

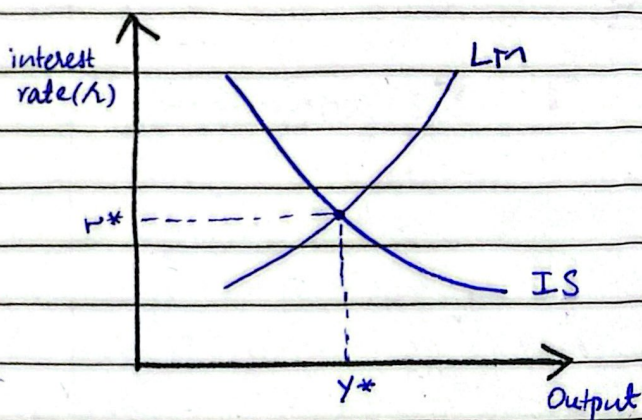
Q03:

I. INTRODUCTION

The Investment-Saving and Liquidity preference of money supply (IS-LM) represents a framework for understanding the interactions between the goods market and the money market. It helps us analyze how fiscal and monetary changes affect the macro-economy.

The model is also used to derive the aggregate demand curve, providing an overview of impacts of short term changes in demand. While application limited, provides useful insights.

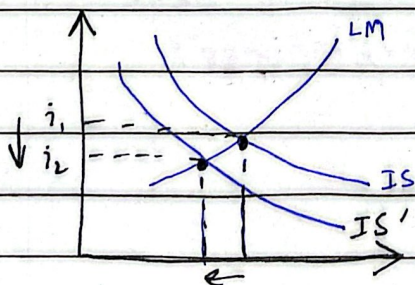
II. IS-LM AS A STABILIZATION TOOL IN DEVELOPING ECONOMIES



A. Goods Market Stability

(i) Stability by increasing taxation or reducing expenditure

The government's taxation policy and expenditure is integral to fiscal stability. Under low tax and high expenditure, the government faces fiscal deficit leading to instability. For stabilization of fiscal economy, the policy of higher taxation and lower government expenditure needs to be adopted.

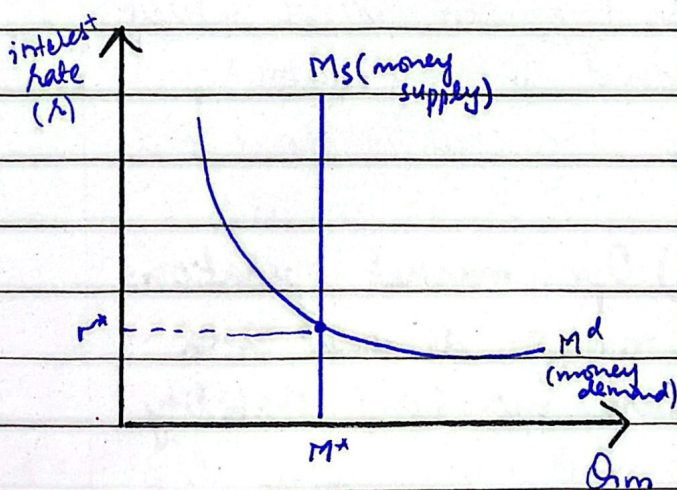


the IS curve shifts left, leading to lower interest rate, to drive future investment.

(ii) Dampening high consumption demand amid limited short term supply

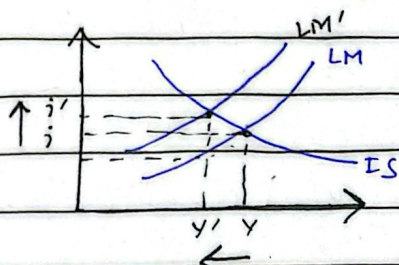
The supply in short term remains limited. Amid rising demand, the economy faces pressure on prices, which leads to inflation and high interest rates. By inducing a shift in IS curve by dampening demand, the economy of developing nations can be stabilized.

B. MONEY MARKET



(i) Interest rate as a tool for stabilization

The interest rate is a monetary market tool, to reduce pressure in market. High interest rate reduces demand for money and reduces inflationary pressure. The LM curve shifts upwards.



(ii) Money supply as a means of inducing growth

The money supply is also a tool for inducing growth as it is a monetary expansion reduces interest rate and improves output, shifting LM curve downwards.

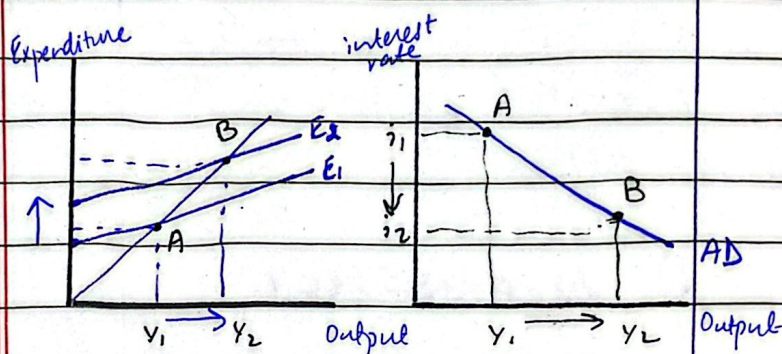
(iii) Open market operations to manage demand and ensure monetary stability

Open market operations like buying and selling of bonds,

currency supply and influx of assets by central bank is another tool for stabilization. Amid expansionary policy, money demand grows, inducing greater consumption. The LM curve shifts downwards, reducing interest rate and improving growth.

III. COMPLEMENTING THE AD-AS ANALYSIS WITH IS-LM

The AS-AD Aggregate demand curve is derived from the IS-LM model.



As price increases, money supply declines, causing LM shift to left. Interest rate rises and output declines.

The rise in price leads to decline in output, resulting in a downward sloping demand curve.

A. STRENGTHS

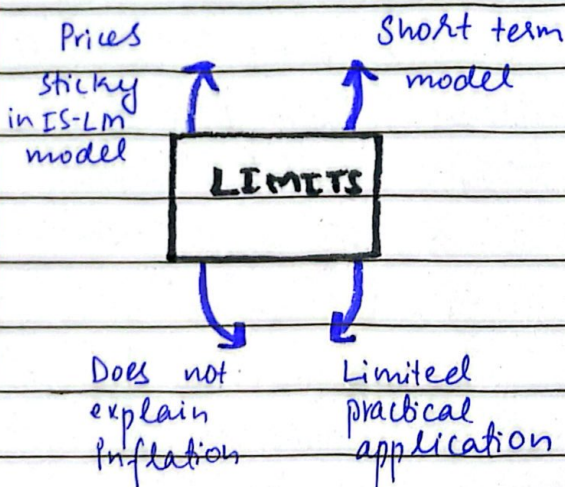
(i) Monetary and fiscal policy insights

The complemented model presents analysis on how fiscal and monetary changes impact the aggregate demand in an economy. Shifts in IS-LM translate into changes in AD, thus impacting macro-economic outlook.

(ii) Consequences of price changes highlighted

The model highlights the effects of price changes in economy. It impacts growth by leading to constricted policy outlook.

B. WEAKNESSES



IV, CONCLUSION

The IS-LM model presents the function of economic policies and impacts on money and goods market. It complements the AS-AD framework. It helps analyze ~~prop~~ problems to guide measures and understanding but has limits in form of short-term outlook and limited applicability.

Q.07:

I. INTRODUCTION

Elasticity refers to the relative change in response to a change in price or income of a good. Elasticities help understand consumption patterns of consumers and market changes. It exists in various forms like price elasticity, income elasticity and cross-price elasticity, each with an individual perspective into market.

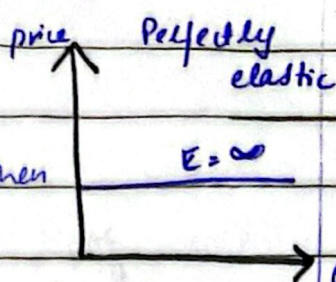
II. CONCEPTS OF ELASTICITY

(i) Own-price elasticity

Own price elasticity refers to the change in quantity demanded of goods relative to a change in price of those goods.

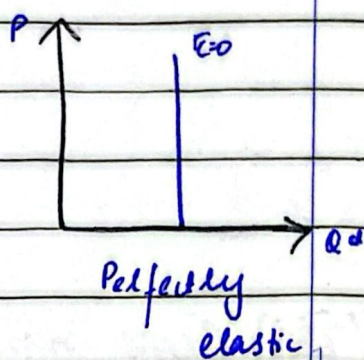
$$\text{elasticity} = \frac{\% \Delta Q_d}{\% \Delta P}$$

Perfectly elastic demand occurs when small change in price leads to a significant change in quantity demanded.



This is more applicable for price conscious goods consumers. (luxury goods)

Perfect in-elastic price is when demand barely changes with relative price changes. This remains true for compulsory goods.



(ii) Income elasticity

Income elasticity refers to the change in quantity demanded amid change in income. As income rises, consumer is able to afford more, thus demand rises.

$$E.O.D = \frac{\% \Delta Q_d}{\% \Delta Y}$$

The elasticity of demand is positive when Normal good and is negative in case of Inferior good as consumer moves to a more expensive alternate.

NECESSARY GOOD: inelastic (elasticity < 1)

LUXURY GOOD: elastic (elasticity > 1)
demand

An elasticity of demand of zero means income has no effect on demand.

(iii) Cross price elasticity

Cross price means the change in demand of good A with respect to change in price of B. The concept of complements and complementary goods is introduced.

$$C.O.D = \frac{\% \Delta Q^d_A}{\% \Delta P_B} \quad ; \quad \begin{array}{l} A = \text{good A} \\ B = \text{good B} \end{array}$$

Complementary goods:

If two goods are complements, then a price increase of good A

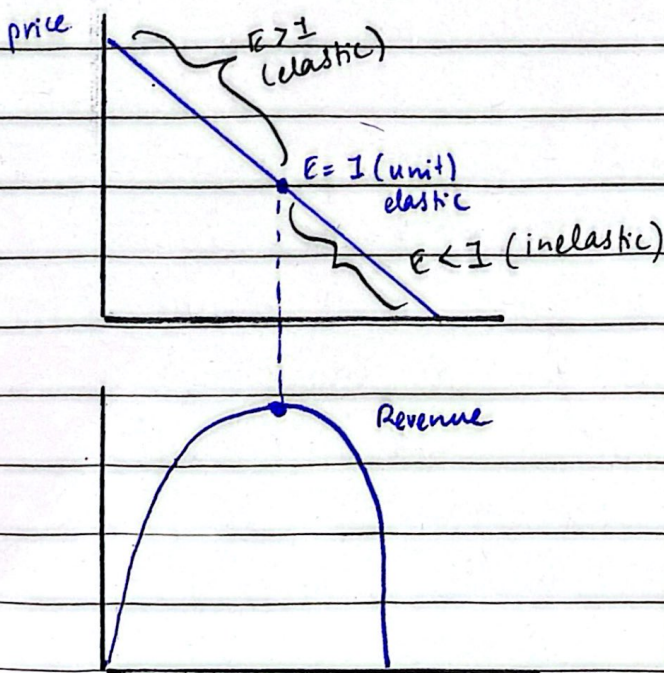
will lead to decline in quantity of good B. Thus ^{negative} ~~positive~~ elasticity of demand.

Substitute goods:

Increase in price of good A increases demand for good B. Positive elasticity of demand.

If ~~the~~ elasticity equals zero, means goods are not related. Similarly factors like time, availability of close substitutes, status of income also impact the demand.

III. RELATION BETWEEN 'OWN-PRICE ELASTICITY' AND TOTAL REVENUE



(i) Price elastic demand

When price elastic;

Price increase leads to a revenue decrease as demand falls.

Price decrease leads to a revenue increase as demand rises.

(ii) Unit elastic, $E = 1$

Price changes up or down has limited impact as Revenues constant

(iii) Price inelastic, $E < 1$

Price increase leads to Revenue increase ^{as} demand changes barely

Price decrease leads to Revenue decrease as consumers shift to better quality goods.

The total revenue is therefore maximized upon the incidence of unit price elasticity. As price decreases, as shown in graph, demand becomes elastic, and small change in price leads to greater change in

demand, impacting overall prices.

IV. CONCLUSION

The concept of elasticities is essential to understand the impacts of variables like price and income upon the demand of goods by consumers. This helps analyze market trends and charts out policies by businesses for growth and improve revenues.