



UGC-NET

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UGC NET PAPER – 2 (ECONOMICS)

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International Trade: Basic Concepts and Analytical Tools

1. Definition and Importance of International Trade

1.1 What is international trade?

- International trade is the exchange of goods and services (and often capital) between countries across national borders.
- It includes exports (goods/services sold to foreigners) and imports (goods/services bought from foreigners).

1.2 Why countries trade

- Scarcity of resources: No country has all resources in desired quantity/quality.
- Specialization and efficiency: Countries specialize in what they produce relatively cheaper and trade, thereby lowering opportunity cost.
- Higher consumption: Through trade, countries can consume beyond their Production Possibility Frontier (PPF), enjoying more goods and better standards of living.

Example:

- India exports tea, textiles, and IT services, and imports crude oil, machinery, and gold. This allows India to use its labor-intensive and skill-intensive sectors efficiently while importing goods it cannot produce or produce costly.

2. Basic Concepts in International Trade

2.1 Balance of Trade (BoT)

- Balance of trade is the difference between the value of a country's exports and imports of goods (merchandise trade) in a given period.

$$\text{BoT} = \text{Value of exports of goods} - \text{Value of imports of goods}$$
- If:
 - Exports > Imports → Trade surplus
 - Imports > Exports → Trade deficit

Example:

- If India exports goods worth ₹20 lakh crore and imports goods worth ₹25 lakh crore, then:
 - $\text{BoT} = 20 - 25 = -5$ lakh crore ⇒ Trade deficit

2.2 Balance of Payments (BoP)

- Balance of payments is a complete record of all economic transactions between residents of a country and the rest of the world
- It has three main accounts:
 1. Current account (goods, services, income, current transfers)
 2. Capital account (capital transfers, non-produced non-financial assets)
 3. Financial account (FDI, portfolio investment, loans, etc.)

By definition:

- Current Account + Capital Account + Financial Account + Statistical I
- So BoP is always balanced in the accounting sense.

2.3 Terms of Trade (Tot) – Definition

- Terms of trade measures the relative prices of a country's exports and imports.
- The most common formula:
$$\text{ToT} = \frac{\text{Index of export prices}}{\text{Index of import prices}} \times 100$$
- If:
 - Tot increases → country can buy more imports per unit of exports (improving TOT).
 - Tot decreases → country can buy less imports per unit of exports (worsening TOT).

Example:

- Export price index = 120, import price index = 100:
$$\text{ToT} = \frac{120}{100} \times 100 = 120$$
- This means the country's exports are relatively more expensive compared to imports → improved terms of trade.

3. Classical and Neoclassical Theories of Trade

3.1 Absolute Advantage (Adam Smith)

- A country has an absolute advantage if it can produce a good more efficiently (using fewer resources per unit) than another country.
- According to Smith, countries should specialize in goods in which they have absolute advantage and trade.

Example (2-country, 2-good):

- India: 1 labor unit → 2 units of cloth
- Bangladesh: 1 labor unit → 1 unit of cloth
- India has absolute advantage in cloth; Bangladesh may have it in tea (suppose).

3.2 Comparative Advantage (David Ricardo)

- Comparative advantage is based on opportunity cost, not absolute cost.
- A country has comparative advantage in a good if its opportunity cost of producing that good is lower than in the other country.

Opportunity cost formula:

Suppose two goods: Cloth and Wheat.

- **In India:**
 - 1 unit of cloth = 2 units of wheat foregone (opportunity cost of cloth).
- **In Bangladesh:**
 - 1 unit of cloth = 4 units of wheat foregone.

Then:

- Opportunity cost of cloth is lower in India → India has comparative advantage in cloth.
- Bangladesh has comparative advantage in wheat.

Net gain from trade

- Trade occurs at some relative price between the two opportunity-cost ratios.
- Then both countries can consume more of both goods than if they produced in autarky (no trade).

3.3 Heckscher–Ohlin (Factor-Proportions) Theory

- **Basic idea:** Countries export goods that use their relatively abundant factor and import goods that use their scarce factor.
- **Factors:** land, labour, capital, etc.
- Stolper–Samuelson Theorem (consequence):
 - Trade raises real return to the abundant factor and lowers real return to the scarce factor.

Example:

- India is labour-abundant → tends to export labor-intensive goods (garments, textiles) and import capital-intensive goods (machinery, automobiles).

4. Analytical Tools: Gains from Trade, PPF, Offer Curve**4.1 Production Possibility Frontier (PPF) under Trade**

- PPF shows maximum combinations of two goods an economy can produce with given resources.
- Under autarky (no trade), consumption = production; the country is forced to consume on its PPF.
- Under trade, the country can:
 - Produce on the PPF, but
 - Consume outside the original PPF → higher welfare.

Example:

- Suppose India can produce:
 - 100 units of cloth, or
 - 60 units of wheat.
- Under trade, it may:
 - produce 100 cloths,
 - export 40 cloth,
 - import 30 wheats,
 - consume 60 cloth + 30 wheats → consumption bundle outside the initial PPF.

4.2 World Relative Price and Gains from Trade

- In a 2-country, 2-good model:
 - Each country has a domestic autarky relative price ratio (e.g., price of cloth ÷ price of wheat).
- Under free trade, one world relative price emerges, between the two countries' autarky prices.
- Gains from trade occur because countries can trade at a world price ratio that is more favorable than their own autarky ratio.

Example (numerical, simple):

- India's autarky: 1 cloth = 2 wheat
- Bangladesh's autarky: 1 cloth = 4 wheat
- Then:
 - India's opportunity cost of cloth is 2 wheats,
 - Bangladesh's is 4 wheats → India has comparative advantage in cloth.
- Suppose world trade price is: 1 cloth = 3 wheat.
 - India:
 - To get 1 wheat, it must give up 3 cloths.
 - In autarky, it gave up 2 cloths → better deal by importing wheat.
 - Bangladesh:
 - To get 1 wheat, it gives only 1 cloth.
 - In autarky, it would have to give up 4 cloths → huge gain.

Thus, both countries gain from trade.

4.3 Offer Curves

- An offer curve shows the quantity of a country's export good offered at each relative price in exchange for imports.
- It is derived from:
 - PPF,
 - preferences (utility), and
 - relative prices.

- Intersection of two countries' offer curves gives the equilibrium world relative price and equilibrium trade volumes.

While detailed construction of offer curves is slightly beyond routine NET-level, the idea is important:

- Shape of offer curve reflects elasticity of demand and supply for traded goods.
 - Reciprocal demand (Ricardian idea) underlies the offer-curve approach.

5. Tariffs, Quotas, and Protectionism (Analytical Tools)

5.1 Tariff – Definition and Effects

- Tariff is a tax on imports. Usually specific (per unit) or ad valorem (percentage of value).
- Economic effects (using partial equilibrium analysis) on a small country:

Let:

- P_w : world price (no trade) → then domestic price = P_w .
- With tariff t : domestic price rises to $P_w + t$.

Then:

1. Consumers lose because price goes up.
2. Producers gain because they sell more at higher price.
3. Government gains tariff revenue.
4. Deadweight loss (net welfare loss) arises due to:
 - Under-consumption,
 - Over-production, etc.

Welfare formula (intuitive):

- Deadweight loss \approx area of two triangles in supply-demand diagram (before and after tariff).
- Net gain/loss = consumer loss + producer gain + government revenue.

5.2 Import Quota

- Quota is a physical limit on the quantity of imports allowed.
- Effect similar to tariff mechanically, but no government revenue is generated unless licenses are auctioned.
- Often creates rent for importers (quota rights) → income privately captured, not used for public welfare.

5.3 Voluntary Export Restraint (VER)

- A VER is a quota imposed by the exporting country under pressure from the importing country.
- Economic effect: similar to import quota for the importing country; the exporting country loses potential export surplus.

6. Elasticity Concepts in International Trade

6.1 Price Elasticity of Demand for Exports/Imports

- Elasticity of demand for exports:

$$\epsilon_d = \frac{\% \text{ change in quantity of exports demanded abroad}}{\% \text{ change in export price}}$$

- If $|\epsilon_d| > 1$: elastic demand → devaluation can improve export revenue.
- If $|\epsilon_d| < 1$: inelastic demand → revenue may fall even if price falls.

6.2 Marshall–Lerner Condition (J-Curve)

- The Marshall–Lerner condition says:
 - Real depreciation / devaluation improves trade balance if:

$$|\epsilon_x| + |\epsilon_m| > 1$$

where:

- ϵ_x = elasticity of demand for exports,
- ϵ_m = elasticity of demand for imports.

- In the short run, currency depreciation may worsen trade balance temporarily (J-curve effect), because contracts are fixed. Over time, elasticity rises and trade balance improves if the condition holds.

7. Exchange Rate and Balance of Payments (Analytical Tools)

7.1 Nominal and Real Exchange Rate

- Nominal exchange rate e :

$$q = e \cdot \frac{P_{\text{foreign}}}{P_{\text{domestic}}}$$

- Real exchange rate q :
e.g., 1USD = 83INR $\Rightarrow e = 83$
where P is price index.
 - High $q \rightarrow$ domestic goods relatively more expensive \rightarrow fewer exports / more imports.

7.2 Balance of Trade under Fixed vs Floating Rates

- Under fixed exchange rate, balance of trade changes may be offset by central bank intervention in foreign-exchange markets.
- Under floating exchange rate, the exchange rate itself adjusts to equilibrate the demand and supply of foreign currency.

8. Migration and Trade

- Trade-labour linkage:
 - Countries abundant in labour tend to export labor-intensive goods.
 - Labour migration acts as a substitute for trade; if workers move to capital-abundant countries, they effectively export “labour services”.
- H-O-type models can be extended to include international movement of factors.

Theories Of International Trade

1. What Are Theories of International Trade?

1.1 Definition

- Theories of international trade are economic models that explain:
 - Why countries trade with each other,
 - What determines the pattern of trade (who exports what), and
 - How trade affects income, prices, welfare, and factor markets.

1.2 Main Purpose

- These theories help understand:
 - Benefits of free trade,
 - Role of resource endowments, productivity, and technology,
 - Justification for trade policy (tariffs, quotas, liberalization),
 - which are frequently tested in Paper 2 (Commerce/Economics).

2. Classical Theories of International Trade

2.1 Mercantilism (Pre-classical)

- Core idea: A country’s wealth is measured by its stock of gold and silver; trade surplus increases national wealth.
- Policy implication:
 - Export more, import less (restrict imports via tariffs, subsidies for exports).

Example: 16th–18th century European powers like Britain and Spain tried to hoard gold by exporting manufactured goods and importing raw materials under

2.2 Absolute Advantage (Adam Smith)

- Definition: A country has absolute advantage in a good if it can produce that good using fewer resources (or less time) than another country. everstudy.co

Intuition:

- Each country specializes in the good in which it has absolute advantage and trades; both countries gain by consuming more than under autarky.

Simple formula idea (two-country, two-good):

Suppose two countries: India and France; two goods: Cloth and Wine.

- Let productivity be units per worker:
 - India: 10 cloth or 4 wine
 - France: 6 cloth or 8 wine

Then:

- India has absolute advantage in cloth ($10 > 6$),
- France has absolute advantage in wine ($8 > 4$).

By specializing and trading:

- India focuses on cloth,
- France focuses on wine,
- Both end up with more of both goods than they could produce alone.

2.3 Comparative Advantage (David Ricardo)

- Core idea: Countries should export goods in which they have comparative advantage, i.e., lowest opportunity cost, not necessarily absolute advantage.

Formal definition:

- Opportunity cost of producing a good = how many units of other good must be forgone to produce one unit of this good.

If:

- India's opportunity cost of 1 unit of cloth = 2 units of wheat,
- France's opportunity cost of 1 unit of cloth = 4 units of wheat,

then:

- India has lower opportunity cost of cloth → comparative advantage in cloth,
- France has comparative advantage in wheat.

Net gain from trade (formal idea):

- Each country specializes in its comparative-advantage good and trades at a world relative price lying between the two countries' opportunity-cost ratios.
- Both countries can consume bundles outside their own PPF → higher welfare for both.

Example (Ricardian-type 2-country, 2-good):

- India:
 - 1 worker makes 10 cloth or 6 wheat.
 - United States:
 - 1 worker makes 6 cloth or 10 wheat.
 - India's opportunity cost of cloth = $6/10 = 0.6$ wheat per cloth.
 - US's opportunity cost of cloth = $10/6 \approx 1.67$ wheat per cloth.
 - India has comparative advantage in cloth, US in wheat.
 - Under trade at a world price say 1 cloth = 1 wheat (between 0.6 and 1.67), both can gain.

3. Neoclassical / Factor-Proportions Theories

3.1 Heckscher–Ohlin (H-O) Theory

- **Main idea:** Countries export goods that use their relatively abundant factor and import goods that use their scarce factor.

Key assumptions:

- Two countries, two goods, two factors (e.g., labour and capital),
- Identical technology, perfect competition, free trade, no transport cost.
- Factor abundance matters:
 - India: labour-abundant → exports labor-intensive goods.
 - Germany: capital-abundant → exports capital-intensive goods.

Example:

- India:
 - Relatively cheap, abundant labour → exports garments, textiles, software services.
- Germany:
 - Relatively abundant capital → exports high-end machinery, automobiles, aircraft.

3.2 Stolper–Samuelson Theorem (H-O Extension)

- Statement:
 - When a country opens to trade and exports its labor-intensive good,
 - The real return to the abundant factor (labour) increases, and
 - The real return to the scarce factor (capital) decreases.

In formula-intuitive language:

- If India exports labor-intensive goods:
 - Wage rate (w) rises relative to rental rate (r) → $w/r \uparrow$
 - Capital-owners may be worse off in the short run, workers better off.

4. New Trade Theories (Modern)

4.1 New Trade Theory (Paul Krugman)

- **Core idea:**
 - Trade arises due to economies of scale (cost falls as output rises) and product differentiation, not just resource differences.

Key points:

- Countries may specialize in producing a subset of similar goods (e.g., cars, electronics) and trade variants among themselves → intra-industry trade.
- Even identical countries can gain from trade because:
 - Firms achieve lower average cost by producing at large scale, and
 - Consumers get greater variety.

Example:

- India and Germany both produce cars, but:
 - India may specialize in compact cars,
 - Germany in high-end luxury cars,
 - Each import from the other → intra-industry trade.

4.2 Product Life Cycle (Raymond Vernon)

- Main idea:
 - A product's stage in life cycle determines where it is produced and traded. [everstudy.co](https://www.everstudy.co)

Stages:

1. Introduction:

- New product launched in innovating country (e.g., USA for many hi-tech goods).
- Firms export to rich countries only.

2. Maturity:

- Demand rises; firms shift production to other developed countries to reduce cost.
- Trade continues among developed countries.

3. Standardization:

- Product becomes mass-produced; cost becomes the key.
- Production shifts to developing countries with cheap labour (e.g., India, Vietnam, Bangladesh).
- Developed countries import from developing countries.

Example:

- Smartphones:
 - Designed in the USA,
 - Later manufactured in China, Vietnam, India,
 - End-users globally buy them → trade pattern changes as product matures.

4.3 Global Strategic Rivalry / Porter's Diamond

- Porter's Diamond (Michael Porter) explains national competitive advantage based on four factors:
 1. Factor conditions:
 - Quantity and quality of factors (skilled labour, infrastructure, R&D).
 2. Demand conditions:
 - Sophisticated domestic demand pushes firms to innovate.
 3. Related and supporting industries:
 - Strong supplier network (e.g., auto parts for automobile industry).
 4. Firm strategy, structure, and rivalry:
 - Intense domestic competition → efficiency and innovation.

Example:

- Silicon Valley (USA) and Infosys/TCS (India):
 - Strong factor conditions (skilled IT labour),
 - Intense rivalry among firms,
 - High-quality demand for software services globally.

5. Analytical Tools Linked to Trade Theories

5.1 Production Possibility Frontier (PPF) and Trade

- PPF is the curve showing maximum combinations of two goods an economy can produce with given resources.
- Under autarky: consumption = production → lies on PPF.
- Under trade:
 - Production stays on PPF,
 - Consumption moves outside PPF → higher welfare.

Example (Ricardian-type):

- India can produce:
 - 100 cloth or 60 wheat.
- Under trade, it may:
 - Produce 100 cloth,
 - Export 40 cloth,
 - Import 30 wheat,
 - Consume 60 cloth + 30 wheat → impossible in autarky.

5.2 Offer Curve and World Equilibrium Price

- An offer curve shows how much of its export good a country is willing to supply at each relative world price in exchange for imports
- Equilibrium world relative price is determined by the intersection of the two countries' offer curves.
- For NET-level:
 - Understand that offer curves depend on:
 - PPF,
 - Preferences (demand),
 - Relative prices.
 - A more elastic offer curve implies a smaller country has less influence on world price.

5.3 Elasticity and Trade: Marshall–Lerner Condition

- Marshall–Lerner condition tells when currency depreciation improves a country's trade balance. Formula (intuitive form):

$$|\varepsilon_x| + |\varepsilon_m| > 1$$

where:

- ε_x = price elasticity of demand for exports,
- ε_m = price elasticity of demand for imports.
- If the condition holds, real depreciation (making domestic goods cheaper abroad and imports more expensive at home) improves trade balance.
- If not, the opposite can happen.

Also linked to the J-curve:

- Immediately after devaluation, trade balance may worsen (due to fixed contracts).
- Over time, as demand responds, trade balance improves if Marshall–Lerner holds.

International Trade Under Imperfect Competition

1. What is Imperfect Competition in International Trade?

1.1 Definition

- Imperfect competition arises when firms have market power, i.e., they can set prices above marginal cost because of product differentiation, barriers to entry, or strategic interaction (oligopoly).
- In international trade, this means markets for many manufactured goods are neither perfect competition nor complete monopoly, but monopolistically competitive or oligopolistic.

1.2 Why it matters for trade

- Classical Heckscher–Ohlin and Ricardian models assume perfect competition and homogeneous goods.
- Many real-world patterns (like intra-industry trade between similar countries) are hard to explain under perfect competition.
- New Trade Theory (Krugman, Brainard, etc.) combines economies of scale with imperfect competition to explain these patterns.

2. Monopolistic Competition and International Trade

2.1 Monopolistic competition (basic structure)

- Large number of firms, differentiated products (e.g., cars, electronics, brands),
- Each firm faces a downward-sloping demand curve and sets price above marginal cost.
- Market entry/exit drives long-run profit toward zero (price = average cost).

2.2 Trade in monopolistic competition

- In a monopolistic competition model of trade (Krugman-type):
 - Countries are similar in size and factor endowments, but firms produce differentiated varieties.
 - Consumers gain when trade opens because they get more varieties at lower average prices due to economies of scale.

Key intuition:

- Without trade, each firm produces limited output → high average cost.
- With trade, total market size increases → each firm can scale up output, lower average cost, and price closer to marginal cost.
- Consumers face more product variety and lower prices → gains from trade even between “similar” countries (e.g., India–China, France–Germany).

Example:

- India and China both produce smartphones, laptops, and garments; each country has many brands. Consumers in both countries gain when they can buy both Indian and Chinese brands, and firms can specialize in certain models while exploiting scale economies.

3. Intra-Industry Trade under Imperfect Competition

3.1 What is intra-industry trade?

- Intra-industry trade = a country exports and imports similar goods (same SITC or HS category).
- Example: India exports some models of cars and imports other models; India exports garments and imports garments from Bangladesh.

3.2 Why imperfect competition explains it

- Under perfect competition, trade is mainly inter-industry (cloth vs wheat, capital- vs labor-intensive).
- Under monopolistic competition / imperfect competition:
 - Firms in each country produce differentiated varieties.
 - Consumers want product variety, so they import foreign varieties even while exporting domestic ones.
 - Firms gain scale economies by producing more when they export.Thus, similar countries (with similar factor endowments) trade similar but differentiated goods → intra-industry trade.

4. Oligopoly, Strategic Interaction, and Trade

4.1 Oligopoly in international markets

- Oligopoly: few firms dominate the market (e.g., aircraft, automobiles, mobile phones).
- Firms interact strategically: each firm’s decision (price, R&D, investment) affects rivals.

4.2 Brander-Krugman (“Export rivalry”) model (dumping-type ideas)

- **Simplified idea:**
 - Suppose two firms, one in each country, compete in third country markets.
 - The government of one country can subsidize its firm to increase exports and capture market share.
- **In this framework:**
 - Export subsidies can sometimes increase national welfare (at the expense of the other country).
 - Such policies are called “strategic trade policy” (a normative application of imperfect competition).

Example:

- A government may subsidize its domestic aerospace or automobile firm so it can underprice a foreign rival in a third-country market and grab market share.

5. Price Discrimination and Dumping

5.1 Price discrimination across markets

- Under imperfect competition, firms may charge different prices in different countries even for the same physical product.
- This is called international price discrimination.

5.2 Dumping

- Dumping occurs when a firm sells exported goods below the price it charges domestically (or below cost) in a foreign market.
- Not always harmful in theory:
 - It may be a profit-maximizing practice when foreign demand is more elastic.
- Regulators often worry about predatory dumping:
 - Firm sells too cheaply to drive out competitors, then raises price later.

6. Economies of Scale as a Bridge to Imperfect Competition

6.1 Increasing returns and imperfect competition

- Economies of scale (increasing returns to scale): average cost falls as output expands.
- Firms with high fixed/ setup costs (e.g., aircraft, smartphones, cars) naturally tend toward:
 - Market power,
 - Few large firms,
 - Scale-based advantages.

6.2 Trade implications

- Countries that host such firms specialize in certain high-tech industries.
- Other countries import those goods while exporting goods in which they have comparative advantage.
- Even under similar factor endowments, trade can be driven by scale economies and product variety → New Trade Theory.

Example:

- India may specialize in IT services and software, while importing civil aircraft from countries where firms benefit from large scale and strong R&D ecosystems.

Tariff and Non-Tariff Barriers to Trade; Dumping

1. Tariff Barriers to Trade

1.1 Definition

- A tariff is a tax imposed by the government on imports (and sometimes exports) of goods and services.
- Import tariff is the most common form; it raises the domestic price of the imported good and reduces quantity imported.

1.2 Types of tariffs

- Specific tariff: A fixed amount per unit (e.g., ₹500 per unit of car).
- Ad valorem tariff: A percentage of the value (e.g., 20% of the import value).
- Compound tariff: A combination of specific and ad valorem (e.g., ₹100 + 10% of value).

1.3 Economic effects of a tariff

In a small country (price-taker in world market):

- Suppose:
 - World price = P_w
 - Tariff = t
 - Then domestic price becomes $P_w + t$

Effects:

- Consumers lose: Pay higher price → consumer surplus ↓.
- Domestic producers gain: Sell more at higher price → producer surplus ↑.
- **Government gains:** Tariff revenue = quantity imported × quantity imported
- Net welfare loss:
 - Two deadweight triangles (from under-consumption and over-production) remain as net loss to society.

1.4 Protective vs revenue tariffs

- Protective tariff:
 - Main aim = protect domestic industry from foreign competition.
 - Sets high tariff → sharp reduction in imports.
- Revenue tariff:
 - Main aim = raise government revenue.
 - Usually moderate tariff so imports do not collapse.

2. Non-Tariff Barriers (NTBs) to Trade**2.1 Definition**

- Non-tariff barriers (NTBs) are measures other than tariffs that restrict or distort international trade.
- They may be formally justified (e.g., safety, environment) but often serve protectionist purposes.

2.2 Main types of non-tariff barriers

| Type | Meaning |
|---|--|
| Import quotas | Physical limit on quantity of a good that can be imported (e.g., 10,000 cars/year). Reduces competition; may raise domestic price. |
| Tariff-rate quotas (TRQs) | A low tariff up to a quota limit, then a high tariff beyond that. Still restricts trade but allows some volume. |
| Import licensing | Imports allowed only with government-issued licence; can be selective and slow. |
| Technical barriers to trade (TBT) | Stringent standards, packaging, labelling, and technical regulations that foreign firms find hard to meet. |
| Sanitary and phytosanitary (SPS) measures | Food, health, animal, plant standards (e.g., lab tests, inspections) that can delay or block imports. |
| Customs and administrative delays | Complex procedures, repeated inspections, documentation hassles → slow clearance and higher cost for exporters. |
| Local-content / domestic-content requirements | Require firms to source a minimum share locally (e.g., 30% components made in India). Increases cost for foreign suppliers. |
| State Trading Enterprises (STEs) | Government-owned firms that have monopoly rights to import/export certain goods → can favor domestic firms. |
| Exchange-rate management | Artificial undervaluation of the currency can act as an implicit export subsidy and import-restriction device. |

2.3 Economic impact of NTBs

- Reduce quantity traded → markets less efficient.
- Raise effective price for consumers (like tariffs) but without clear government revenue (often creates private rents for importers/licence-holders).
- Can be more trade-restrictive than tariffs because they are opaque and discretionary.

3. Dumping in International Trade

3.1 Definition

- Dumping occurs when a firm exports a product at a price lower than the price it charges in its domestic market or below its cost of production.
- It is not always illegal, but it can be challenged under WTO anti-dumping rules if it materially injures domestic producers in the importing country.

3.2 Why dumping occurs (motives)

- Predatory dumping:
 - Export below cost to drive out competitors in the foreign market, then raise prices later.
- Cyclical dumping:
 - Temporarily dump during domestic recession when demand is low.
- Persistent dumping (price discrimination):
 - Charge higher price in the home market and lower price abroad because foreign demand is more elastic.

3.3 How to prove dumping (WTO-style logic)

Here is the corrected and cleanly formatted text with the equations:

Under the WTO Anti-Dumping Agreement:

A product is considered dumped when:

$$P_{\text{export}} < P_{\text{domestic}}$$

or

$$P_{\text{export}} < \text{Cost of production}$$

where:

- P_{export} = export price to the importing country.
- P_{domestic} = price in the exporting country.

Then, the importing country must further show that:

- Dumping has caused or threatens to cause material injury to its domestic industry.

3.4 Anti-dumping measures

- Anti-dumping duty: Extra import duty imposed on the dumped product from the specific country to:
 - Bring its price closer to the “normal value” (either domestic price or cost-based price).
 - Remove injury to domestic firms.
- Quantitative restrictions: Sometimes import quotas or cause-related restrictions are imposed, but WTO rules prefer duties.

Example:

- India may impose anti-dumping duty on cheap steel imports from a foreign country that sells steel far below its domestic price and injures Indian steel producers.

3.5 Net effects of dumping

- Short-term:
 - Consumers benefit from lower prices.
 - Domestic producers suffer loss of sales, profits, and employment.
- Long-term:
 - Domestic industry may be weakened or driven out,
 - Potential trade disputes and retaliation between countries.

MCQ

1. International trade theory primarily explains:

- A. Domestic price determination
B. Allocation of public expenditure
C. Pattern and gains from trade among nations
D. Monetary policy formulation

Answer: C

Explanation: International trade theory studies why countries trade, what goods they trade, and the gains arising from specialization and exchange.

2. Absolute advantage theory was propounded by:

- A. David Ricardo
B. Adam Smith
C. Heckscher
D. Ohlin

Answer: B

Explanation: Adam Smith introduced the theory of Absolute Advantage in his work Wealth of Nations.

3. According to Ricardo's theory, trade takes place because of:

- A. Absolute cost differences
B. Comparative cost differences
C. Equal production costs
D. Demand similarities

Answer: B

Explanation: Ricardo argued that countries benefit from trade when they specialize according to comparative advantage.

4. Opportunity cost approach to international trade was developed by:

- A. Haberle
B. Keynes
C. Marshall
D. Leontief

Answer: A

Explanation: Gottfried Haberle reformulated comparative advantage using opportunity costs.

5. Heckscher–Ohlin theory emphasizes:

- A. Labor productivity differences
B. Technological gap
C. Factor endowment differences
D. Transport costs

Answer: C

Explanation: H-O theory states that countries export goods using abundant factors intensively.

6. Which factor is assumed immobile internationally in classical trade theory?

- A. Goods
B. Services
C. Capital
D. Labor

Answer: D

Explanation: Classical models assume labor immobility across nations while goods move freely.

7. The production possibility curve under increasing costs is:

- A. Straight line
B. Concave to origin
C. Convex to origin
D. Horizontal

Answer: C

Explanation: Increasing opportunity cost leads to a convex PPC.

8. Terms of trade refer to:

- A. Exchange rate policy
B. Ratio of export prices to import prices
C. Tariff rate structure
D. Capital inflows

Answer: B

Explanation: Terms of trade measure how many imports can be obtained per unit of exports.

9. Improvement in terms of trade implies:

- A. Export prices rise relative to import prices
B. Import prices rise relative to export prices
C. Exports decline
D. Balance of trade deficit

Answer: A

Explanation: Favorable terms of trade occur when export prices increase more than import prices.

10. Immiserating growth concept was developed by:

- A. Samuelson B. Bhagwati C. Krugman D. Meade

Answer: B

Explanation: Jagdish Bhagwati explained that growth may worsen welfare under certain trade conditions.

11. The Leontief paradox challenged:

- A. Keynesian theory B. Purchasing power parity
C. Heckscher–Ohlin theory D. Quantity theory of money

Answer: C

Explanation: Leontief found that the U.S. exported labor-intensive goods despite being capital abundant.

12. Intra-industry trade is most common among:

- A. Developing and developed countries B. Socialist economies
C. Developed countries D. Agricultural economies

Answer: C

Explanation: Developed countries often trade differentiated manufactured products.

13. Dumping means:

- A. Selling below domestic price in foreign market B. Selling at monopoly price
C. Export subsidy D. Currency devaluation

Answer: A

Explanation: Dumping occurs when firms sell abroad at prices lower than domestic prices or cost.

14. Which tariff is imposed as a fixed amount per unit?

- A. Ad valorem tariff B. Specific tariff C. Revenue tariff D. Protective tariff

Answer: B

Explanation: Specific tariff is charged as a fixed amount per physical unit.

15. Ad valorem tariff is levied:

- A. Per kilogram B. Per unit quantity C. As percentage of value D. On exports only

Answer: C

Explanation: Ad valorem tariffs are charged as a percentage of product value.

16. Quotas are classified as:

- A. Tariff barriers B. Non-tariff barriers C. Monetary measures D. Exchange controls

Answer: B

Explanation: Import quotas directly restrict quantity and are non-tariff barriers.

17. Which organization replaced GATT in 1995?

- A. IMF B. World Bank C. WTO D. UNCTAD

Answer: C

Explanation: WTO was established in 1995 as successor to GATT.

18. The headquarters of WTO is located at:

- A. New York B. Geneva C. Washington D.C. D. Paris

Answer: B

Explanation: WTO headquarters are situated in Geneva, Switzerland.

19. GATT mainly dealt with:

- A. Monetary cooperation B. Trade in goods
C. Exchange rates D. Development finance

Answer: B

Explanation: GATT focused on reducing tariffs and trade barriers for goods.

20. Balance of payments records:

- A. Domestic transactions only
- B. Government expenditure only
- C. International economic transactions
- D. Budget deficit

Answer: C

Explanation: BOP records all economic transactions between residents and foreigners.

21. Current account includes:

- A. Foreign direct investment
- B. Portfolio investment
- C. Merchandise exports and imports
- D. Gold reserves

Answer: C

Explanation: Trade in goods forms part of current account transactions.

22. Capital account primarily records:

- A. Commodity trade
- B. Income receipts
- C. Capital transfers and investments
- D. Invisible exports

Answer: C

Explanation: Capital account records financial and capital transactions.

23. A deficit in balance of payments means:

- A. Total receipts exceed payments
- B. Total payments exceed receipts
- C. Exports exceed imports
- D. Gold stock increases

Answer: B

Explanation: Deficit arises when international payments are greater than receipts.

24. Devaluation refers to:

- A. Market-driven fall in exchange rate
- B. Official reduction in currency value
- C. Rise in interest rates
- D. Inflation control

Answer: B

Explanation: Devaluation is deliberate reduction in currency value under fixed exchange rate system.

25. Depreciation of currency occurs under:

- A. Fixed exchange rates
- B. Managed exchange rates only
- C. Floating exchange rates
- D. Gold standard only

Answer: C

Explanation: Depreciation occurs through market forces in flexible exchange rate systems.

26. Purchasing Power Parity theory is associated with:

- A. Cassel
- B. Ricardo
- C. Ohlin
- D. Keynes

Answer: A

Explanation: Gustav Cassel developed PPP theory of exchange rate determination.

27. Spot exchange rate means:

- A. Future delivery rate
- B. Immediate delivery exchange rate
- C. Long-term exchange rate
- D. Government fixed rate

Answer: B

Explanation: Spot rate applies to immediate foreign exchange transactions.

28. Forward exchange market helps in:

- A. Inflation creation
- B. Speculation only
- C. Hedging exchange risk
- D. Reducing exports

Answer: C

Explanation: Forward contracts protect against exchange rate fluctuations.

29. Arbitrage in foreign exchange market refers to:

- A. Government intervention
- B. Simultaneous buying and selling to gain from price differences
- C. Currency devaluation
- D. Import restriction

Answer: B

Explanation: Arbitrage exploits exchange rate differences across markets.

30. The Marshall-Lerner condition relates to:

- A. Inflation control
- B. Effectiveness of devaluation
- C. Tariff policy
- D. Capital flows

Answer: B

Explanation: It states that devaluation improves trade balance if elasticities exceed unity.

31. J-curve effect explains:

- A. Immediate improvement after devaluation
- B. Initial worsening then improvement in trade balance
- C. Decline in exports permanently
- D. Balance budget policy

Answer: B

Explanation: Trade balance may initially worsen after devaluation before improving.

32. Which is not a regional trading bloc?

- A. ASEAN
- B. SAARC
- C. NAFTA
- D. IMF

Answer: D

Explanation: IMF is a monetary institution, not a regional trade bloc.

33. NAFTA includes:

- A. India, China, Japan
- B. USA, Canada, Mexico
- C. France, Germany, Italy
- D. Brazil, Argentina, Chile

Answer: B

Explanation: NAFTA was formed among the USA, Canada, and Mexico.

34. ASEAN stands for:

- A. Asian Economic Security Association
- B. Association of South East Asian Nations
- C. American South Economic Alliance
- D. African Security Economic Network

Answer: B

Explanation: ASEAN promotes regional cooperation in Southeast Asia.

35. Trade creation effect is associated with:

- A. Currency unions
- B. Customs unions
- C. IMF lending
- D. Devaluation

Answer: B

Explanation: Customs unions may replace costly domestic production with cheaper imports from member nations.

36. Trade diversion implies:

- A. Efficient allocation of resources
- B. Shift from low-cost to high-cost member country imports
- C. Rise in exports only
- D. Free trade worldwide

Answer: B

Explanation: Trade diversion can reduce welfare by replacing efficient suppliers.

37. IMF was established at:

- A. Tokyo Conference
C. Geneva Convention
- B. Bretton Woods Conference
D. Doha Round

Answer: B

Explanation: IMF and World Bank were created at Bretton Woods in 1944.

38. IMF mainly provides:

- A. Long-term development loans
C. Short-term balance of payments assistance
- B. Military aid
D. Export subsidies

Answer: C

Explanation: IMF assists countries facing short-term external payment difficulties.

39. The World Bank mainly finances:

- A. Short-term trade deficits
C. Currency stabilization only
- B. Long-term development projects
D. Import quotas

Answer: B

Explanation: World Bank provides long-term loans for development and infrastructure.

40. SDR stands for:

- A. Special Drawing Rights
C. Special Debt Ratio
- B. Standard Deposit Reserve
D. Systematic Development Rights

Answer: A

Explanation: SDR is an international reserve asset created by IMF.

41. Which theory explains trade due to technological differences?

- A. Ricardo theory
C. Theory of overlapping demand
- B. Product cycle theory
D. Availability doctrine

Answer: B

Explanation: Vernon's product cycle theory highlights technological innovation and product stages.

42. The factor-price equalization theorem was developed by:

- A. Samuelson
B. Haberle
C. Viner
D. Kindleberger

Answer: A

Explanation: Samuelson explained how trade tends to equalize factor prices.

43. Which measure directly restricts quantity of imports?

- A. Tariff
B. Subsidy
C. Quota
D. Exchange rate

Answer: C

Explanation: Quotas place quantitative limits on imports.

44. Export subsidy tends to:

- A. Increase domestic prices
C. Improve imports
- B. Reduce exports
D. Eliminate production

Answer: A

Explanation: Export subsidies may raise domestic prices due to increased external demand.

45. Which account records unilateral transfers?

- A. Capital account
C. Official reserve account
- B. Current account
D. Monetary account

Answer: B

Explanation: Remittances and gifts are included in the current account.