IAS General Studies (M) - Indian Economy

SHORT NOTES - I

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1. Gini Coefficient: An inequality indicator. The Gini coefficient measures the inequality of income distribution within a country. It varies from zero, which indicates perfect equality, with every household earning exactly the same, to one, which implies absolute inequality, with a single household earning a country's entire income. Latin America is the world's most unequal region, with a Gini coefficient of around 0.5; in rich countries the figure is closer to 0.3.

2. Purchasing Power Parity (PPP): A method for calculating the correct value of a currency, which may differ from its current market value. It is helpful when comparing living standards in different countries, as it indicates the appropriate exchange rate to use when expressing incomes and prices in different countries in a common currency. By correct value, economists mean the exchange rate that would bring demand and supply of a currency into equilibrium over the long-term. The current market rate is only a short-run equilibrium. Purchasing power parity (PPP) says that goods and services should cost the same in all countries when measured in a common currency.

3. Game theory : Game theory is a technique for analysing how people, firms and governments should behave in strategic situations (in which they must interact with each other), and in deciding what to do must take into account what others are likely to do and how others might respond to what they do. For instance, competition between two firms can be analysed as a game in which firms play to achieve a long-term competitive advantage (perhaps even a monopoly). The theory helps each firm to develop its optimal strategy for, say, pricing its products and deciding how much to produce; it can help the firm to anticipate in advance what its competitor will do and shows how best to respond if the competitor does something unexpected.

4. Nash Equilibrium : An important concept in game theory, a Nash equilibrium occurs when each player is pursuing their best possible strategy in the full knowledge of the strategies of all other players. Once a Nash equilibrium is reached, nobody has any incentive to change their strategy. It is named after John Nash, a mathematician and Nobel prize-winning economist.

5. Negative income tax : A way of building redistribution into the taxation system by taking money from people with high incomes and paying it to people with low incomes. Because it takes place automatically through the tax system, it may attach less stigma to the receipt of financial help than some other forms of welfare assistance. However, it may also discourage recipients from working to increase their income , which is why some countries have introduced a form of negative income tax that is available only to the working poor. In the United States, this is known as the earned income tax credit.

6. Welfare Economics: Welfare economics is a branch of economics that uses microeconomic techniques to simultaneously determine the allocational efficiency within an economy and the income distribution associated with it. It attempts to achieve social welfare by examining the economic activities of the individuals that comprise society.Welfare economics is concerned with the welfare of individuals, as opposed to groups, communities, or societies because it assumes that the individual is the basic unit of measurement. It also assumes that individuals are the best judges of their own welfare, that people prefer greater welfare to less welfare, and that welfare can be adequately measured either in monetary terms or as a relative preference.

7. Human Development Index (**HDI**) : The Human Development Index (HDI) is a comparative measure of life expectancy, literacy, education, and standard of living for countries worldwide. It is a standard means of measuring well-being, especially child welfare. It is used to determine and indicate whether a country is a developed, developing, or underdeveloped country and also to measure the impact of economic policies on quality of life.

8. International Finance Corporation (IFC): IFC is a member of the World Bank Group and is headquartered in Washington, DC. IFC promotes sustainable private sector investment in developing countries as a way to reduce poverty and improve people's lives.Established in 1956, IFC is the largest multilateral source of loan and equity financing for private sector projects in the developing world. It promotes sustainable private sector development primarily by:

1. Financing private sector projects located in the developing world.
2. Helping private companies in the developing world mobilize financing in international financial markets.
3. Providing advice and technical assistance to businesses and governments.

9. Hot money: Money that is held in one currency but is liable to switch to another currency at a moment's notice in search of the highest available returns, thereby causing the first currency's exchange rate to plummet. It is often used to describe the money invested in currency markets by speculators.

10. Alternative minimum tax: An IRS mechanism created to ensure that high-income individuals, corporations, trusts, and estates pay at least some minimum amount of tax, regardless of deductions, credits or exemptions. It operates by adding certain tax-preference items back into adjusted gross income. While it was once only important for a small number of high-income individuals who made extensive use of tax shelters and deductions, more and more people are being affected by it. The AMT is triggered when there are large numbers of personal exemptions on state and local taxes paid, large numbers of miscellaneous itemized deductions or medical expenses, or by Incentive Stock Option (ISO) plans.

11. Bretton Woods: An international monetary system operating from 1946-1973. The value of the dollar was fixed in terms of gold, and every other country held its currency at a fixed exchange rate against the dollar; when trade deficits occurred, the central bank of the deficit country financed the deficit with its reserves of international currencies. The Bretton Woods system collapsed in 1971 when the US abandoned the gold standard.

12. Call money: Price paid by an investor for a call option. There is no fixed rate for call money. It depends on the type of stock, its performance prior to the purchase of the call option, and the period of the contract. It is an interest bearing band deposits that can be withdrawn on 24 hours notice.

13. Classical economics: The economics of Adam Smith, David Ricardo, Thomas Malthus, and later followers such as John Stuart Mill. The theory concentrated on the functioning of a market economy, spelling out a rudimentary explanation of consumer and producer behaviour in particular markets and postulating that in the long term the economy would tend to operate at full employment because increases in supply would create corresponding increases in demand.
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14. Countervailing duties: duties (tariffs) that are imposed by a country to counteract subsidies provided to a foreign producer Current account: Part of a nation's balance of payments which includes the value of all goods and services imported and exported, as well as the payment and receipt of dividends and interest. A nation has a current account surplus if exports exceed imports plus net transfers to foreigners. The sum of the current and capital accounts is the overall balance of payments.

15. Currency appreciation: An increase in the value of one currency relative to another currency. Appreciation occurs when, because of a change in exchange rates; a unit of one currency buys more units of another currency. Opposite is the case with currency depreciation.

16. **Double taxation:** Corporate earnings taxed at both the corporate level and again as a stockholder dividend Economic growth: Quantitative measure of the change in size/volume of economic activity, usually calculated in terms of gross national product (GNP) or gross domestic product (GDP).

17. Fiscal deficit is the gap between the government's total spending and the sum of its revenue receipts and non-debt capital receipts. It represents the total amount of borrowed funds required by the government to completely meet its expenditure

18. Gross national product (GNP) is the value of all final goods and services produced within a nation in a given year, plus income earned by its citizens abroad, minus income earned by foreigners from domestic production. The Fact book, following current practice, uses GDP rather than GNP to measure national production. However, the user must realize that in certain countries net remittances from citizens working abroad may be important to national well being. GNP equals GDP plus net property income from abroad. Globalisation: The process whereby trade is now being conducted on ever widening geographical boundaries. Countries now trade across continents and companies also trade all over the world.

19. Imperfect market A market where the theoretical assumptions of perfect competition are violated by the existence of, for example, a small number of buyers and sellers, barriers to entry, nonhomogeneity of products, and incomplete information. The three imperfect markets commonly analyzed in economic theory are monopoly, oligopoly, and monopolistic competition.

20. Money supply: The total stock of money in the economy; currency held by the public plus money in accounts in banks. It consists primarily currency in circulation and deposits in savings and checking accounts. Too much money in relation to the output of goods tends to push interest rates down and push inflation up; too little money tends to push rates up and prices down, causing unemployment and idle plant capacity. The central bank manages the money supply by raising and lowering the reserves banks are required to hold and the discount rate at which they can borrow money from the central bank. The central bank also trades government securities (called repurchase agreements) to take money out of the system or put it in. There are various measures of money supply, including M1, M2, M3 and L; these are referred to as monetary aggregates.

21. Capital flight: When capital flows rapidly out of a country, usually because something happens which causes investors suddenly to lose confidence in its economy. (Strictly speaking, the problem is not so much the money leaving, but rather that investors in general suddenly lower their valuation of all the assets of the country.) This is particularly worrying when the flight capital belongs to the country's own citizens. This is often associated with a sharp fall in the exchange rate of the abandoned country's currency.

22. Soft loan: A loan provided at below the market INTEREST RATE. Soft loans are used by international agencies to encourage economic activity in DEVELOPING COUNTRIES and to support non-commercial activities.

23. Import substitution A deliberate effort to replace major consumer imports by promoting the emergence and expansion of domestic industries such as textiles, shoes, and household appliances. Import substitution requires the imposition of protective tariffs and quotas to get the new industry started.

24. Income inequality The existence of disproportionate distribution of total national income among households whereby the share going to rich persons in a country is far greater than that going to poorer persons (a situation common to most LDCs). This is largely due to differences in the amount of income derived from ownership of property and to a lesser extent the result of differences in earned income. Inequality of personal incomes can be reduced by progressive income taxes and wealth taxes.

25. Monetary policy: The regulation of the money supply and interest rates by a central bank in order to control inflation and stabilize currency. If the economy is heating up, the central bank (such as RBI in India) can withdraw money from the banking system, raise the reserve requirement or raise the discount rate to make it cool down. If growth is slowing, it can reverse the process - increase the money supply, lower the reserve requirement and decrease the discount rate. The monetary policy influences interest rates and money supply.

26. Repo rate: This is one of the credit management tools used by the Reserve Bank to regulate liquidity in South Africa (customer spending). The bank borrows money from the Reserve Bank to cover its shortfall. The Reserve Bank only makes a certain amount of money available and this determines the repo rate. If the bank requires more money than what is available, this will increase the repo rate - and vice versa.

27. Revenue expenditure: This is expenditure on recurring items, including the running of services and financing capital spending that is paid for by borrowing. This is meant for normal running of governments' maintenance expenditures, interest payments, subsidies and transfers etc. It is current expenditure which does not result in the creation of assets. Grants given to State governments or other parties are also treated as revenue expenditure even if some of the grants may be meant for creating assets. Subsidy : Financial assistance (often from the government) to a specific group of producers or consumers.

28. Revenue receipts: Additions to assets that do not incur an obligation that must be met at some future date and do not represent exchanges of property for money. Assets must be available for expenditures. These include proceeds of taxes and duties levied by the government, interest and dividend on investments made by the government, fees and other receipts for services rendered by the government.

29. Subsidy: A payment by the government to producers or distributors in an industry to prevent the decline of that industry (e.g., as a result of continuous unprofitable operations) or an increase in the prices of its products or simply to encourage it to hire more labor (as in the case of a wage subsidy). Examples are export subsidies to encourage the sale of exports; subsidies on some foodstuffs to keep down the cost of living, especially in urban areas; and farm subsidies to encourage expansion of farm production and achieve self-reliance in food production.

30. Devaluation: Devaluation is a reduction in the value of a currency with respect to other monetary units. In common modern usage, it specifically implies an official lowering of the value of a country's currency within a fixed exchange rate system, by which the monetary authority formally sets a new fixed rate with respect to a foreign reference currency. In contrast, (currency) depreciation is most often used for the unofficial decrease in the exchange rate in a floating exchange rate system. The opposite of devaluation is called revaluation.

31. Countervailing duties: duties (tariffs) that are imposed by a country to counteract subsidies provided to a foreign producer Current account: Part of a nation's balance of payments which includes the value of all goods and services imported and exported, as well as the payment and receipt of dividends and interest. A nation has a current account surplus if exports exceed imports plus net transfers to foreigners. The sum of the current and capital accounts is the overall balance of payments.

32. Phillips curve: In 1958, an economist from New Zealand, A.W.H. Phillips , proposed that there was a trade-off between inflation and unemployment. The lower the unemployment rate, the higher was the rate of inflation. Governments simply had to choose the right balance between the two evils. He drew this conclusion by studying nominal wage rates and jobless rates in the UK between 1861 and 1957, which seemed to show the relationship of unemployment and inflation as a smooth curve.

33. Stagflation: Term coined in the 1970s for the twin economic problems of stagnation and rising inflation. Until then, these two economic blights had not appeared simultaneously. Indeed, policymakers believed the message of the Phillips curve: that unemployment and inflation were alternatives.

34. Money illusion: When people are misled by inflation into thinking that they are getting richer, when in fact the value of money is declining. Whether, and how much, people are fooled by inflation is much debated by economists. Money illusion, a phrase coined by KEYNES, is used by some economists to argue that a small amount of inflation may not be a bad thing and could even be beneficial, helping to “grease the wheels” of the economy. Because of money illusion, workers like to see their nominal wages rise, giving them the illusion that their circumstances are improving, even though in real (inflation-adjusted) terms they may be no better off. During periods of high inflation double-digit pay rises (as well as, say, big increases in the value of their homes) can make people feel richer even if they are not really better off. When inflation is low, growth in real incomes may hardly register.

35. Dumping : Selling something for less than the cost of producing it. This may be used by a dominant firm to attack rivals, a strategy known to antitrust authorities as predatory pricing participants in international trade are often accused of dumping by domestic firms charging more than rival imports. Countries can slap duties on cheap imports that they judge are being dumped in their markets. Often this amounts to thinly disguised protectionism against more efficient foreign firms.

In practice, genuine predatory pricing is rare – certainly much rarer than anti-dumping actions – because it relies on the unlikely ability of a single producer to dominate a world market. In any case, consumers gain from lower prices; so do companies that can buy their supplies more cheaply abroad.

36. Transfer Pricing: The Prices assumed, for the purposes of calculating tax liability, to have been charged by one unit of a multinational company when selling to another (foreign) unit of the same firm. FIRMS spend a fortune on advisers to help them set their transfer prices so that they minimise their total tax bill. For instance, by charging low transfer prices from a unit based in a high-tax country that is selling to a unit in a low-tax country, a firm can record a low profit in the first country and a high profit in the second. In theory, however, transfer prices are supposed to be set according to the arm’s-length principle: that they should be the same as would be charged if the sale was to a business unconnected in any way to the selling firm. But when there is no genuinely independent market with which to compare transfer prices, what an arm’s length price would be can be a matter of great debate and an opportunity for firms that want to lower their tax bill.

37. Laissez faire: It is an economic system where there is no government intervention and economic activities are organized by the private sector through markets. Classical economist is proponents of laissez faire.

38. International Development Association (IDA): The International Development Association (IDA) created on September 24, 1960, is the part of the World Bank that helps the world’s poorest countries. It complements the World Bank's other lending arm—the International Bank for Reconstruction and Development (IBRD)—which serves middle-income countries with capital investment and advisory services.

The International Development Association (IDA) is responsible for providing long-term interest-free loans to the world's 81 poorest countries, 40 of which are in Africa. IDA provides grants and credits, with repayment periods of 35 to 40 years and no interest. Since its inception, IDA credits and grants have totaled $161 billion, averaging $7–$9 billion a year in recent years and directing the largest share, about 50 percent, to Africa. IDA is part of the World Bank Group based in Washington, D.C.

39. Amartya Sen: Amartya Kumar Sen, is an Indian economist, philosopher, and a winner of the Bank of Sweden Prize in Economic Sciences (Nobel Prize for Economics) in 1998, for his work on famine, human development theory, welfare economics, the underlying mechanisms of poverty, and political liberalism. Among his many contributions to development economics, Sen has produced work on gender inequality. He is currently the Lamont University Professor at Harvard University.

40. Milton Friedman: Milton Friedman was an American Nobel Laureate economist and public intellectual. An advocate of laissez-faire capitalism, Friedman made major contributions to the fields of macroeconomics, microeconomics, economic history and statistics. In 1976, he was awarded the Nobel Prize in Economics for his achievements in the fields of consumption analysis, monetary history and theory and for his demonstration of the complexity of stabilization policy.

Practice ~ SHORT NOTES

- Human development theory
- The Argumentative Indian
- Laffer curve
- Progressive Tax
- Patent
- Future Trading
- Agriculture export zone
- Pump Pricing
- Green GDP
- Open Market Operations
- CRISIL
- Hyperinflation
- Lawrence curve
- NREGA
- PURA
- Edmund Phelps
- Disinflation
- Demat Account
- UNCTAD
- Tobin Tax
- Deficit Financing
- Fiscal Drag
- Millennium Development goals
- J Curve
- Zero based budgeting
- Fringe benefits
- Automatic route of FDI
- Most Favored nation
- TIFAC
- National Investment commission

Ajay Kr. Singh Niranjan, B.Tech. IIT Roorkee
Co-Founder & Consultant ~ 09968029039
Google Talk : ajay.niranjan Email : ajay_uor@yahoo.com Yahoo talk : ajay_uor