MAYANG ANCHALIK COLLEGE

Economics Honours

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Q.1:- what is Balance of payments? what are the different accounts of a balance of payments?

Ans:- The balance of payments of a country is a systematic record of all its economic transaction with the outside world in a given year. It is a statistical record of the character and dimensions of the country's economics relationship with the rest of the world. According to Bo. Sodersted, "The balance of payments is merely a way of listing recipts and payments in international transactions for a country", "Its shows the country's tranding position, changes in its net position as official reseme holding."

The Balance of payments account of a country is constructed on the principle of double-entry book-keeping. Each transaction is entered on the credit and debit side of the balance steet. But balance of payments accounting differs from business accounting in one respect.

In business accounting debits (-) are shown on the left side and credits (+) on the right side of the balance of payment sheet. But in balance of payments accounting the practice is to show credits on the left side and debits on the right side of the balance of payment sheet.

The different ~~b~~ accounts of a balance of payment are as follows —

(i) The current account :- The current account of the balance of payments includes a country's key activity, such as capital markets and services. The current account balance ~~of~~ should theoretically be zero, which is impossible, so in reality, it will ~~tell~~ tell whether a country is in a surplus or deficit.

(ii) The capital account :- The ~~p~~ capital account of a country consists of its transactions in financial assets in the form of short-term and long-term lending and borrowings, and private and official investments. In other words, the capital

account shows international flow of loans and investments, and represents a change in the countries' foreign assets and liabilities. Long-term capital transactions relate to international capital movements with maturity of one year or more and include direct investments like building of a foreign plant, portfolio investment like the purchase of foreign bonds stocks, and international loans. On the other hand, short-term international capital transactions are for a period ranging between ~~three~~ three months and less than one year.

(iii) The official settlements account: The official settlements account or official ~~asset~~ reserve assets account is, in fact, a part of the capital account. But in the UK and USA balance of payments account measures the change in nations liquid and non-liquid liabilities ~~to~~ to foreign official holders and the change in assets ~~of~~ a ~~country~~ nation's official reserve assets during the year.' The official reserve

assets of a country include its gold stock, holding of its ~~net~~ convertible foreign currencies and SDRs, and its net position in the IMF.

Table: Balance of payment account

Credits (+) (Reciepts)	Debits (-) (Payments)
1. Current account	
Exports	Imports
(a) Goods	(a) Goods
(b) services	(b) Services
(c) Transfer payment	(c) Transfer Payments
2. capital account	
(a) Borrowings from foreign countries	(a) Lending to foreign countries.
(b) Direct Investments by foreign countries	(b) Direct investments in foreign countries
3. official settlement account	
(a) Increate in foreign. official holdings	(a) Increate in official reserves of gold and foreign currentes.
Errors and Omissions	

Q.2. Explain the Fisher's cash transaction Approch to the quantity theory of money.

Ans:- The quantity theory of money states that the quantity of money is the main determination of the price level or the value of money. Any change in the quantity of money produces an exactly proportionate change in the price level. In the words of Irving Fisher, "other things remaining unchanged, as the quantity of money in circulation increases, the price level also increases in direct proportion and the value of money decreases. ~~the price level~~ and vice-versa." If the quantity of money is doubled, the price level will also double and the value of money will be one half. On the other hand, if the quantity of money is reduced by one half, the price level with also be reduced by one half and the value of money ~~with~~ will be twice.

Fisher has explained his theory in

terms of this equation of exchange:

$$PT = MV + M'V'$$

where P = price level, or $1/P$ = the value of money;

M = the total quantity of legal tender money;

V = the velocity of circulation of M

M' = the total quantity of credit money;

V' = the velocity of ~~credit money~~ circulation of M';

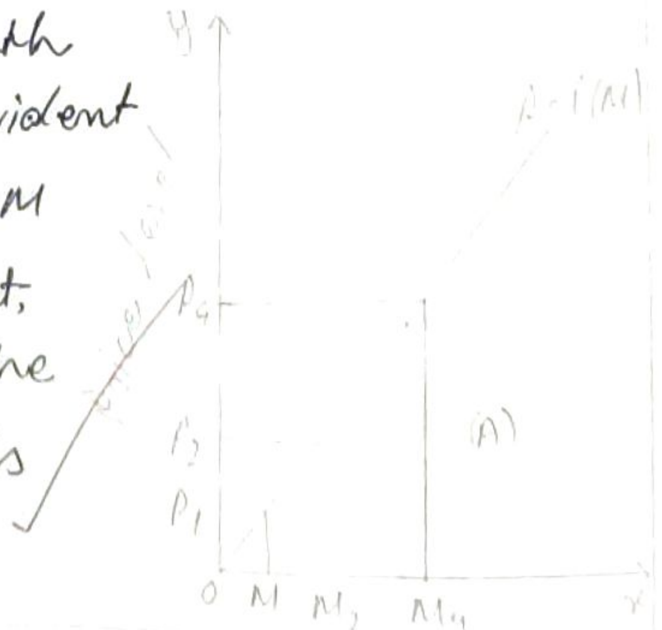
T = the total amount of goods and services exchanged for money or transactions performed by money.

This equation equates the demand for money (PT) to supply of money (MV=MV) The total volume of transactions multiplied by the price level (PT) represent the demand for money. According to Fisher, PT is ΣPQ. In other words, price level (P) money. This equals the total supply of money in the community consisting of the

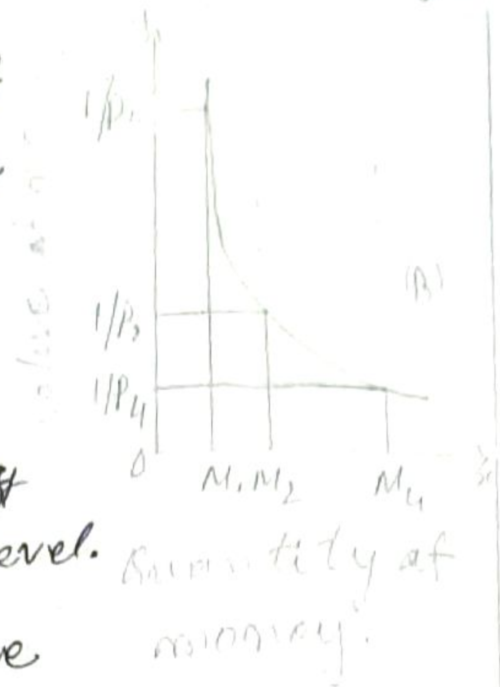
quantity of actual money M and its velocity of circulation v plus the total quantity of credit of actual money M' and its velocity of circulation V'. Thus the total value of purchases (PT) in a year is measured by MV+M'V'. Thus the equation of exchange is PT= MV+M'V'. In order to find out the effect of the quation of exchange price level or the valeee of money. we write the equations as -

$$P = \frac{MV+M'V'}{T}$$

Fisher points out the price level (P) varies directly as the ~~quat~~ quantity of money (M+M') provided the value of trade (T) and velocity of circulation (V, V') remain unchanged. The truth of this proposition is evident from the fact that if M and T remain constant, P is also doubled, but the value of money (1/P) is reduced to half.



Fisher's quantity theory of money is explained with the help of figure A and B. Panel A of the figure shows the effect of changes in the quantity of money on the price level. To begin with, when the quantity of money is M. the price level is P.



when the quantity of money is doubled to M_2. the price level is the doubled to P_2. Further, when four-fold to M_4. the price level also increases by four times to P_4. This relationship is expressed by the curve $P = f(M)$ from the origin at 45°.

In panel B of the figure, the inverse relation between the quantity of money and the value of money is depicted where the value of money is taken on the vertical axis. when the quantity of money is M_1, the value of money is $1/P$. But with the doubling of the quantity of money to M_2. the value of money becomes one-half of

what it was before, $1/P_2$. And with the quantity of money increasing by four-fold to M_4, the value of money is reduced by $1/P_4$. This inverse relationships between the quantity of money and the value of money is shown by downward sloping curve $1/P = f(M)$.

Q.3. What is inflation? What are the causes of demand-Pull inflation?

Ans:- Inflation is fundamentally a monetary phenomenon. In the words of Friedman, "Inflation is always and everywhere a monetary phenomenon; .. and can be produced. ~~economists do~~ only by a more rapid increase in the quantity of money that output. But economists do not agree that money supply alone is the cause of inflation. As pointed out by Hicks. "Our present troubles are not of a monetary character." Economists therefore, define inflation in terms of a ~~monetary character~~ continuous rise in prices. Johnson define inflation as

"a continuing increase in the general price level".

The causes of demand-pull inflation are —

① Increase in money supply: — Inflation is caused by an increase in the supply of money which leads to increase in aggregate demand. The higher the growth rate of the nominal money supply, the higher is the rate of inflation. Modern quantity theorists do not believe that true inflation starts after the full employment level. This view is realistic because all advanced countries are faced with high levels of unemployment and high rates of inflation.

② Increase in Disposable Income: — when the disposable income of the people increases, it raises their demand for goods and services. Disposable income may increase with the rise in

national income or de reduction in taxes or reduction in the saving of the people.

3. Increase in Public Expenditure:- Government activities have been expanding much with the result that government expenditure has also been increasing at a phenomenon rate. thereby raising aggregate demand for goods and services. Governments of both developed and developing countries are providing more facilities under public enterprises with the result that they help in increasing aggregate demand.

4. Increase in consumer spending:- The demand for goods and services increases when consumer expenditure increases. consumer may spend more due to conspicuous consumption or demonstration effect. They may also spend more when they are given credit facilities to buy goods on hire-purchase and instalment basis.

5. Cheap Monetary Policy:- cheap monet-

ary policy or the policy of credit expansion also leads to increase in the money supply which raises the demand for goods and services in the economy. when credit expands, it raises the money income of the borrowers which in turn, raises aggregate demand relative to supply, thereby leading to inflation. this is also known as credit-induced inflation.

6. Repayment of Public dept :- whenever the government repays its past internal debt to the public, it leads to increase in the money supply with the public. this tends to raise the aggregate demand for ~~domestically~~ goods and services.