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Churning Ideas to Power the Mind

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RECENT ECONOMIC UPDATES

Slowdown-hit Indian economy counts costs of stronger rupee

India's stronger currency has become a threat for its growth aspirations, piling pressure on the central bank to aggressively intervene in the foreign exchange market even at the risk of incurring the wrath of the United States. The rupee has risen more than 6 percent this year against the dollar, snapping six consecutive years of depreciation, with the impact magnified by the decline of many competitors' currencies against the greenback over the same period.

That is weighing on an economy that is struggling to cope with disruption caused by ambiguous rules of a recently launched Goods and Services Tax (GST), and has yet to fully recover from Prime Minister Narendra Modi's crackdown on "black money". While the rupee's surge is being driven by strong capital inflows lured by India's economic and political stability, it is making the country's exports less competitive and is also driving up imports, prolonging a slump in manufacturing.

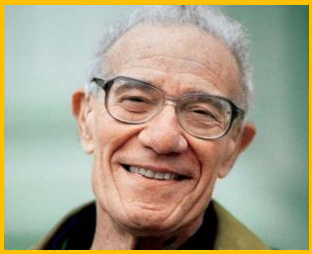
Former RBI chief Rajan says had cautioned government on demonetization

Former central bank head Raghuram Rajan had cautioned the government that short-term costs of a radical ban of high-value currency notes would outweigh the long-term benefits, Times of India newspaper reported on Sunday. He had first given his opinion on whether to carry out the ban in February 2016, the paper reported, citing excerpts from Rajan's book on his stint at the Reserve Bank of India (RBI), titled "I Do What I Do: On Reforms Rhetoric and Resolve".

That was months before Prime Minister Narendra Modi stunned the country on Nov. 8 by abolishing 500- and 1,000-rupee notes, removing 86 percent of the currency in circulation in a bid to crack down on "shadow economy". "The RBI flagged what would happen if preparation was inadequate," the paper cited Rajan as saying in the book that will be released next week.

KNOW AN ECONOMIST

Robert Merton Solow



Robert M. Solow was born in Brooklyn, New York, USA on August 23, 1924 into a Jewish family. Solow joined the Harvard College in 1940 where he studied sociology, anthropology and elementary economics initially. In 1942, at the age of 18, he left the university and joined the Army Signal Corps to fight in the Second World War and served briefly in North Africa, Sicily and Italy.

After being discharged from the Armed Forces in 1945 when the war was over, Solow rejoined the Harvard University as research assistant under Wassily Leontief. He devised the first set of coefficients related to capital for using in the input-output model built by Leontief. He was awarded the 1987 Nobel Prize in Economic Sciences for his important contributions to theories of economic growth.

Solow Residual Model

The Solow residual is a number describing empirical productivity growth in an economy from year to year and decade to decade. Robert Solow defined rising productivity as rising output with constant capital and labor input. It is a "residual" because it is the part of growth that cannot be explained through capital accumulation or increased labor. It is also called the rate of growth of total factor productivity.

Solow assumed a very basic model of annual aggregate output over a year (t). He said that the output quantity would be governed by the amount of capital (the infrastructure), the amount of labour (the number of people in the workforce), and the productivity of that labour. He thought that the productivity of labour was the factor driving long-run GDP increases.

Robert M. Solow (1957) set up the grounds for growth accounting. He considered a neoclassical production function

$$Y_t = A_t F(K_t, L_t)$$

where Y_t is aggregate output, K_t is the stock of physical capital, L_t is the labor force and A_t represents Total Factor Productivity (TFP).

TFP is influenced by a variety of technological, economic and cultural factors. Usually, these changes will increase TFP. It may go down for some other reasons such as trade unions restrictions, environmental regulations and safety measures that limit the use of production factors. Other factors include frictions in financial markets, physical and human capital externalities, public expenditures or any other element that affect the aggregate productivity of the economy.

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INVISIBLE HAND

Definition: The unobservable market force that helps the demand and supply of goods in a free market to reach equilibrium automatically is the invisible hand.

Description:

The phrase invisible hand was introduced by Adam Smith in his book 'The Wealth of Nations'. He assumed that an economy can work well in a free market scenario where everyone will work for his/her own interest. He explained that an economy will comparatively work and function well if the government will leave people alone to buy and sell freely among themselves.

He suggested that if people were allowed to trade freely, self-interested traders present in the market would compete with each other, leading markets towards the positive output with the help of an invisible hand. In a free market scenario where there are no regulations or restrictions imposed by the government, if someone charges less, the customer will buy from him.

Therefore, you have to lower your price or offer something better than your competitor. Whenever enough people demand something, it will be supplied by the market and everyone will be happy. The seller end up getting the price and the buyer will get better goods at the desired price.

Example

An example of invisible hand is an individual making a decision to buy coffee and a bagel to make them better off, that person decision will make the economic society as a whole better off. The decision of buying the coffee and the bagel will make the seller better because of profit and it also makes the production market that distributes the goods better. This pattern will benefit everyone because it will make the firms (companies) and the factor market (labor) that produce resources better off.

Importance

The concept of invisible hand has been a great factor in understanding the basics of economics. The invisible hand is a natural force that self regulates the market economy. The concept explains that an individual decision in a market economy to benefit them will actually make the economy better off as a whole

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> “ ONE OF THR GREAT MISTAKES IS TO JUDGE POLICIES AND PROGRAMS BY THEIR INTENTIONS RATHER THAN THEIR RESULTS ”
>
> MILTON FRIEDMAN (1912- 2006)

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THANK YOU!!!

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