero.

Thus, Ricardo's model states that with growth, the share of rent and wages increases but the share of profit reduces.

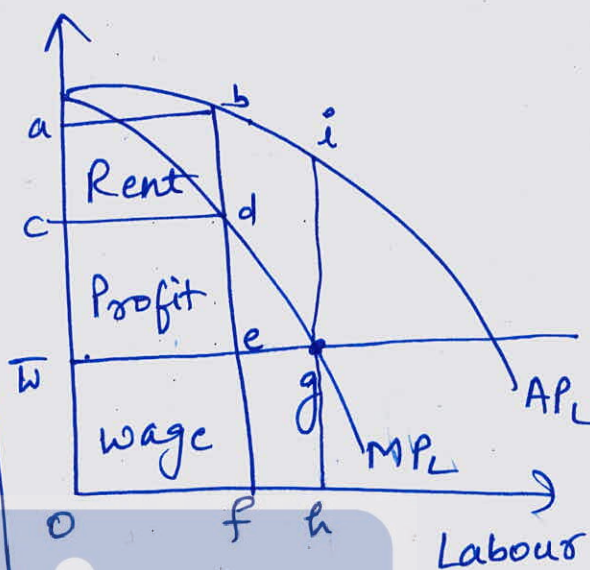


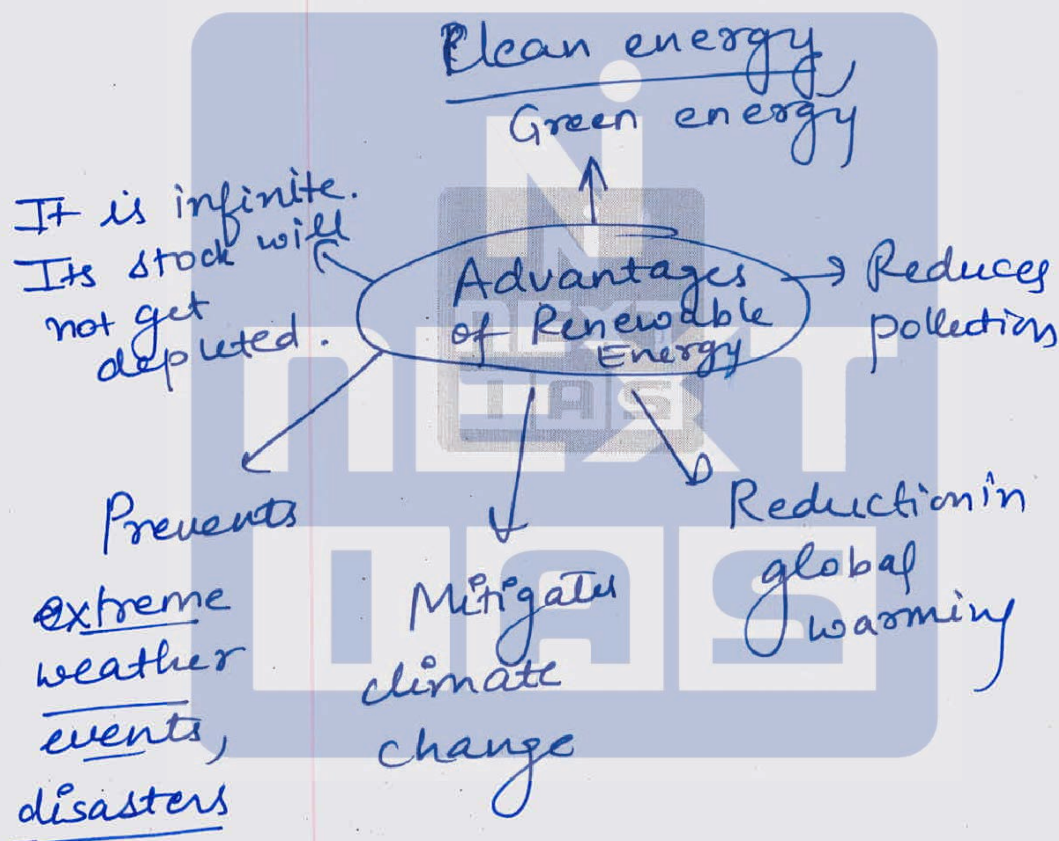
Fig 1 :- Ricardo Model

Q.1

(c) What are the advantages of renewable energy? Examine few steps taken by the Government of India to promote its use.

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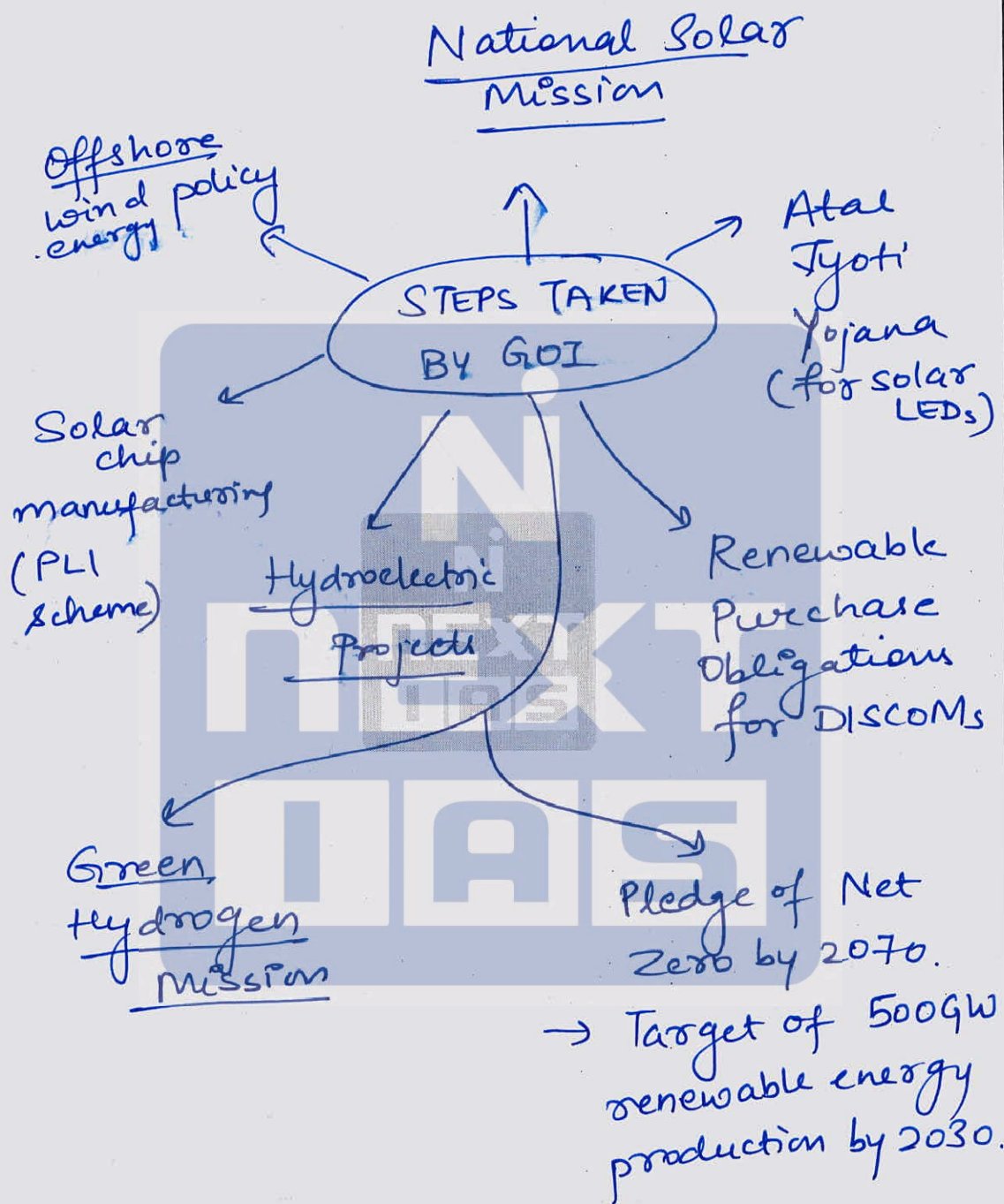
Renewable energy is the energy which can be replenished over time. Eg:- solar, wind



Thus, renewable energy is hugely advantageous for environment and can prevent global temperatures from exceeding the 1.5°C limit above pre-industrial levels.

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~~The govt~~ PROMOTION OF RENEWABLES :-



Thus, the government needs to keep ~~string~~ stringing towards promotion of renewables and phasing down of coal.

Q.1

(d) Explain Rybzyński Theorem.

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Rybyński Theorem states that when there is increase in a factor, the production of the commodity (intensive in that factor) increases more and the other commodity decreases.

For example,

if the amount of labour ~~increases~~ ^{doubles} then ~~the~~ in Nation 1, then the quantity produced of X (labour-intensive commodity) more than doubles.

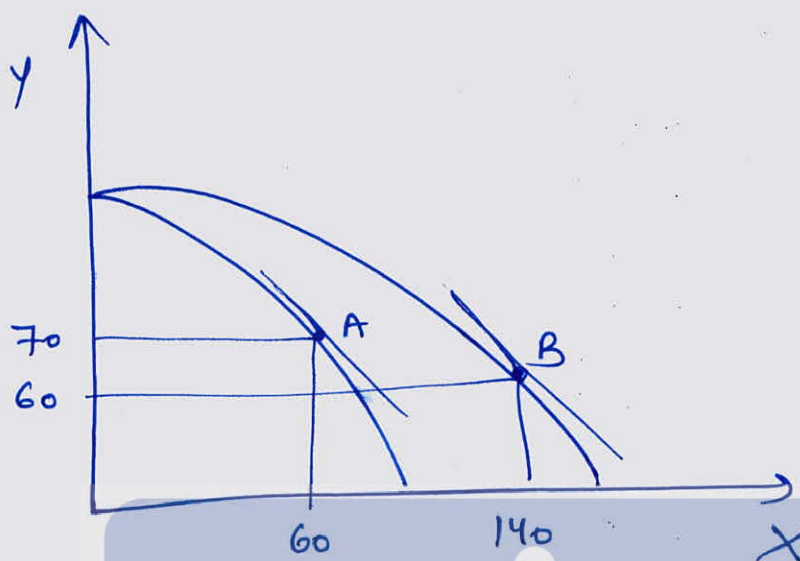
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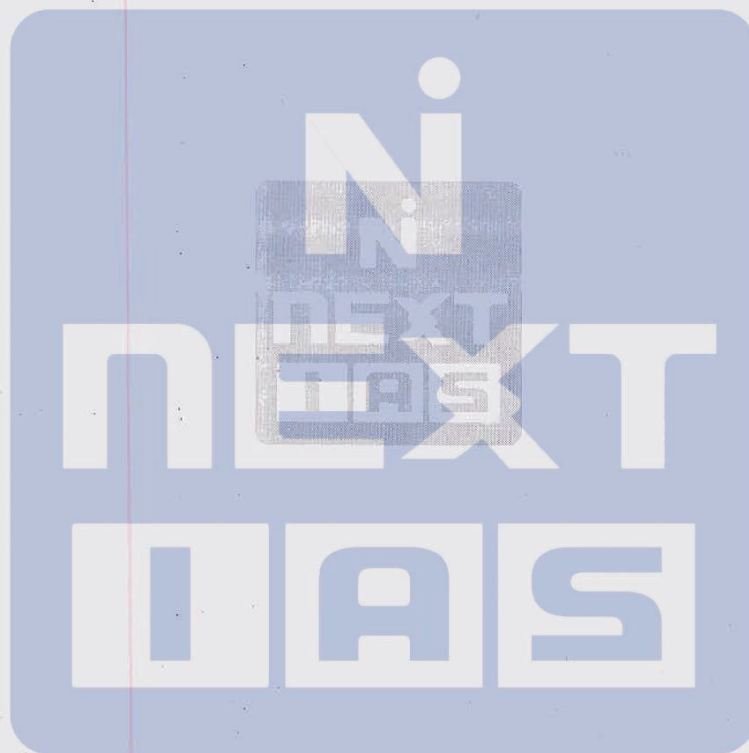
Fig 1 :- Rybczynski Theorem

Thus, on doubling of labour, the production of X more than doubles from 60 units (point A) to 140 (point B).

Q.1

(e) "Gradual Monetarism couldn't explain supply side impact". Do you agree?

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Q.2

- (a) Explain the impact of positive external shock in case of fixed exchange rate in short run and long run.

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- Q.2 (b) "Technology can create increasing returns to human capital and it can negate diminishing returns to physical capital". Analyse the Growth Model on this statement. 20

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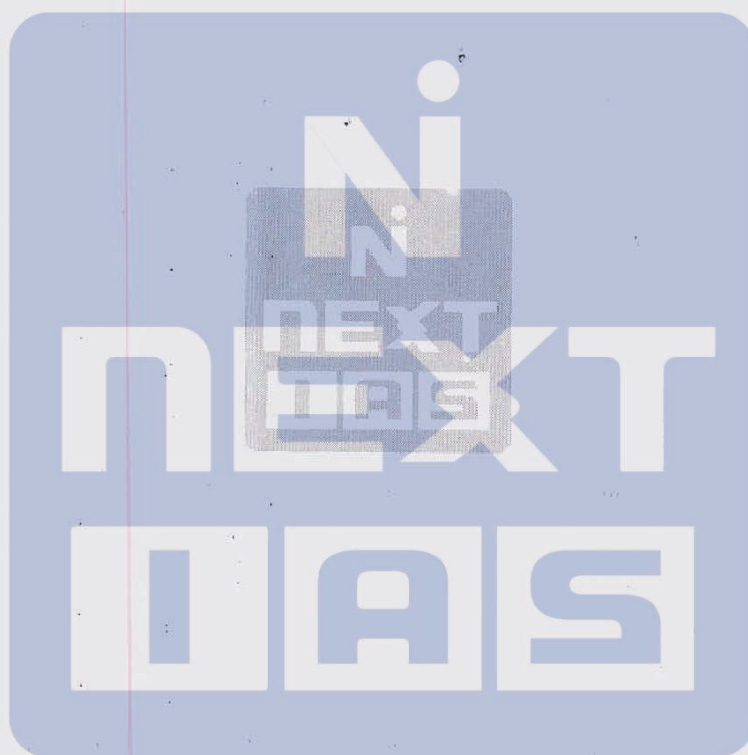


Q.2 (c) Explain how tax burden is shifted depending on the elasticity of demand and supply. **15**

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Q.3

(a) What is meant by Peak load pricing? Do you think it is always efficient?

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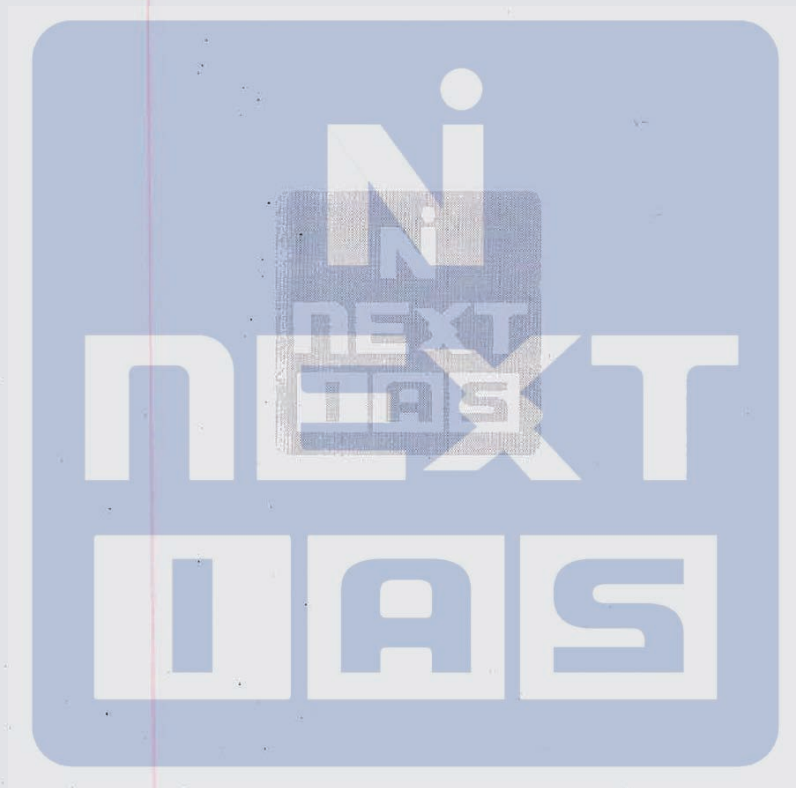
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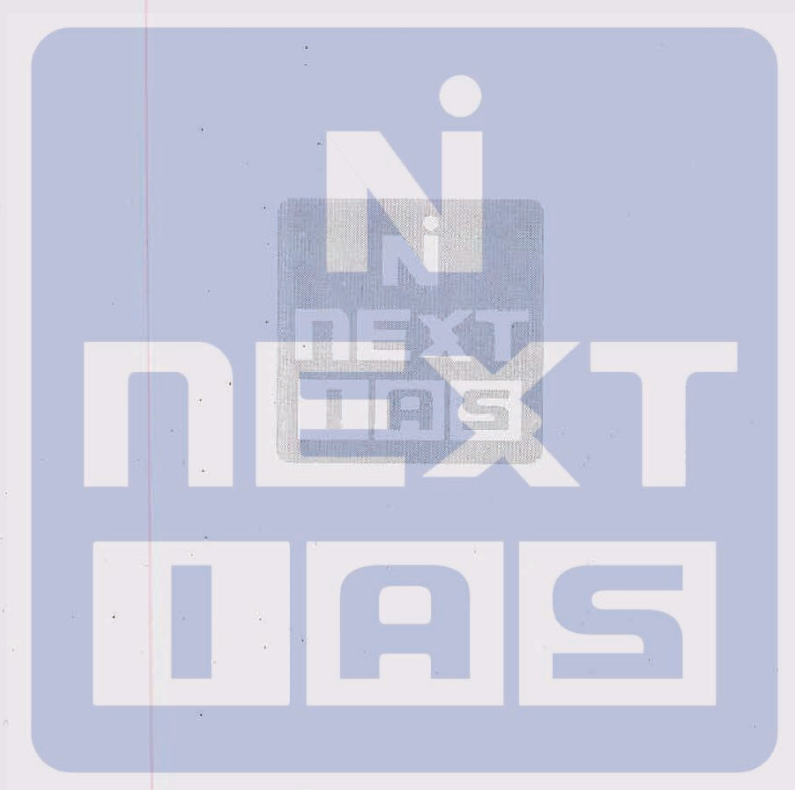
Q.3

(b) Explain Equivalent Variation. What is the other method of compensation?

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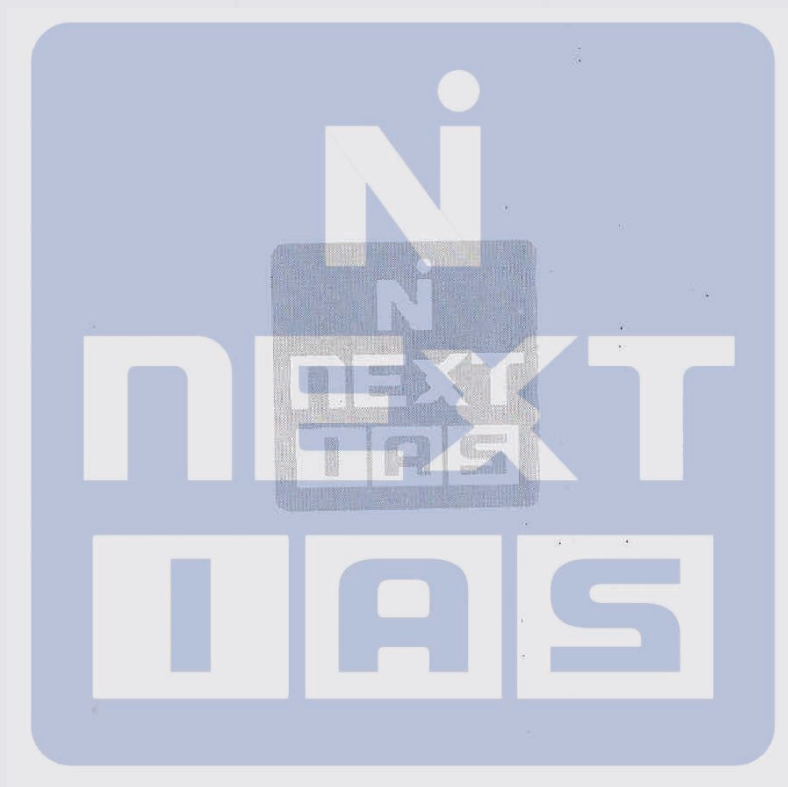


Q.3 (c) Explain the impact of crowding out in the case of Endogenous Money Supply. 20

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Q.4

- (a) Comment on fiscal consolidation with respect to its impact on economic development.

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Fiscal consolidation refers to the process of reduction of fiscal deficit.

$$\text{Fiscal Deficit} = \text{Total Expenditure} - \left(\text{Total ~~income~~ receipts} - \text{Loans or borrowings} \right)$$

Thus, reduction in total expenditure through rationalisation of revenue expenditure, rationalisation of expenditure on schemes, constitutes fiscal consolidation.

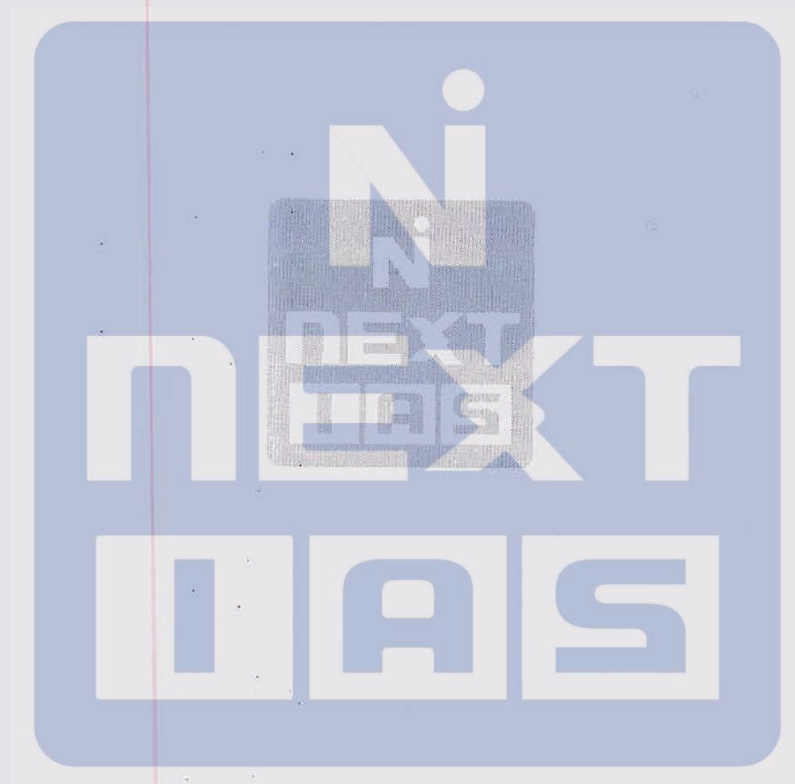
Also, increase in receipts via dividends, direct taxes, GST revenue and interest receipts, constitutes fiscal consolidation.

IMPACT OF FISCAL CONSOLIDATION ON ECONOMIC DEVELOPMENT :-

- Reduces fiscal deficit
- Reduces inflation
- Reduces current account deficit
- Increases the ratings of Indian sovereign bonds
- Decreases revenue expenditure
- Decreases freebies
- Creates more room for higher capex.
- Results in rationalisation of subsidies
- Reduces wasteful expenditure
- Diverts resources towards more productive uses like health, education, research and development.

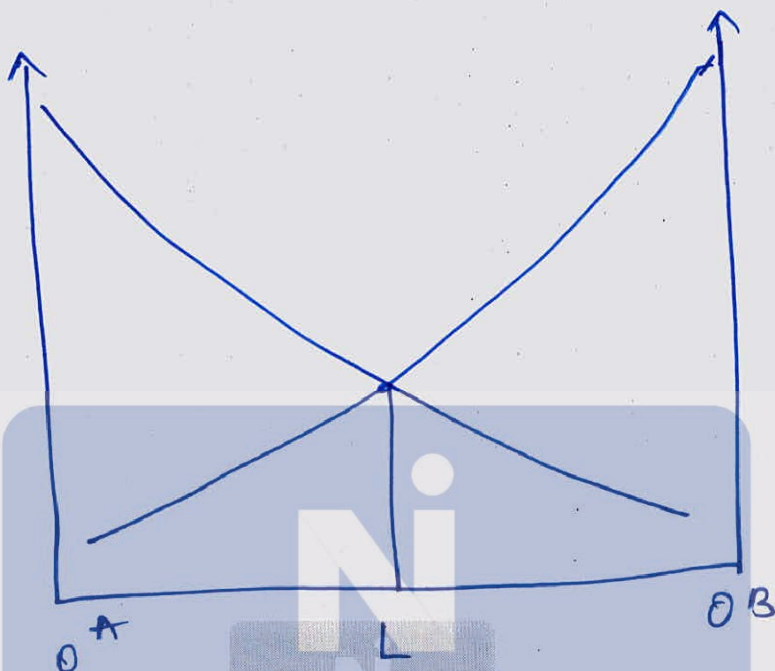
Thus, Indian government must focus on reducing its fiscal deficit and aim to achieve fiscal consolidation.

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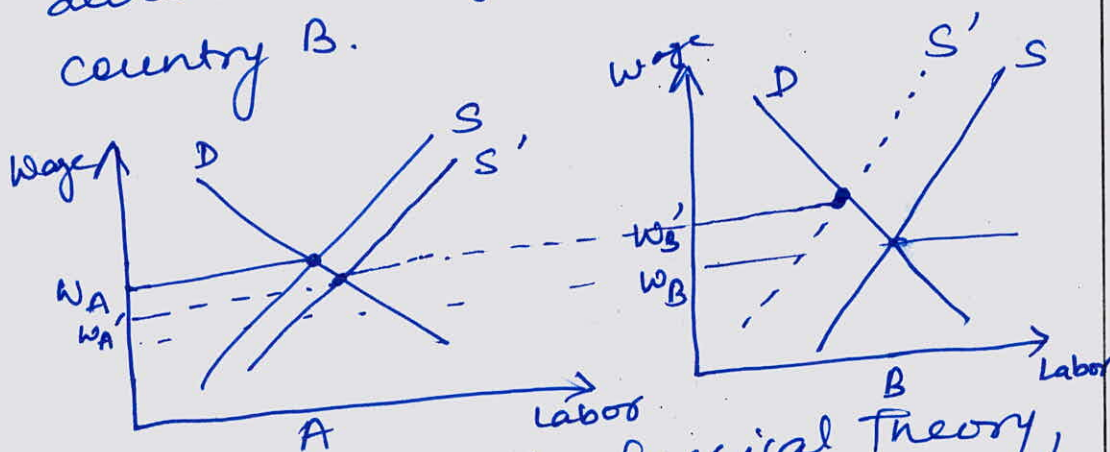


Q.4 (b) Examine the impact of emigration in case of Classical Model. How can the policy counter it? Suggest any two measures. 20

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Emigration results in movement of labour from one country (B) to another (A) where $wage_A > wage_B$. This results in increase in supply of labour in country A and decreases supply of labour in country B.



Thus, as per Neoclassical Theory, wages get equalized in both countries i.e. $w'_A = w'_B$.

However, the wage in country A reduces from w_A to w'_A

Wage in country B increases from w_B to w'_B .

WAYS TO COUNTER EMIGRATION :-

- A Brain Drain Tax (as proposed by Jagdish Bhagwati)
- Increase in jobs in the original country so that people are not forced to migrate
- Raise the level of high education in the original country

These are some of the ways to counter emigration.

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Q.4

(c) How is export subsidy a double jeopardy for the imposing country?

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Export subsidy is a payment made by a country's government to its exporters.

Since export subsidy is a payment obligation for the government, hence it is costly for the government.

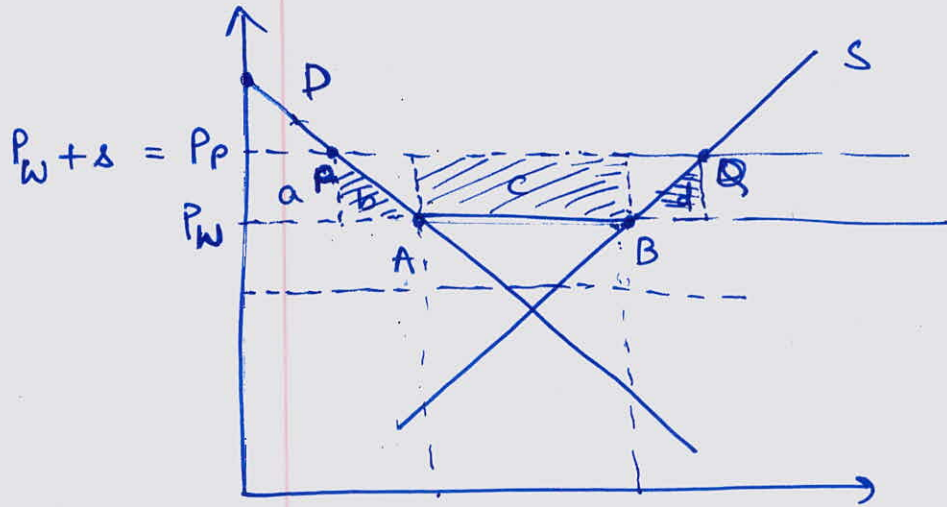
It is a double jeopardy for the imposing country because:

→ It increases the supply of exports in the world market and hence reduces the world export price → this reduces the Terms of Trade (TOT) for the exporting nation resulting in

TOT loss.

→ It leads to production and consumption distortions, resulting in Deadweight loss.

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let ~~Producer Surplus~~ before Export subsidy be

Distortion (Deadweight loss) = $b + d$

TOT loss = c

Hence export subsidy results in double jeopardy.

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SECTION-B

Write notes on the following in about 150 words each:

(10 × 5 = 50)

Q.5

(a) What are the different types of conjectural variations?

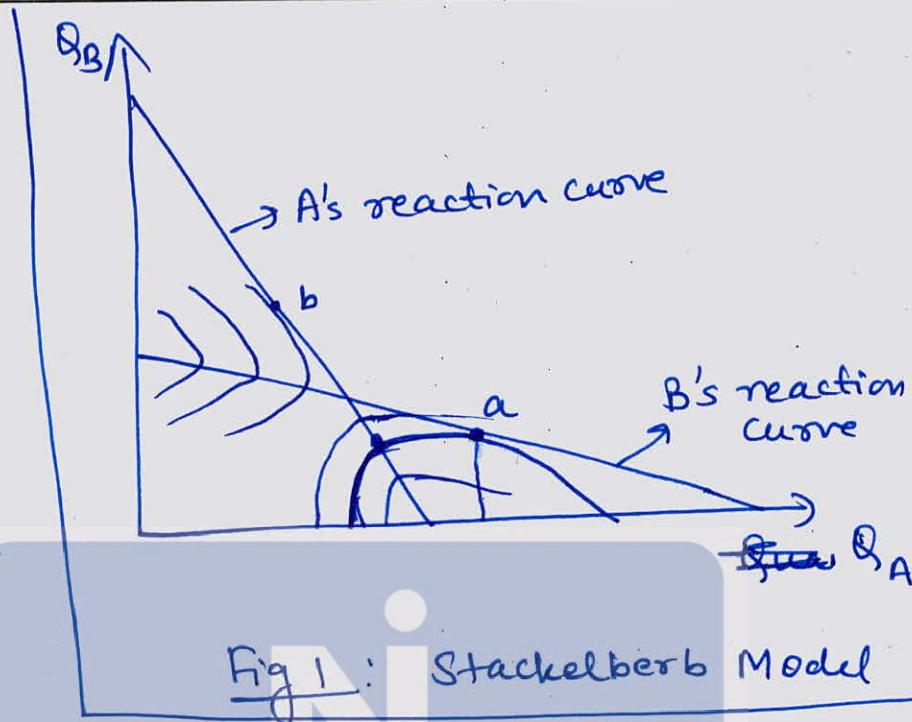
Conjectural variation refers to the phenomenon in which a firm forms conjectures about the action and reaction of its rival firms.

For example, Stackelberg Model is an example of Conjectural variation in which the leader firm is a sophisticated firm who determines the reaction curve of the naive follower firm (which ignores the impact of its decision on the other firm).

→ The leader incorporates this reaction curve into its profit function and maximizes its profits like a monopolist.

Here
firm A
= leader
firm

Firm B =
follower
firm.



Leader firm A maximizes its profits at point a (given B's reaction curve).

Thus, the leader makes more profits with conjectural variation in Stackelberg model as opposed to zero conjectural variation (in Cournot).

Q.5

- (b) "WTO has to reinvent itself by discussing the concerns of developing countries and creating an even support for all". Discuss mainly focusing on contentious issues in TRIMS and TRIPS.

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WTO must promote the ^{interests} ~~concerns~~ of developing countries and create an even support for all.

CONTENTIOUS ISSUES IN TRIMS :-

- National Treatment Obligation needs to be adhered by all nations.
- Local Content requirements should not be imposed on investors. However, India mandates that for FDI, 30% of value addition should occur from local sources.
- Export Balancing requirements should not be imposed. Eg:- India had imposed ~~on~~ a condition on automobile companies that they need to export a minimum amount of exports in order to operate in India.

Thus, TRIMS must make countries investor-friendly but also take into account concerns of developing countries.

CONTENTIOUS ISSUES IN TRIPS :-

- TRIPS waiver to be granted for vaccines and not just for medicines and therapeutics during pandemics.
- Parallel Imports be allowed.
- Companies must disclose the origin of the material used for research and innovation.
- Patent Pools be created.
- Patents be relaxed during public health emergencies (Doha Declaration on TRIPS)

Thus, WTO needs to redesign TRIMS and TRIPS to accommodate the interests of developing nations.

Q.5

(c) Explain the role of linkages in development. Do you think a global linkage is unmixed blessing?

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A combination of backward and forward linkages (as propounded by Hirschman) are essential for the development of a nation.

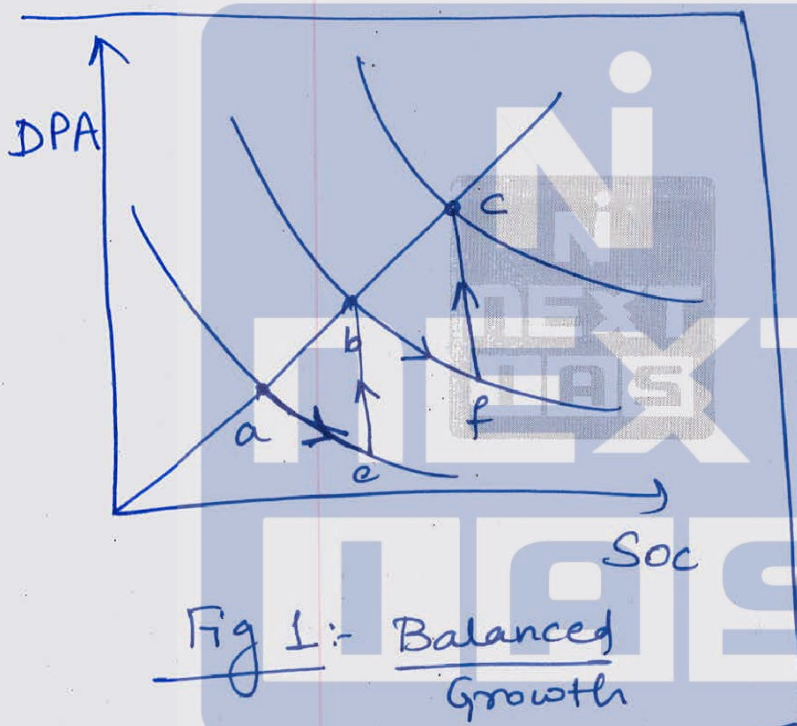


Fig 1:- Balanced Growth

Here,
 Soc = Socially Overhead Capital
 and
 DPA = Directly Productive Activities

GROWTH IN SHORTAGE OF SOC :-

- Hirschman states that there should be balanced growth from a to b to c.
- However, in unbalanced growth, government must initiate soc,

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this will create a forward linkage and stimulate DPA (private investment). This will further induce SOC and so on.

Thus, a combination of forward and backward linkages will determine the path from a to e to b to f to c.

A global linkage ~~is~~ ^{has both} pros and cons

PROS

CONS

→ It increases diversity and choice for consumers

→ supply chain disruptions can occur in wars, pandemics

→ It leads to growth ^{exports and}

→ Volatility in price

→ leads to economies of scale

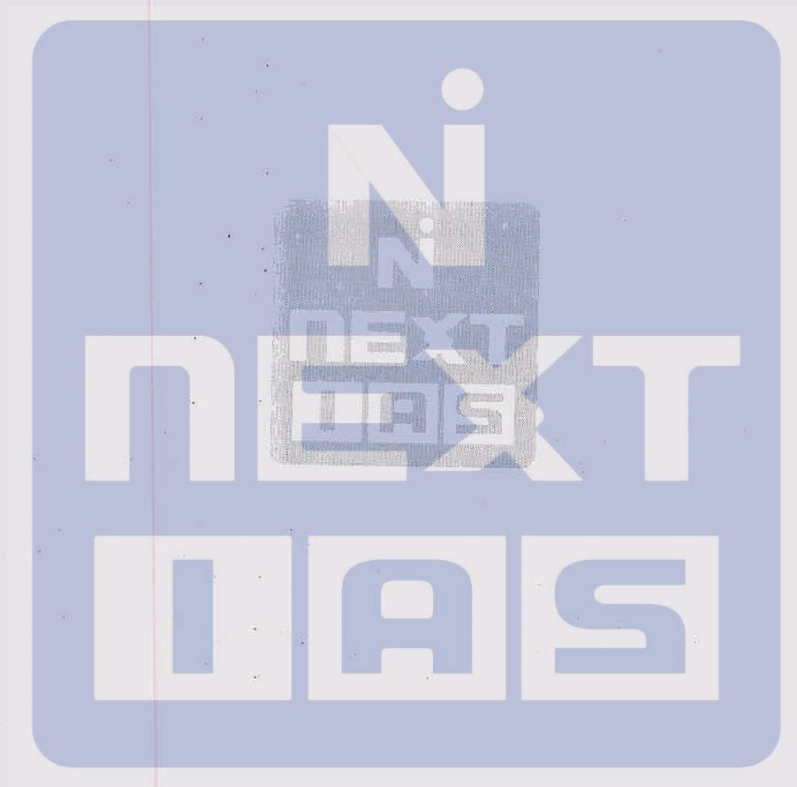
→ Drain on forex.

Thus, global linkages are a mixed blessing.

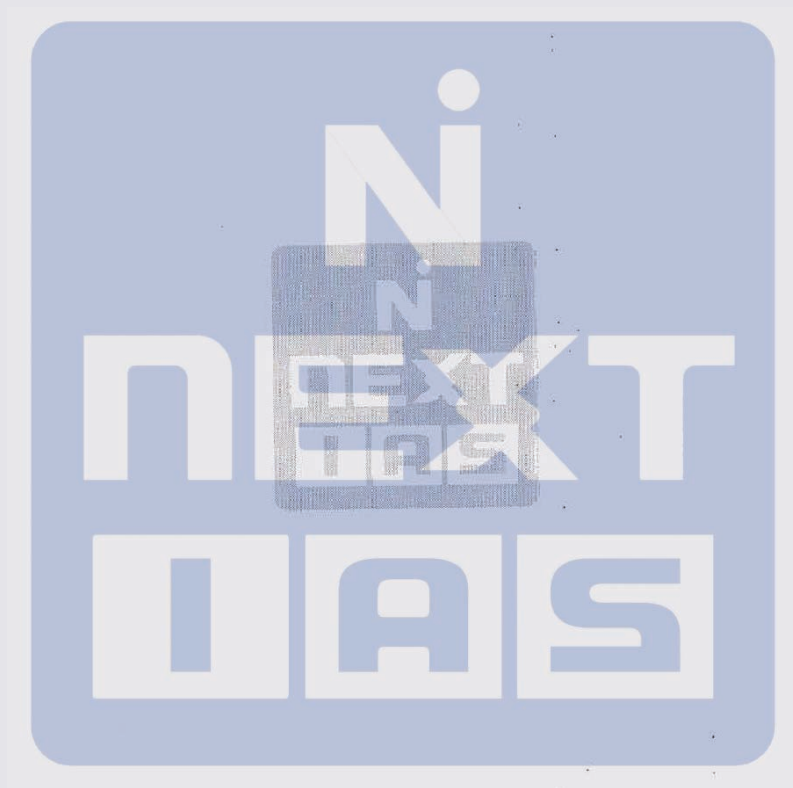
Q.5

- (d) Explain the relation between AVC, ATC and AFC by deriving ATC from AVC and AFC.

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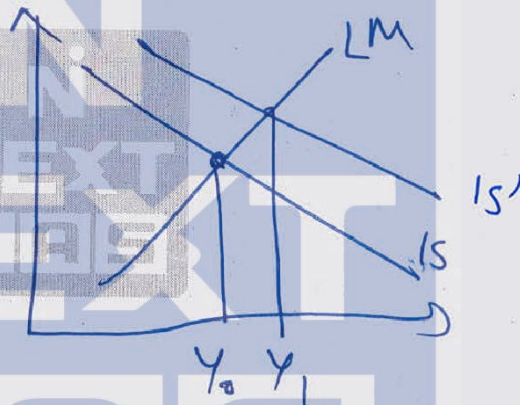


Q.5

(e) Highlight how Keynes gave a solution to output gap.Candidates
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Keynes suggested government intervention in the form of expansionary fiscal policy (increased government expenditure, reduction in taxes) to bridge the output gap.

This will shift the IS curve to right and reduce the output gap.



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Q.6

(a) What is trade enhancement and trade diversion created by Customs Union.

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Trade enhancement or trade creation occurs when production and trade pattern shifts from a high-cost producer to a low-cost member producer within the Customs Union.

For example, if UK joins the EU, then before joining EU, UK's exports to EU faced a tariff and hence EU ~~As seen as~~ found consumption of French goods cheaper.

As soon as UK joins EU, ~~these~~ tariffs on UK are removed and EU now buys goods from UK as they are cheaper than French goods.

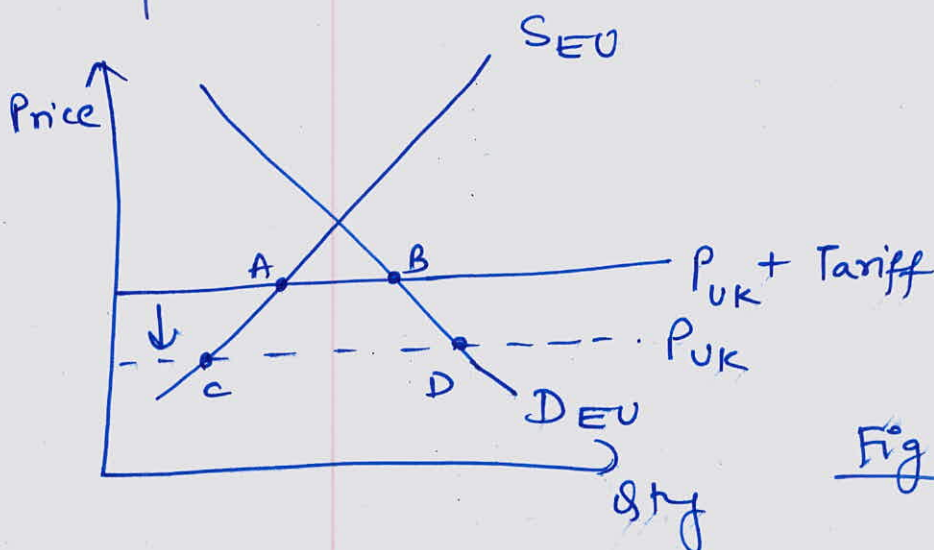


Fig 1.

Thus, figure 1 shows that on removal of tariff, exports from UK to EU increase from AB to CD.

TRADE DIVERSION is said to occur when there is movement from a ~~low~~ low-cost foreign producer to a high-cost member nation within the customs union.

Example, let UK be a member buy watches from Thailand at price P_{Thai} . Once UK enters the EU, UK will have to impose a tariff on Thailand's watches.

If $P_{\text{Thai}} + \text{Tariff}$ exceeds the price of watch in EU = P_{EU} , then trade diverts from Thailand to EU even if Thailand produces at a lower cost than EU.

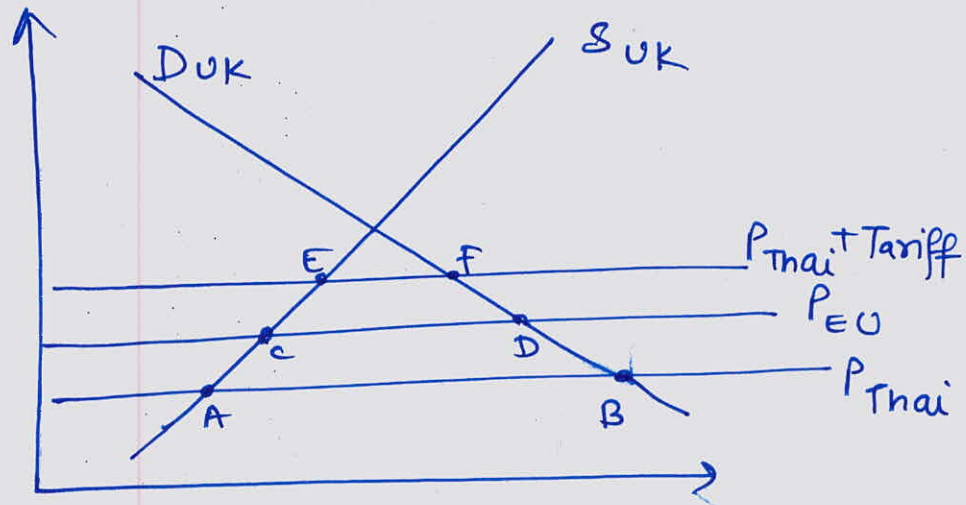


Fig 2: Trade Diversion.

Thus, once UK enters EU as a member, trade is diverted from Thailand to EU, even though Thailand is a much more efficient producer of watches than EU (as $P_{Thai} < P_{EU}$).

Thus, trade diversion diverts trade away from an efficient foreign producer to an inefficient member nation of the Customs Union.

Q.6

- (b) "Bank failure is not only a result of systemic failure, it can cause systemic failure too". In the context of above statement explain the steps that should be taken to restrict such a situation from arising.

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Bank failure is a result of a systemic failure as it is caused by lack of due diligence by the bankers, worsening of economic conditions or excessive risk taking or poor regulatory policies.

However, bank failure can also lead to systemic failures like :-

- Reduction of confidence of public in the banking system.
- Reduction in savings
- Reduction in investment
- Halting of infrastructure projects due to lack of credit
- Lack of credit facilities to the farmers resulting in increasing reliance ^{on} moneylenders.

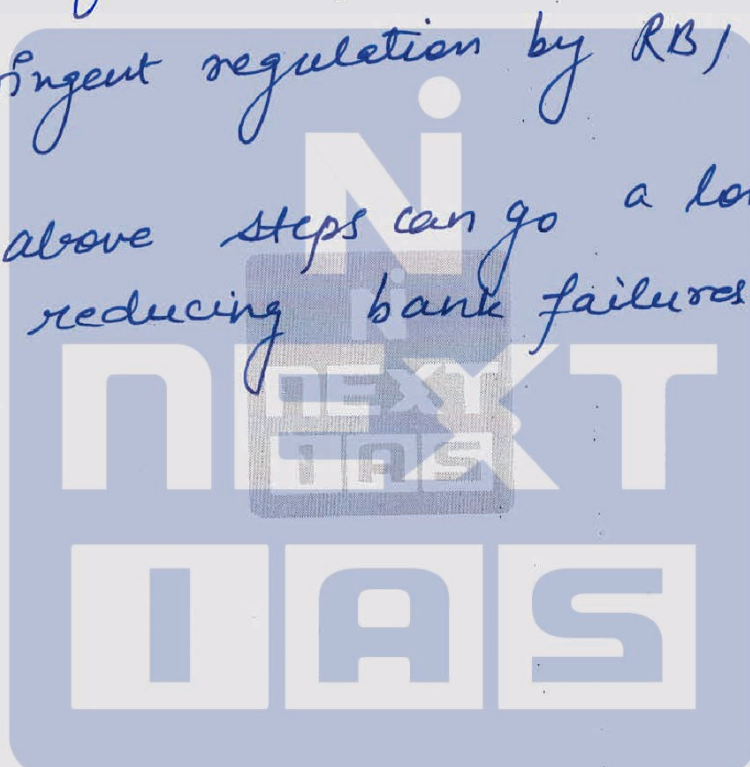
STEPS THAT SHOULD BE TAKEN TO

RESTRICT SUCH BANK FAILURES :-

- Proper recapitalisation of banks
- Debt restructuring
- Formation of a bad Bank
- Capital adequacy regulations
- Following of Basel III norms
- Reduction in NPAs of banks
- Strengthening of Debt Recovery Tribunals (DRTs) and SARFAESI Act
- Strengthening of Insolvency and Bankruptcy code.
- Transparency in functioning of banks
- Reduction in excessive risk-taking and cases of conflict of interest.

- Prompt Corrective Action against ailing banks
- Due diligence by banking officials
- Diversification of portfolio
- Stringent regulation by RBI

The above steps can go a long way
in reducing bank failures



Q.6

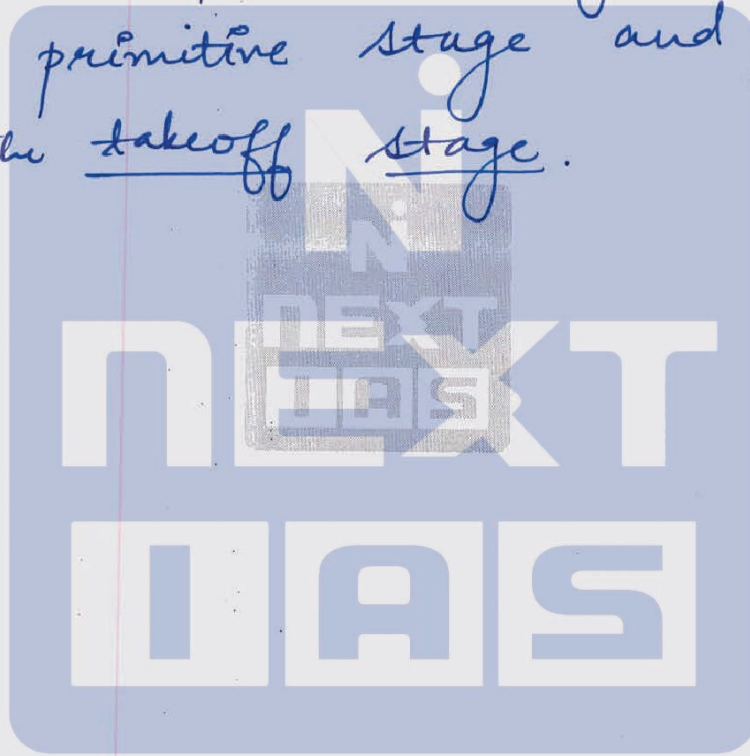
(c) Explain Rostow's stages of growth.

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Rostow's model of growth was followed in the 3rd five year plan of India.

It starts from the agricultural and primitive stage and goes till the takeoff stage.



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Q.7

(a) Explain Okun's law. Do you think it can explain the recent global situation.

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Okun's law states that growth results in decrease in unemployment.

Okun's law fairly explains the global situation to some extent:

- Growth in IT sector is creating jobs
- However, on the whole, jobless growth is being witnessed.
- Due to automation, industries are not able to absorb excess labour.
- People who do not have highly specialized skills to serve in the service sector.

Thus, people need to upskill
and reskill themselves so
that unemployment reduces with
growth.

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Q.7

(b) Explain different measures of poverty with their relevance.

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Poverty refers to deprivation in basic necessities of life like food and nutrition, housing and health and education.

DIFFERENT MEASURES OF POVERTY:

i) HEAD COUNT RATIO (HCR)

= $\frac{\text{No. of people below poverty line}}{\text{Total population}}$

Total population

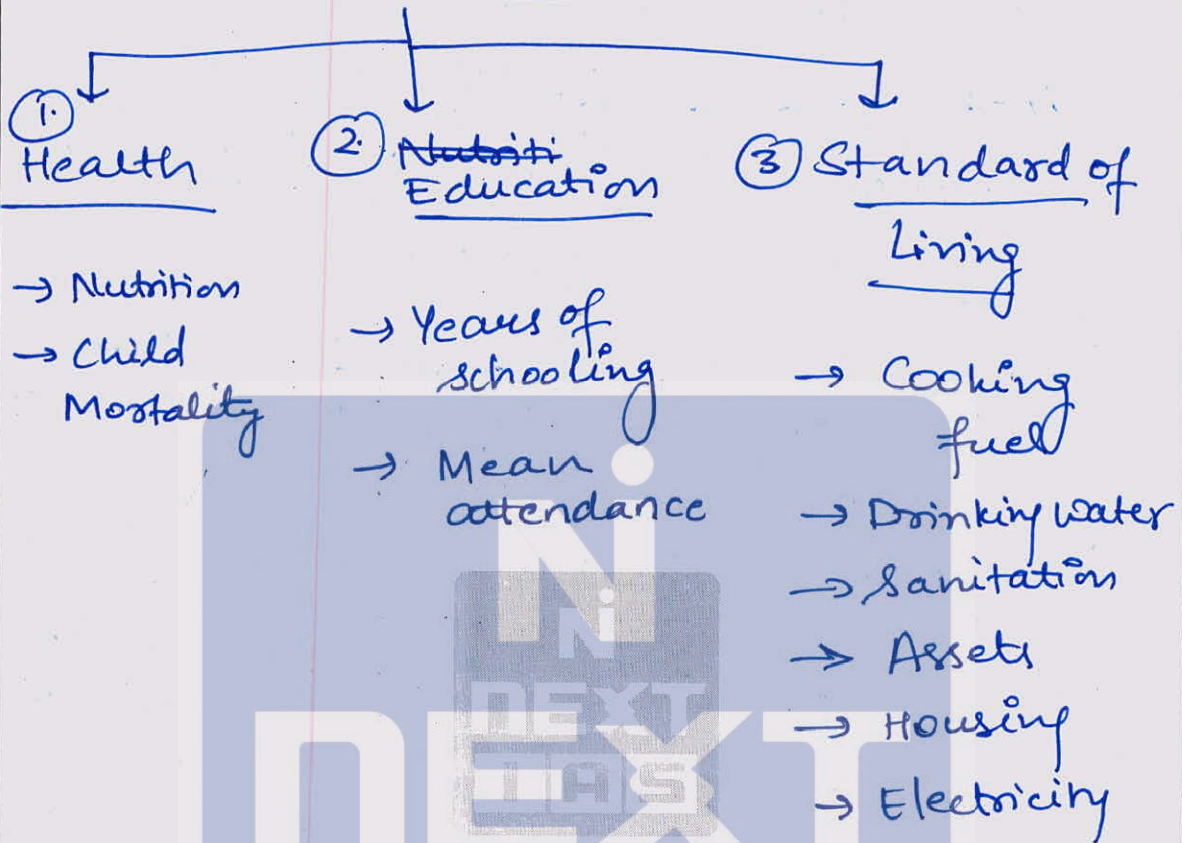
Relevance :- HCR is used to measure the incidence of poverty and follows Sen's axioms of focus, monotonicity.

ii) Multidimensional Poverty Index (MPI)

∴ MPI measures both incidence as well as intensity of poverty.

→ It calculates deprivation scores

for each household across 10 indicators
in 3 dimensions :-



If deprivation score $< 33\%$, then a household is considered poor.

Intensity of poverty = $\frac{\text{weighted average of deprivation scores of multidimensionally poor population}}{q}$

$$\text{Intensity} = \frac{\sum_{i=1}^q c_i}{q}$$

and

$$\text{Incidence} = \frac{q}{n} \quad \text{where } q = \text{No. of multidimensionally poor}$$

Thus, $\boxed{\text{MPI} = \text{Incidence} \times \text{Intensity}}$

Thus, MPI is the most relevant poverty measure today as it measures poverty in all dimensions comprehensively and enabled targeted intervention.

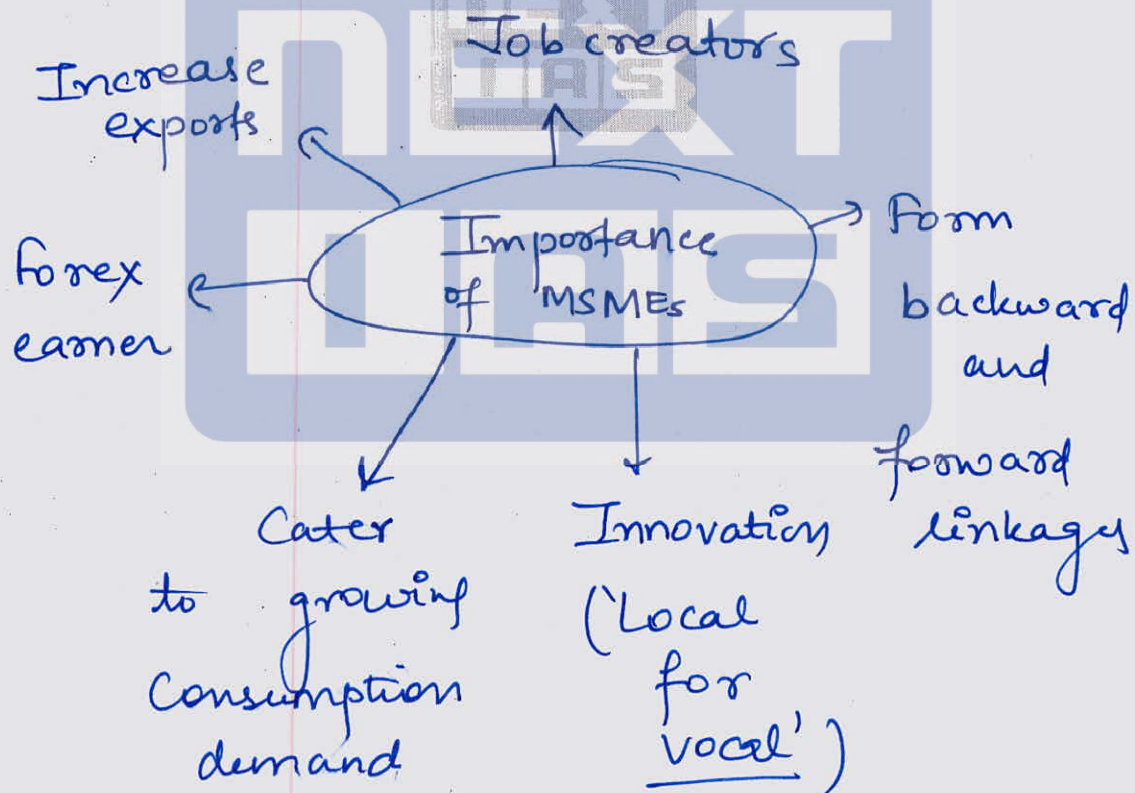


Q.7

(c) What is the importance of MSME in case of economic development of a developing economy? Explain some measures that can be taken for their development. 20

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MSMEs form the backbone of the economy of a ~~develop~~ developing nation as they create a huge number of jobs, and contribute massively to exports and GDP of a nation.



MEASURES THAT CAN BE TAKEN FOR THE DEVELOPMENT OF MSMEs :-

- Access to Credit :- Timely access to credit can enable MSMEs to start and expand their businesses. The loan processing time must be shortened.
- CLUSTER DEVELOPMENT of MSMEs can ensure that MSMEs learn from each other when located together in a cluster. Schemes like SFORTI that promotes cluster-based development of MSMEs, must be strengthened.
- TECHNOLOGY SUPPORT :- must be provided to MSMEs through incubators and accelerators.
Eg:- T-Hub model of Hyderabad must be replicated in other states.

- MARKETING SUPPORT should be provided to MSMEs so that they can add value and brand their products as per market needs.
- QUALITY TESTING :- The products of MSMEs must be rigorously tested for their quality in dedicated labs so that they meet all safety standards.
- EXPORT PROMOTION :- MSMEs must be linked to Export Promotion Councils like APEDA, EPC so that they can search appropriate market for their product.
- CREDIT GUARANTEE can be provided by government ~~to~~ ^{to} MSMEs so that banks are not reluctant to lend to MSMEs.

- **TRAINING, SKILLING** about entrepreneurship needs to be provided to MSMEs.
- **TAX CONCESSIONS** can be provided to select MSMEs.
- **DELAY IN PAYMENTS** to MSMEs should be reduced. TReDS platforms must be utilized for this.

Thus, MSMEs must be provided all technical and financial support so that they generate employment and help India to achieve the target of \$5 trillion economy by 2025.

Q.8

(a) Derive and discuss monetary and fiscal multiplier in Neo Keynesian Model. 15

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Q.8

(b) Explain the impact of tax in case of monopoly.

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Q.8

- (c) "BOP crisis is actually a result of macro economic Instability and poor economic policies". Discuss the statement in the light of recent international experience. 20

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SPACE FOR ROUGH WORK

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