

1. Introduction

1

The Nature of Macroeconomics	1
The Major Macroeconomic Issues	2
Macroeconomic Stability and Business Environment	4
Business Environment in India	6
Major Schools of Thought in Macroeconomics	6
Macro Theory and Policy for India	8
Some Basic Economic Concepts and Distinctions	9
How Economists Explain	14
Outline of the Book	14
Appendix 1.1 Some Elementary Mathematical Concepts and Results	16

2. Measuring the Economy's Performance

18

National Income Accounting	18
Three Methods of Measuring GDP	22
Two Important Identities	25
National Income and Social Welfare	27
India's National Accounts	28
Sources of Data on the Indian Economy	29

3. Theory of Income Determination

32

Determination of Equilibrium Income	33
Change in Autonomous Demand: The Multiplier	37
Economy with Government	40
Observations on Fiscal Policy	43
An Open Economy	45
Fiscal Operations of the Government of India	47
Appendix 3.1 International Business Cycle Transmission	52
Appendix 3.2 Forward Looking Theories of Consumption: Life Cycle and Permanent Income	53

4. Money, Interest, and Income	58
Interest Rate and Aggregate Demand: The Investment Function	58
The <i>IS</i> Curve	60
The Asset Market	61
The <i>LM</i> Curve	66
Determination of Income and Interest Rate: Integrated Model	67
Appendix 4.1 More on Business Investment	70
5. Fiscal and Monetary Policy	74
Fiscal Policy	74
The Burden of Public Debt	76
Monetary Policy	79
New Classical Economics and Economic Policy	85
6. Banking System, Supply of Money, and the Conduct of Monetary Policy	88
Definitions and Functions of Money; Measures of Money Supply	88
Money Creation by the Banking System	90
Targets of Monetary Policy	93
Instruments of Monetary Policy	95
Financial Sector Reform: Changes in Fiscal and Monetary Policy in India	97
7. Opening up the Economy	102
Economic Openness	102
The Balance of Payments	103
Exchange Rate Concepts	108
Determination of the Exchange Rate	110
Domestic Adjustment	113
BoP Crisis and Speculative Attack on Currency	115
Internal and External Balance under Fixed Rate	116
Flexible Exchange and Insulation from Foreign Shocks	117
Advantages of Fixed Exchange	118
Foreign Exchange Market Reform in India	118
Devaluation	119
The Purchasing Power Parity Principle	121
Economic Policy in an Open Economy	122
Appendix 7.1 The World Trade Organization	132
8. Determination of the Aggregate Price Level	134
Aggregate Demand	134
Aggregate Supply	136
Fiscal and Monetary Policy, Demand and Supply Shocks	138
Full Wage–Price Flexibility	140
Wage and Price Rigidity	142

Keynesian Aggregate Supply	143
Classical Aggregate Supply	143
Appendix 8.1 The Microeconomics of Labour Supply	147

9. The Problem of Inflation **149**

Definition and Costs	149
Causes of Inflation	151
Inflation and Unemployment: The Phillips Curve	154
The Quantity Theory of Money	156
Budget Deficit and Inflation	159
Inflation Control by Reserve Bank of India	160
Money Growth, Inflation, and Interest Rate	161

10. Economic Growth **163**

Theory of Growth	164
Growth Accounting	172
Economic Reform and Growth	173
Growth, Globalization, and the Environment	175

11. Special Topics **178**

Rational Expectations and Policy Ineffectiveness	178
Sellers' Misperception and Non-neutrality of Money	180
Keynesian Counter Critique	181
Real Business Cycle Theory	182
Supply-side Economics	183