

(GI-1, GI-2, GI-3, GI-4, GI-5, GI-6, GI-7, VI-1, VDI-1, Drive, FMT)

DATE: 15.10.2023

MAXIMUM MARKS : 100

TIMING: 3¼ Hours

FM + ECO**SECTION - A****Q. No. 1 is compulsory.****Candidates are also required to answer any four questions from the remaining five questions.****In case, any candidate answers extra question(s)/sub-question(s) over and above the required number, then only the requisite number of questions top answered in the answer book shall be valued and subsequent extra question(s) answered shall be ignored.****Working Notes should form part of the respective answer.****Answer 1:****(a)**

Liabilities	Rs.	Assets	Rs.
Capital	5,00,000	Fixed Assets	10,00,000
Reserve	3,00,000	Current Assets:	Rs.
Debts	5,00,000	Stock	2,00,000
Current Liabilities	4,00,000	Debtors	2,50,000
		Cash	2,50,000
	17,00,000		7,00,000
			17,00,000

{2 M}**Working Note: (a) Calculation of cost of goods sold:**

Sales	15,00,000
Less: Gross Profit (20%)	3,00,000
Cost of goods sold	12,00,000

{1/2 M}

- (b) Closing Stock = $\frac{\text{Cost of Goods Sold}}{\text{Stock Turnover Ratio}} = \frac{\text{Rs.12,00,000}}{6} = \text{Rs.2,00,000}$ **{1/2 M}**
- (c) Debtors = $\frac{\text{Debt Collection Period} \times \text{Sales}}{12}$
= $\frac{2 \times \text{Rs.15,00,000}}{12} = \text{Rs.2,50,000}$ **{1/2 M}**
- (d) Fixed Assets = $\frac{\text{Cost of Goods Sold}}{\text{Fixed Assets Turnover}} = \frac{\text{Rs.12,00,000}}{1.2} = \text{Rs.10,00,000}$ **{1/2 M}**
- (e) Current Assets (CA) = 1.75 Current Liabilities (CL)
Liquid Assets (LA) = 1.25 Current Liabilities (CL)
LA + Stock-LA = CA - LA = 0.50 CL
Rs. 2,00,000 = 0.50 CL
Current Liabilities = Rs. 4,00,000 **{1/2 M}**
Current Assets = 1.75 x CL
= 1.75 X Rs. 4,00,000 = Rs. 7,00,000 **{1/2 M}**
Cash = Current Assets - Debtors - Stock
= Rs. 7,00,000 - Rs. 2,50,000 - Rs. 2,00,000
= Rs. 2,50,000 **{1/2 M}**
- (f) Net Worth = $\frac{\text{Fixed Assets}}{1.25} = \frac{\text{Rs.10,00,000}}{1.25} = \text{Rs.8,00,000}$ **{1/2 M}**

- (g) Capital = 1.0 = Rs. 5,00,000 }
 Reserve = 0.6 = Rs. 3,00,000 } {1/2 M}
 Net Worth = 1.6 = Rs. 8,00,000 }
 (h) Debt = Equity Shareholders Funds x Capital Gearing Ratio }
 = Rs. 8,00,000 x 0.625 = Rs. 5,00,000 } {1/2 M}

Answer:

(b) Price Earning Ratio = $\frac{\text{Market Price}}{\text{EPS}}$

$$8 = \frac{\text{Market Price}}{5}$$

∴ Market Price = 8 x 5 = Rs. 40

$$\text{EPS} = \frac{\text{Earnings}}{\text{Number of Outstanding Shares}} = \frac{10,00,000}{2,00,000} = \text{Rs.5}$$

$$\text{DPS} = \frac{\text{Dividend Paid}}{\text{No. of Shares}} = \frac{6,00,000}{2,00,000} = \text{Rs.3}$$

$$\text{Dividend Payout Ratio} = \frac{\text{DPS}}{\text{EPS}} \times 100 = \frac{3}{5} \times 100 = 60\%$$

K_e is defined as reciprocal of P/E ratio

Therefore $K_e = \frac{1}{8} = .125$ or 12.5% } {1 M}

In this firm, the rate of return on investment is 15% and cost of capital is 12.5% }
 hence it is a developing firm and in such a case the Retention Ratio should be } {2 M}
 highest (i.e., 100%) to maximise the value of shares of the firm. In other words,
 dividend payout ratio should be 0%.

The value of share shall be as below if 100% Retention Ratio is maintained.

$$P = \frac{D}{K_e} + \frac{(r/K_e)(E-D)}{K_e} = \frac{0}{.125} + \frac{(.15/.125)(5-0)}{.125} \quad \left. \vphantom{\frac{D}{K_e}} \right\} \text{{1 M}}$$

$$= [0] + [6 \div .125] = \text{Rs. 48}$$

Comments: The present value of share is Rs. 40. However if dividend payout ratio is maintained at 0% the value shall be increased to Rs. 48. Therefore the present dividend policy (i.e. 60%) is not good. The company should change its dividend policy to 0%. } {2 M}

Answer:

- (c) (i) Statement of Weighted Average Cost of Capital

Project cost	Financing	Proportion of capital Structure	After tax cost (1 - Tax 50%)	Weighted average cost (%)	
Upto Rs. 2 Lakhs	Debt	0.4	10 (1 - 0.5) = 5%	0.4 x 5 = 2.0	(1 M Each)
	Equity	0.6	12%	0.6 x 12 = 7.2	
				9.2%	{4 M}
Above Rs. 2 lakhs & upto Rs. 5 Lakhs	Debt	0.4	11% (1 - 5) = 5.5%	0.4 x 5.5 = 2.2	
	Equity	0.6	13%	0.6 x 13 = 7.8	

				10.0%
Above Rs. 5 lakhs & upto Rs. 10 Lakhs	Debt	0.4	12% (1 - 0.5) = 6%	0.4 x 6 = 2.4
	Equity	0.6	14%	0.6 x 14 = 8.4
				10.8%
Above Rs. 10 lakhs & upto Rs. 20 Lakhs	Debt	0.4	13% (1 - 0.5) = 6.5%	0.4 x 6.5 = 2.6
	Equity	0.6	14.5%	0.6 x 14.5 = 8.7
				11.3%

Project	Fund requirement	Cost of capital
X	Rs. 6.5 lakhs	10.8% (from the above table)
Y	Rs. 14 lakhs	11.3% (from the above table)

- (ii) If a Project is expected to give after tax return of 10%, it would be acceptable provided its project cost does not exceed Rs. 5lakhs or, after tax return should be more than or at least equal to the weighted average cost of capital. }{1 M}

Answer 2:

(A)	Current Assets:	Rs.
(1)	Stock of Raw Material (16 x Rs. 180 x 30) or 8,64,000 x 30/300	86,400
(2)	Stock of Packing Material (16 X Rs. 60 X 15) or 2,88,000 x 15/300	14,400
(3)	Work-in-Progress	
	Raw Material (16 X Rs. 180 x 7)	20,160
	Direct Labour (16 x Rs. 90 x 7 x 1/2)	5,040
	Direct Expenses (16 x Rs. 30 x 7 x 1/2)	1,680
	Fixed Overheads (16 x Rs. 90 x 7 x 1/2)	5,040
	Or (8,64,000 + 4,32,000 x 50% + 1,44,000 x 50% + 4,32,000 x 50%) x 7/300	31,920
(4)	Stock of Finished (200 x Rs. 450) or 21,60,000 x 200/4800	90,000
(5)	Debtors (16 x Rs. 450 x 30) x 80 ÷ 100 or 21,60,000 x 80% x 30/300	1,72,800
	Total Current Assets (A)	3,95,520
(B)	Current Liabilities:	
(1)	Creditors for Raw Material (16 x Rs. 180 x 21) or 8,64,000 x 21/300	60,480
(2)	Creditors for Packing Material (16 x Rs. 60 x 21) or 2,88,000 x 21/300	20,160
(3)	Lag in Payment of Direct Expenses (16 x Rs. 30 x 15) or 1,44,000 x 15/300	7,200
(4)	Lag in Payment of Overheads (16 x Rs. x 90 x 15) or 4,32,000 x 15/300	21,600
	Total Current Liabilities (B)	1,09,440
(C)	Net Working Capital (A - B)	2,86,080
Add:	Contingency reserve required at 12% of act working capital	34,330
	Total Working Capital Required	3,20,410

Working Notes:

(1) Production per day = $\frac{400 \times 12}{300} = 16$ units

(2)	Selling Price and Cost per unit:	Rs.
	Raw Material (30% of Selling Price Rs. 600)	180
	Packing Material (10% of Selling Price Rs. 600)	60
	Direct Labour (15% of Selling Price Rs. 600)	90
	Direct Expenses (5% of Selling Price Rs. 600)	30
	Fixed Overheads [Rs. 4,32,000 + (400 x 12)]	90
	Total Cost	450
	Profit	150
	Selling Price	600

- (3) Work-in-Progress has been valued at 100% of Raw material and 50% of Labour and Overhead.

(4) Debtors has been valued at cost.

(5) **Cost Sheet**

Raw Material 400 x 12 x 180	8,64,000
Add: Direct Labour 400 x 12 x 90	4,32,000
Add: Direct Expenses 400 x 12 x 30	1,44,000
Prime Cost	14,40,000
Add: Factory Overhead	4,32,000
Cost of Production	18,72,000
Add: Packing Material 400 x 12 x 60	2,88,000
Cost of Good Sold/Total Cost	21,60,000

Answer 3:

Statement showing the details of Present Values of Cash Inflows

Year	Net Income Before Depn. and Tax	Depreciation	Net Income after Depn. before tax	Tax	Net Income after Depn. and Tax	Cash Inflow	PV Factor 10%	Present Value of Cash Inflow
	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.	Rs.
1.	10,000	10,000	-	-	-	10,000	0.909	9,090
2.	11,000	10,000	1,000	500	500	10,500	0.826	8,673
3.	14,000	10,000	4,000	2,000	2,000	12,000	0.751	9,012
4.	15,000	10,000	5,000	2,500	2,500	12,500	0.683	8,538
5.	25,000	10,000	15,000	7,500	7,500	17,500	0.621	10,868
Total Present Value of Cash Inflow								46,181

{2 M}

$$\text{Depreciation} = \frac{\text{Cost of the Machine}}{5} = \frac{50,000}{5} = 10,000$$

Cash Inflow = Net Profit after tax but before depreciation or Net profit after Tax + Depreciation

(1) Pay-back Period:

Recovery of the Original Investment

= 1st year + 2nd year + 3rd year + 4th year

= 10,000 + 10,500 + 12,000 + 12,500 = 45,000 + 5,000/17,500 = 4.29 years }{2 M}

(2) Average Rate of Return

$$= \frac{\text{Average Annual Income(after depn. \& Tax)}}{\text{Average Investment}}$$

$$\text{Average Annual Income} = \frac{0 + 500 + 2,000 + 2,500 + 7,500}{5} = \frac{12,500}{5} = 2,500$$

$$\text{Average Investment} = \frac{\text{Original Investment}}{2} = \frac{50,000}{2} = 25,000$$

$$\text{Substitute the values of ARR} = \frac{2,500}{25,000} \times 100 = 10\% \text{ } \{2 M\}$$

(3) NPV at 10%

Total Present Value of cash inflow

Rs.

46,181

Less: Original Investment

50,000

NPV

(-) 3,819 }{2 M}

(4) Profitability Index = $\frac{\text{PV of Cash Inflows}}{\text{Initial Cash Outlay}} = \frac{46,181}{50,000} = 0.92$ }{2 M}

Answer 4:

(a) We know that as per the realised yield approach, cost of equity is equal to the realised rate of return. Therefore, it is important to compute the internal rate of return by trial and error method. This realised rate of return is the discount rate which equates the present value of the dividends received in the past five years plus the present value of sale price of Rs. 1,128 to the purchase price of Rs. 1,000. The discount rate which equalises these two is 12 percent approximately. Let us look at the table given for a better understanding:

Year	Dividend (Rs.)	Sale Proceeds (Rs.)	Discount Factor @ 12%	Present Value (Rs.)
1	100	-	0.893	89.3
2	100	-	0.797	79.7
3	100	-	0.712	71.2
4	100	-	0.636	63.6
5	100	-	0.567	56.7
6	Beginning	1,128	0.567	639.576
				1,000.076

We find that the purchase price of Alpha Limited's share was Rs. 1,000 and the present value of the past five years of dividends plus the present value of the sale price at the discount rate of 12 per cent is Rs. 1,000.076. Therefore, the realised rate of return may be taken as 12 percent. This 12 percent is the cost of equity. }{2 M}

Answer:

(b)

Year 1			Year 2			Year 3		
Cash Flow (Rs.)	Probability	Expected Value (Rs.)	Cash Flow (Rs.)	Probability	Expected Value (Rs.)	Cash Flow (Rs.)	Probability	Expected Value (Rs.)
2,000	0.1	200	2,000	0.2	400	2,000	0.3	600
4,000	0.2	800	4,000	0.3	1,200	4,000	0.4	1,600
6,000	0.3	1,800	6,000	0.4	2,400	6,000	0.2	1,200
8,000	0.4	3,200	8,000	0.1	800	8,000	0.1	800
ENCF		6,000 }{1 M}			4,800 }{1 M}			4,200 }{1 M}

The present value of the expected value of cash flow at 10 per cent discount rate has been determined as follows:

$$\begin{aligned} \text{Present Value of cash flow} &= \frac{ENCF_1}{(1+k)^1} + \frac{ENCF_2}{(1+k)^2} + \frac{ENCF_3}{(1+k)^3} \\ &= \frac{6,000}{(1.1)^1} + \frac{4,800}{(1.1)^2} + \frac{4,200}{(1.1)^3} \end{aligned}$$

$$= (6,000 \times 0.909) + (4,800 \times 0.826) + (4,200 \times 0.751) = 12,573$$

$$\begin{aligned} \text{Expected Net Present value} &= \text{Present Value of cash flow} - \text{Initial Investment} \\ &= \text{Rs. } 12,573 - \text{Rs. } 10,000 = \text{Rs. } 2,573. \end{aligned}$$
 }{2 M}

Answer 5:

Income Statement

Particulars	Amount (Rs.)
Sales	75,00,000
Less: Variable cost (56% of 75,00,000)	42,00,000
Contribution	33,00,000

Less: Fixed costs	6,00,000
Earnings before interest and tax (EBIT)	27,00,000
Less: Interest on debt (@ 9% on Rs. 45 lakhs)	4,05,000
Earnings before tax (EBT)	22,95,000

$$(i) \quad ROI = \frac{EBIT}{\text{Capital employed}} \times 100 = \frac{EBIT}{\text{Equity} + \text{Debt}} \times 100$$

$$= \frac{\text{Rs. } 27,00,000}{\text{Rs. } (55,00,000 + 45,00,000)} \times 100 = 27\% \quad \text{\textbf{\{1 M\}}}$$

(ii) ROI = 27% and Interest on debt is 9%, hence, it has a favorable financial leverage. \textbf{\{1 M\}}

$$(iii) \quad \text{Capital Turnover} = \frac{\text{Net Sales}}{\text{Capital}}$$

$$\text{Or } = \frac{\text{Net Sales}}{\text{Capital}} = \frac{\text{Rs. } 75,00,000}{\text{Rs. } 1,00,00,000} = 0.75$$

Which is very low as compared to industry average of 3. \textbf{\{1 M\}}

(iv) Calculation of Operating, Financial and Combined leverages

$$(a) \quad \text{Operating Leverage} = \frac{\text{Contribution}}{\text{EBIT}} = \frac{\text{Rs. } 33,00,000}{\text{Rs. } 27,00,000} = 1.22(\text{approx}) \quad \text{\textbf{\{1 M\}}}$$

$$(b) \quad \text{Financial Leverage} = \frac{\text{EBIT}}{\text{EBT}} = \frac{\text{Rs. } 27,00,000}{\text{Rs. } 22,95,000} = 1.18(\text{approx}) \quad \text{\textbf{\{1 M\}}}$$

$$(c) \quad \text{Combined Leverage} = \frac{\text{Contribution}}{\text{EBT}} = \frac{\text{Rs. } 33,00,000}{\text{Rs. } 22,95,000} = 1.44(\text{approx}) \quad \text{\textbf{\{1 M\}}}$$

$$\text{Or } = \text{Operating Leverage} \times \text{Financial Leverage} = 1.22 \times 1.18 = 1.44 (\text{approx})$$

(v) Operation Leverage is 1.22 So if sales is increased by 10%. \textbf{\{1 M\}}
EBIT will be increased by 1.22×10 i.e. 12.20% (approx)

(vi) Since the combined Leverage is 1.44 sales have to drop by $100/1.44$ i.e. 89.44% to bring EBT to Zero

$$\begin{aligned} \text{Accordingly, New Sales} &= \text{Rs. } 75,00,000 \times (1 - 0.6944) \\ &= \text{Rs. } 75,00,000 \times 0.3058 \\ &= \text{Rs. } 22,92,000 (\text{approx}) \quad \text{\textbf{\{2 M\}}} \end{aligned}$$

Hence at Rs. 22,92,000 sales level EBT of the firm will be equal to Zero.

(vii) Financial leverage is 1.18 So, if EBIT increase by 20% then EBT will increase by \textbf{\{1 M\}}
 $1.18 \times 20 = 23.6\%$ (approx)

Answer 6:

(a) **Global Depository Receipts (GDRs):** These are negotiable certificate held in the bank of one country representing a specific number of shares of a stock traded on the exchange of another country. These financial instruments are used by companies to raise capital in either dollars or Euros. These are mainly traded in European countries and particularly in London. \textbf{\{2½ M\}}

Answer:

- (b) **Indian Depository Receipts (IDRs):** The concept of the depository receipt mechanism which is used to raise funds in foreign currency has been applied in the Indian Capital Market through the issue of Indian Depository Receipts (IDRs). IDRs are similar to ADRs/GDRs in the sense that foreign companies can issue IDRs to raise funds from the Indian Capital Market in the same lines as an Indian company uses ADRs/GDRs to raise foreign capital. The IDRs are listed and traded in India in the same way as other Indian securities are traded. } **2½ M**

Answer:

- (c) **Meaning of Venture Capital Financing :** The venture capital financing refers to financing of new high risky venture promoted by qualified entrepreneurs who lack experience and funds to give shape to their ideas. In broad sense, under venture capital financing venture capitalist make investment to purchase equity or debt securities from inexperienced entrepreneurs who undertake highly risky ventures with a potential of success. } **2½ M**

Answer:

- (d) **Plain Vanilla Bond:** } **2½ M**
- The issuer would pay the principal amount along with the interest rate.
 - This type of bond would not have any options.
 - This bond can be issued in the form of discounted bond or can be issued in the form of coupon bearing bond.

SECTION - B

Q. No. 7 is compulsory.

Answer any three from the rest.

In case, any candidate answers extra question(s)/sub-question(s) over and above the required number, then only the requisite number of questions top answered in the answer book shall be valued and subsequent extra question(s) answered shall be ignored.

Working Notes should form part of the respective answer.

Answer 7:**(a) By Expenditure method**

$$\begin{aligned} \text{GDP}_{\text{MP}} &= \text{Private final consumption expenditure} + \text{Government final consumption} \\ &\quad \text{expenditure} + \text{Gross domestic capital formation (Net domestic capital} \\ &\quad \text{formation} + \text{depreciation)} + \text{Net export} \\ &= 2000 + 1100 + (770 + 130) + 30 = 4030 \text{ Crores} \\ \text{NNP}_{\text{FC}} \text{ or NI} &= \text{GDP}_{\text{MP}} - \text{Depreciation} + \text{NFIA} - \text{NIT} \\ &= 4030 - 130 + 20 - 120 = 3800 \text{ Crores} \end{aligned} \quad \left. \begin{array}{l} \{1 \text{ M}\} \\ \{1 \text{ M}\} \end{array} \right\}$$

By Income method

$$\begin{aligned} \text{NNP}_{\text{FC}} \text{ or NI} &= \text{Compensation of Employees} + \text{Operating Surplus} + \text{Mixed} \\ &\quad \text{Income of Self-Employed} + \text{NFIA} \\ &= 1200 + 1820 + 700 + 20 = 3740 \text{ Crores} \end{aligned} \quad \{1 \text{ M}\}$$

Answer:

- (b)** Direct controls prohibit specific activities that explicitly create negative externalities or require that the negative externality be limited to a certain level, for instance limiting emissions. Government initiatives towards negative externalities may include
1. Direct controls that openly regulate the actions of those involved in generating negative externalities, and
 2. Market-based policies that would provide economic incentives so that the self-interest of the market participants would achieve the socially optimal solution.

Direct controls prohibit specific activities that explicitly create negative externalities or require that the negative externality be limited to a certain level, for instance limiting emissions. Production, advertising, use and sale of many commodities and services may be prohibited. Stringent rules may be established in respect of advertising, packaging and labelling etc. Governments may, through legislation, stipulate stringent standards such as environmental standards, emissions standards non adherence of which will invite monetary penalties or/and criminal liabilities. Another method is to create negative incentives through charging fees on activities creating negative externalities Governments may also form special bodies/ boards to specifically address the problem of negative externality. The market-based approaches (such as environmental taxes and cap-and-trade), operate through price mechanism to create an incentive for change.

Answer:

- (c)** An export duty tax is a tax collected on exported goods and may be either specific or ad valorem. The effect of an export tax is to raise the price of the good and to decrease exports. Since an export tax reduces exports and increases domestic supply, it also reduces domestic prices and leads to higher domestic consumption.

Answer:

- (d)** The GATT lost its relevance by 1980s because-

- (i) It was obsolete to the fast evolving contemporary complex world trade scenario characterized by emerging globalization.
- (ii) International investments had expanded substantially.
- (iii) Intellectual property rights and trade in services were not covered by GATT.
- (iv) World merchandise trade increased by leaps and bounds and was beyond its scope.
- (v) The ambiguities in the multilateral system could be heavily exploited.
- (vi) Efforts at liberalizing agricultural trade were not successful.
- (vii) There were inadequacies in institutional structure and dispute settlement system.
- (viii) It was not a treaty and therefore terms of GATT were binding only insofar as they are not incoherent with a nation's domestic rules.

} Any 4 Points each 1/2 Mark}

Answer 8:

- (a)**
- (i) The spot exchange rate between AUD and USD will not be affected as increased demand for foreign currency in each country will be matched by a proportionate increase in the supply of foreign exchange. }{1 M}
 - (ii) Investors in Australia would demand more USD for making dollar denominated financial investments in the US. Supply of US dollars remaining the same, being in floating rate, AUD will depreciate and USD will appreciate. }{1 M}
 - (iii) Large scale shift of Australian financial investments back to home due to political uncertainties in the US would result in large scale sale of financial assets and capital outflow from the US. This will lead to more inflow of US dollars to Australia and demand remaining the same, depreciation in the value of USD viz a viz AUD. }{2 M}
 - (iv) Ban of exports to the US reduces USD inflows to Australia; demand for USD remaining the same, AUD may depreciate. }{1 M}

Answer:

- (b)** In an open economy, the main advantages of a fixed rate regime are:
- I. A fixed exchange rate avoids currency fluctuations and eliminates exchange rate risks and transaction costs that can impede international flow of trade and investments. A fixed exchange rate can thus greatly enhance international trade and investment.
 - II. A fixed exchange rate system imposes discipline on a country's monetary authority and therefore is more likely to generate lower levels of inflation.
 - III. The government can encourage greater trade and investment as stability encourages investment.
 - IV. Exchange rate peg can also enhance the credibility of the country's monetary- policy
 - V. However, in the fixed or managed floating (where the market forces are allowed to determine the exchange rate within a band) exchange rate regimes, the central bank is required to stand ready to intervene in the foreign exchange market and, also to maintain an adequate amount of foreign exchange reserves for this purpose.

} Any 3 Points, Each 1 Mark}

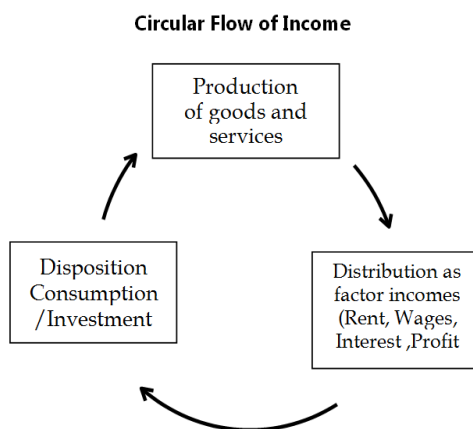
Answer:

- (c)** Integration of the Indian economy with the rest of the world is evident not only in terms of higher level of FDI inflows but also in terms of increasing level of FDI outflows as overseas investments by the Indian entrepreneurs in joint ventures (JV) and wholly owned subsidiaries (WOS). Outbound investments from India have undergone substantial changes not only in terms of size but also in terms of geographical spread and sectoral composition. Outward Foreign Direct Investment (OFDI) from India stood at US\$ 1.86 billion in the month of June, 2016. }{1 M}

The overseas investments have been primarily driven by resource seeking, market seeking or technology seeking motives. Many Indian IT firms like Tata Consultancy Services, Infosys, WIPRO, and Satyam acquired global contracts and established overseas offices in developed economies to be close to their key clients. Of late, there has been a surge in resource seeking overseas investments by Indian companies, especially to acquire energy resources in Australia, Indonesia and Africa. Indian entrepreneurs are also choosing investment destinations in countries such as Mauritius, Singapore, British Virgin Islands, and the Netherlands on account of higher tax benefits they provide. At present, any Indian investor can make overseas direct investment in any bona- fide activity except in certain real estate activities. This has been made possible by progressive relaxation of the capital controls and simplification of procedures for outbound investments from India. For example, the annual overseas investment ceiling to establish joint ventures (JV) and wholly owned subsidiaries has been raised to US\$ 125,000 from US\$ 75,000. The RBI has also relaxed norms for foreign investment by Indian corporates by raising the borrowing limit.

Answer 9:

(a) Circular flow of income refers to the continuous circulation of production, income generation and expenditure involving different sectors of the economy. There are three different interlinked phases in a circular flow of income, namely: production, distribution and disposition as can be seen from the following figure.



- (i) In the production phase, firms produce goods and services with the help of factor services.
- (ii) In the income or distribution phase, the flow of factor incomes in the form of rent, wages, interest and profits from firms to the households occurs.
- (iii) In the expenditure or disposition phase, the income received by different factors of production is spent on consumption goods and services and investment goods. This expenditure leads to further production of goods and services and sustains the circular flow.

Answer:

(b) The Ministry of Statistics and Programme Implementation has released the new series of national accounts, revising the base year from 2004-05 to 2011-12. In the revision of National Accounts statistics done by Central Statistical Organization (CSO) in January 2015, it was decided that sector-wise estimates of Gross Value Added (GVA) will now be given at basic prices instead of at factor cost. In simple terms, for any commodity the 'basic price' is the amount receivable by the producer from the purchaser for a unit of a product minus any tax on the product plus any subsidy on the product.

Answer:

- (c) (a) Income distributions and, therefore, GDP per capita is a completely inadequate measure of welfare. Countries may have significantly different income distributions and, consequently, different levels of overall well-being for the same level of per capita income.
- (b) Quality improvements in systems and processes due to technological as well as managerial innovations which reflect true growth in output from year to year.
- (c) Productions hidden from government authorities, either because those engaged in it are evading taxes or because it is illegal (drugs, gambling etc).
- (d) Non-market production (with a few exceptions) and Non-economic contributors to well-being for example: health of a country’s citizens, education levels, political participation, or other social and political factors that may significantly affect well-being levels.
- (e) The dis-utility of loss of leisure time. We know that, other things remaining the same, a country’s GDP rises if the total hours of work increase.
- (f) Economic ‘bads’ for example: crime, pollution, traffic congestion etc. which make us worse off.
- (g) The volunteer work and services rendered without remuneration undertaken in the economy, even though such work can contribute to social well-being as much as paid work.
- (h) Many things that contribute to our economic welfare such as, leisure time, fairness, gender equality, security of community feeling etc.,

{Any 6 Points, Each 1/2 Mark}

Answer:

- (d) The multiplier refers to the phenomenon whereby a change in an injection of expenditure will lead to a proportionately larger change (or multiple change) in the level of national income. Multiplier explains how many times the aggregate income increases as a result of an increase in investment. When the level of investment increases by an amount say ΔI , the equilibrium level of income will increase by some multiple amounts, ΔY . The ratio of ΔY to ΔI is called the investment multiplier. k.

{1 M}

$k = \frac{\Delta Y}{\Delta I} \qquad (2.11)$

{1 M}

The size of the multiplier effect is given by $\Delta Y = k \Delta I$.

Answer 10:

- (a)
- (i) Not FDI because less than 10 percent (which is the globally accepted criterion)
- (ii) FDI since 100 percent shares are bought
- (iii) Not FDI because an insignificant part of the total stake is acquired
- (iv) FDI because it involves more than 10 percent of the company’s shares.
- (v) FDI; lending to a company in which Kora has majority stake

{Each 1 Mark}

Answer:

- (b)
- (i) Ban on exports: Export-related measures refer to all measures applied by the government of the exporting country including both technical and non-technical measures. For example, during periods of shortages, export of agricultural products such as onion, wheat etc may be prohibited to make them available for domestic consumption. Export restrictions have an important effect on international markets. By reducing international supply, export restrictions have been shown to increase international prices.

- (ii) Export Taxes: An export tax is a tax collected on exported goods and may be either specific or ad valorem. The effect of an export tax is to raise the price of the good and to decrease exports. Since an export tax reduces exports and increases domestic supply, it also reduces domestic prices and leads to higher domestic consumption.
- (iii) Export Subsidies and Incentives : We have seen that tariffs on imports hurt exports and therefore countries have developed compensatory measures of different types for exporters like export subsidies ,duty drawback, duty-free access to imported intermediates etc. Governments or government bodies also usually provide financial contribution to domestic producers in the form of grants, loans, equity infusions etc. or give some form of income or price support. If such policies on the part of governments are directed at encouraging domestic industries to sell specified products or services abroad, they can be considered as trade policy tools.
- (iv) Voluntary Export Restraints : Voluntary Export Restraints (VERs) refer to a type of informal quota administered by an exporting country voluntarily restraining the quantity of goods that can be exported out of that country during a specified period of time. Such restraints originate primarily from political considerations and are imposed based on negotiations of the importer with the exporter. The inducement for the exporter to agree to a VER is mostly to appease the importing country and to avoid the effects of possible retaliatory trade restraints that may be imposed by the importer. VERs may arise when the import-competing industries seek protection from a surge of imports from particular exporting countries. VERs cause, as do tariffs and quotas, domestic prices to rise and cause loss of domestic consumer surplus. Over the past few decades, significant transformations are happening in terms of growth as well as trends of flows and patterns of global trade. The increasing importance of developing countries has been a salient feature of the shifting global trade patterns. Fundamental changes are taking place in the way countries associate themselves for international trade and investments. Trading through regional arrangements which foster closer trade and economic relations is shaping the global trade landscape in an unprecedented way. Alongside, the trading countries also have devised ingenious policies aimed at protecting their economic interests. The discussions in this unit are in no way comprehensive considering the faster pace of discovery of such protective strategies. Students are expected to get themselves updated on such ongoing changes.

{Any 3
Points,
Each 1
Mark}

Answer:

- (c) Despite wide ranging benefits, a number of countries hinder the free flow of international trade by imposing trade barriers. It was felt necessary that all countries embark on cooperative economic relations for establishing mutual self- interest. The General Agreement on Tariffs and Trade (GATT) provided the rules for much of world trade for 47 years, from 1948 to 1994; but it was only a multilateral instrument governing international trade or a provisional agreement along with the two full-fledged "Bretton Woods" institutions, the World Bank and the International Monetary Fund. The original intention to create an International Trade Organization (ITO) as a third institution to handle the trade side of international economic cooperation did not succeed for want of endorsement by some national legislatures, especially the US. Eight rounds of multilateral negotiations known as "trade rounds" held under the auspices GATT resulted in substantial international trade liberalization. Though the GATT trade rounds in earlier years contemplated tariff reduction as their core issue, later on the Kennedy Round in the mid-sixties, and the Tokyo Round in the 1970s led to massive reductions in bilateral tariffs, establishment of negotiation rules and procedures on dispute resolution, dumping and licensing. The arrangements

{1 M}

{1 M}

were informally referred to as 'codes' because they were not acknowledged by the full GATT membership. A number of codes were ultimately amended in the Uruguay Round and got converted into multilateral commitments accepted by all WTO members. The eighth, the Uruguay Round of 1986-94, was the last and most consequential of all rounds and culminated in the birth of WTO and a new set of agreements.

Answer 11:

- (a)
- (i) Excess reserves are those reserves that the commercial banks hold with the central bank in addition to the mandatory reserve requirements. Excess reserves result in an increase in reserve-deposit ratio of banks; less money for lending reduces money multiplier; money supply declines.
 - (ii) When people hold more money, it increases the currency-deposit ratio ;reduces money multiplier; money supply declines.
 - (iii) ATMs let people to withdraw cash from the bank as and when needed, reduces cost of conversion of deposits to cash and makes deposits relatively more convenient. People hold less cash and more deposits, thus reducing the currency-deposit ratio; increasing the money multiplier causing the money supply to increase.
 - (iv) See iii) above.
 - (v) If people, for any reason, are expected to withdraw money from ATMs with more frequency, then banks will want to keep more reserves. This will raise the reserve ratio, and lower the money multiplier. As a result money supply will decline.

{Each 1 Mark}

Answer:

(b) Foreign direct investment (FDI) VS Foreign portfolio investment (FPI)

Foreign direct investment (FDI)	Foreign portfolio investment (FPI)
Investment involves creation of physical assets	Investment is only in financial assets
Has a long term interest and therefore remain invested for long	Only short term interest and generally remain invested for short periods
Relatively difficult to withdraw	Relatively easy to withdraw
Not inclined to be speculative	Speculative in nature
Often accompanied by technology transfer	Not accompanied by technology transfer
Direct impact on employment of labour and wages	No direct impact on employment of labour and wages
Enduring interest in management and control	No abiding interest in management and control
Securities are held with significant degree of influence by the investor on the management of the enterprise	Securities are held purely as a financial investment and no significant degree of influence on the management of the enterprise

{Any 6 Points, Each 1/2 Mark}

Answer:

- (c) Foreign direct investments can be made in a variety of ways, such as:
- (i) Opening of a subsidiary or associate company in a foreign country,
 - (ii) Equity injection into an overseas company,
 - (iii) Acquiring a controlling interest in an existing foreign company,
 - (iv) Mergers and acquisitions(M&A)
 - (v) Joint venture with a foreign company.
 - (vi) Green field investment (establishment of a new overseas affiliate for freshly starting production by a parent company).

{Any 4 Points, Each 1/2 Mark}

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