

Answer: Capital market is a platform where long-term credit instruments which mature in more than a year like stocks, bonds, debentures, mutual funds, exchange traded funds etc. are traded in capital market. The banks and stock exchanges are main responsible authority to deal with it.

6. What is monetary policy?

Answer: Monetary policy is an economic policy adopted by the central bank of a country. It regulates and controls money supply through its monetary instruments like bank rates, credit control, liquidity ratio, etc.

Give short/long answers (5/8 marks)

7. Explain the role/importance of banking system for economic development of a country.

Answer: Banking system is necessary pre-condition and financial wheel of economic system. The roles of it are discussed as:

- 1. Mobilization of people's savings:** Commercial banks accept deposits as savings and mobilize it by giving loans to entrepreneurs, investors to invest in productive sectors of the economy.
- 2. Monetization of the economy:** People keep money in banks and withdraw in times of need. So, monetization is necessary for exchange of goods or services as money is the medium of exchange.
- 3. Capital formation:** The banks collect the money from the people in the form of savings and channelize them for productive investments in all sectors. This helps in the capital formation and economic development.
- 4. Creation of job opportunities:** Banks themselves need manpower to manage and run the banking system creates job opportunities directly. On other hand, investors who got loan from banks also creates job opportunities.
- 5. Promotion of foreign trade of a country:** All the transactions of foreign trades, transfer money among foreign countries are done through banks.
- 6. Others:** Uplift the poor, implement government policies, balance economy, etc.

8. What is central bank? Explain its function in context of Nepal.

Answer: A central bank is an authority of financial institution which is responsible for a country's monetary policy, currency issuance, and regulating the money supply. Nepal Rastra Bank (NRB) is the central bank of Nepal which was established in 2013 Baisakh 14. The functions of central bank in context of Nepal can be explained as:

- 1. Issue of notes:** Nepal Rastra Bank has the monopoly authority to issue notes and coins of different denominations of rupees like 1, 2, 5, 10, 20, 25, 50, 100, 500 and 1000 since 2016 B.S.
- 2. Bank of banks:** It is the bank of banks including commercial and development banks, finance and microfinance companies in Nepal. They have their account deposits in the central and withdraw deposits from it.
- 3. Government's bank and advisor:** All ministries, departments and offices of the government have their account in a central bank. It helps to the government to formulate economic policies.
- 4. Clearing house function:** Other banks should keep a cash reserve with record of their transactions in the central Bank. It can adjust banks' debit and credit of their mutual claims and dues if any.
- 5. Custodian of gold and foreign currency:** It protects the gold, silver and the foreign currency reserves and fixes the rates of foreign currency on the basis of their demand and supply.
- 6. Lender of last resort:** When other banks face severe financial crisis, central bank can provide loans to them as it is lender of last resort and save them from financial crisis.
- 7. Credit Control:** It controls the credit creation of banks through bank rate policy, open market operations, changes in cash reserve ratio and money supply in the economy.
- 8. Developmental functions:**
 - It encourages to establish banks and their branches in other parts of country.
 - It conducts researches, surveys, trainings and contribute to economic policies.
 - It builds sound relation with foreign banks like the IMF, ADB, World Bank, etc.

9. What is commercial bank? Explain its functions. (8 marks)

Answer: Commercial banks are financial institutions which are established under banking act of a country which provide banking services of accepting deposits, advancing loans, and facilitating various financial transactions. The functions of commercial banks can be explained as:

A. Primary Functions

1. Accepting deposits: The commercial banks accept deposits from the people in three types of accounts as:

- a. **Current Account:** This type of the account is made by people who need money every day with no interest. But bank charges some amount for services fees.
- b. **Saving Account:** People save money in saving account who do not need money frequently. The bank gives some amount of interest in this account.
- c. **Fixed Deposit Account:** Fixed deposits are amount deposited for fixed period like 6 months, 1, 2....10 years or more are called fixed deposits. The interest is higher in this account than saving account.

2. Providing Loans: Commercial banks provide loans as explained below to the needy borrowers and charge high interest.

- a. **Ordinary loan:** Ordinary loan is provided against adequate collateral even without collateral
- b. **Overdraft loan:** Commercial banks allow trustworthy customers to withdraw cash more than the amount in their account for short term.
- c. **Discounting bills of exchange:** Commercial banks provide loans to customer on bills like share certificates, fixed deposit certificate, promissory notes, etc.
- d. **Cash credit:** Cash credit is provided against the securities like shares, bonds, stock, etc. The interest is charged on the money withdrawn from the account of the borrower

B. Secondary Functions

- a. **Remittance of money:** Commercial banks transfer of money from one place/bank to another, both within or outside the country.
- b. **Purchase and sale of securities:** Commercial banks sale and purchase of securities like shares, bonds on request of customers.
- c. **Collection and payment of credit instruments:** Commercial banks collect and pay various credit instruments like cheques, draft, promissory notes, etc.
- d. **Income receiving and payments:** Commercial banks receive dividends and bonus on share and debentures of their customers and make payments of insurance premium, income tax, etc.

C. Contingent Functions

- a. C. banks provide locker facilities for keeping the valuables of customers like diamond, gold in safe lockers.
- b. C. banks issue traveler's cheque as credit instruments like visa card, traveler card, ATM cards, etc. on the basis of deposits,
- c. C. banks deal in foreign currencies exchange with prior approval from Central Bank.
- d. C. banks publish the information of the commercial banks on a daily, monthly or yearly bulletins.

10. Differentiate between money market and capital market. (5 marks questions)

Differences between money market and capital market

Money Market	Capital Market
1. The credit instruments on money market mature in less than a year.	The credit instruments on capital market mature in more than a year.
2. The market provides short term funds to the business sector.	The market provides long term funds to the business sector.
3. The funds are made available for expenses for working capital	The funds are made available for investment in fixed assets
4. The rate of interest is generally high	The rate of interest is generally low
5. The main instruments of credit are treasury bills, commercial papers, etc.	The main instruments of credit are shares, bonds, debentures, etc.
6. There is less risk of investment in money market	There is more risk of investment in capital market.

11. What are the types of monetary policy? Explain its importance in the economy.

There are two types of monetary policy as explained below:

- 1. Expansionary monetary policy:** It aims to increase the money supply by decreasing interest rates, purchasing government securities, lowering the reserve requirements to reduce economic problems like unemployment, deflations, etc. It encourages the borrowing, investment, spending and job creations in the economy.
- 2. Contractionary Monetary Policy:** It aims to decrease the money supply by increasing interest rates, selling government securities, increasing the reserve requirements and aims to control inflation. It discourages investment and spending in economy.

The role of monetary policy in the economy can be explained as:

- 1. Controlling Inflation:** Monetary policy helps to control inflation by adjusting interest rates and the money supply. Contractionary measures can be used to cool down an overheated economy and reduce inflationary pressures.
- 2. Economic Growth:** Through expansionary measures, such as lowering interest rates and increasing the money supply, monetary policy aims to stimulate borrowing, spending, and investment, fostering economic growth.
- 3. Manage unemployment:** By influencing economic activity, monetary policy plays a role in managing unemployment. During economic downturns, expansionary measures can encourage job creation and reduce unemployment rates.
- 4. Maintaining Financial Stability:** Central banks use monetary policy to promote a stable financial system. By regulating interest rates and credit conditions, they aim to prevent excessive risk-taking and speculative bubbles that could lead to financial crises.
- 5. Aim to meet government objectives:** Central banks often work in coordination with government fiscal policies to achieve broader economic objectives, such as sustainable growth, low inflation, and full employment.

Thus monetary policy influences the overall level of economic activity, inflation, and employment. Central banks adjust these tools based on economic conditions to maintain stability.

12. Prepare a chart showing banks and their branches in a different provinces of Nepal.

Answer: There is 1 central bank as Nepal Rasta Bank (NRB) established in 2013 Baishakh 14 in Nepal and including head of commercial banks(22), development banks(17), finance companies(17) and micro-finance(64) which are established under Bank and Financial Institutions Act 2073 as per NRB

Government Finance

Very short answers questions: (1 mark)

1. What is government/ public finance?

Answer: Public finance is the statement of income and expenditure of government. Government collects income as revenue from tax and non-tax revenue, grants, etc. and spends it as expenditure on different activities for the public welfare.

2. What is public/government expenditure?

Answer: The public expenditure includes all the expenses made by the government on administrative services and development activities for the public welfare.

3. What are the major sources of Government Revenue?

The different sources of government revenue are as:

1. Tax revenue collected from direct/ indirect taxes, etc.
2. Non-tax revenue collected from registration fees, license, penalties, etc.
3. Foreign assistance received from bilateral and multilateral sources

4. Define tax.

Answer: Tax is a compulsory payment made by the government to people as per taxation policy whereas taxpayers do not receive immediate benefits in return. Fund raised from taxes is spent for public welfare like transport, education, etc.

5. Define Direct Taxes with examples.

Answer: Direct taxes are those taxes of which the impact and incidence of the tax fall on the same person. For examples: income tax, property tax, rent tax, etc.

6. Define Indirect taxes with examples.

Answer: Indirect taxes are those taxes of which the impact and incidence of the tax falls on different persons. For examples: sales tax, excise duties, custom duties, value added tax (VAT), etc.

7. What is public borrowings?

Answer: Public borrowing is the loan taken by the government from internal or external sources to meet the budget deficit, to develop infrastructures and other development works. This is a temporary source of government revenue and has to be repaid together with interest on their maturity.

8. Define budget.

Answer: The word 'budget' has been derived from the French word '*bougette*' which means leather bag or purse. Budget is a document of financial planning for upcoming fiscal year that contains estimation of government income and expenditure.

Short/long answers questions (5/8 marks)

9. Explain the role/importance of government finance.

Answer: The role/importance of public finance are explained as:

1. **Increase agricultural and industrial production:** If the government reduces the taxes and provides subsidies to the productive sectors like agriculture and industries, there will be increase in production.
2. **To reduce the gap between the rich and the poor:** Government charges progressive taxation and spends the same for the welfare of the poor through social welfare programs, it reduces inequality in the country.
3. **Development of infrastructures:** Government should spend huge budget to develop infrastructures like education, health, transport, communication drinking water, electricity, etc.
4. **Maintain economic stability:** Public finance controls both inflation by increasing taxes and deflation by increasing public expenditure to maintain economic stability.

5. **Increase in employment opportunities:** The government collects a lot of money from different sources and spends it in different social and economic infrastructures which creates more job opportunities
6. **Achieve a favorable balance of payments:** The government can charge high taxes on imports and reduce taxes on exports to achieve a favorable balance of payments.

10. What are the importance of government expenditure? Explain.

Answer: The importance of government expenditure are explained as:

1. **Maintain law and order:** The government has to spend a huge budget in security to maintain law and order and to protect the country from foreign aggression.
2. **Provide administrative services:** The government spends a lot of money through ministries, departments, local councils and other offices to provide administrative services to the public.
3. **Provide infrastructures:** The government spends budget to provide the basic infrastructures like education, health, drinking water, transport, communication, irrigation, electricity, etc.
4. **Maintain equality:** The government expenditure is directed mainly for the upliftment of the poor through different socially benefitting programs and help to reduce the inequality gap.
5. **For economic growth and development:** The government launches economic plans to development of different sectors and spends budget to implement it to achieve economic growth and development.

11. What are the sources of government revenue in Nepal? Explain.

There are different sources of government revenue as explained below:

1. Tax Revenue: Tax is the major source of revenue of any government. The tax revenue consists of the followings:

a. Custom duties: It includes the income obtained from taxes imposed by the government on the export and import of goods and services.

b. Taxes on the production and consumption of goods and services: It includes the income obtained from sales tax, VAT, entertainment tax, contract tax, road tax, etc.

c. Land revenue and registration tax: It includes the income obtained from land revenue and registration tax, house tax, house registration tax, etc.

d. Taxes on property, income and profit: It includes the income obtained from the imposition of property tax, income tax, vehicle tax, tax on profit, etc.

2. Non-Tax Revenue: The main non-tax revenue consists of the followings:

a. Fee, license and permits: The government collects revenue in the form of service fee from education, health, electricity, drinking water, etc. The government receives revenue by providing license to vehicles, guns, pistols business, teachers, auditors, drivers, etc. Similarly, the government collects revenue by giving permits to visit zoo, museums, national parks, trekking, mountaineering, visa, passport, etc.

b. Fines and penalties: The government collects revenue from people who violate the laws and rules as fines and penalties. The fines on late payments of electricity, telephone and water bills, the fine on violation of traffic rules, etc. are examples.

c. Escheats: The claim of the government on the property of dead persons who don't have legal heir is called escheats. The bank deposits not claimed and other unclaimed property of people and organizations also come under escheats.

d. Income from public properties and public enterprises: It includes the income that the government collects from the sale of public properties like land, buildings, vehicles, goods and services. It also includes the profit earned from public enterprises.

3. **Foreign assistance:** It includes the grants and assistance the government receives from foreign governments or international organizations as bilateral or multilateral grants and assistance.

12. Distinguish between direct tax and indirect tax.

Differences between direct tax and indirect tax

Direct tax	Indirect tax
1. Its burden cannot be shifted to others	1. Its burden can be shifted to others
2. Its impact and incidence fall on same person	2. Its impact and incidence fall on different persons
3. It is progressive in nature	3. It is regressive in nature
4. It has a narrow scope	4. It has a broader scope
5. It is inconvenient for tax payers	5. It is more convenient for taxpayers as they do not feel the burden
6. It ensures equality in the society	6. It widens the inequality in the society
7. It reduces the spirit of tax payers to work hard and earn more	7. It does not reduce the spirit of the taxpayers to work harder and earn more
8. Example: income tax, property tax, etc.	8. Example: sales tax, VAT, etc.

13. What are the qualities/features/principles of a goods tax system? Explain.

Answer: A goods tax system should have the following qualities as explained:

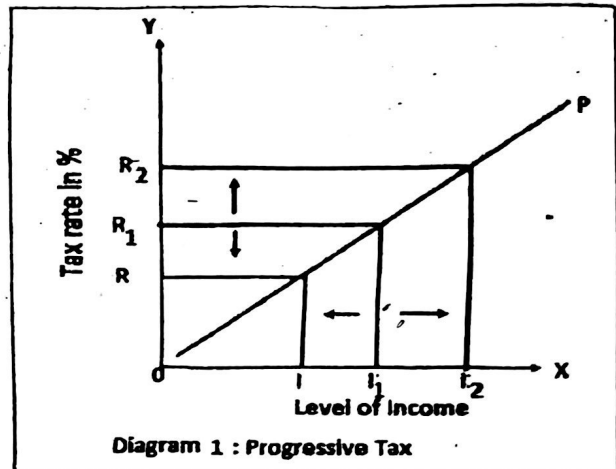
1. **Canon of Ability:** A good tax has the quality of ability to pay. For example, rich pays higher tax and poor pays less.
2. **Canon of Certainty:** A goods tax should be certain about the amount, time, place and the method of tax payment.
3. **Canon of Convenience:** A goods tax should be convenient to the taxpayers in terms of time, place and method of tax payment.
4. **Canon of Economy:** A goods tax system should be able to collect maximum revenue than the cost of its collection.
5. **Canon of Productivity:** The tax imposed should not discourage the people to work harder and earn more but increase production in the country.
6. **Canon of Simplicity:** A goods tax system should be simple and be easily understood even by common people. They should know the reason of paying the tax.
7. **Canon of Elasticity:** Government can change tax rate to collect more revenue as per change in its expenditure.
8. **Canon of Popularity:** The tax should be popular among the payers. They should feel proud to pay the tax.
9. **Canon of Uniformity:** The tax should be imposed on all citizens of the country according to their paying capacity.
10. **Canon of Diversity:** It should find new areas of tax collections. The more number of taxes with minimum tax rates and minimum burden is the diversity of tax.

14. Explain progressive/regressive/digressive/proportional tax systems with the help of diagram. (8 marks)

Answer: The different types of tax systems are explained below as:

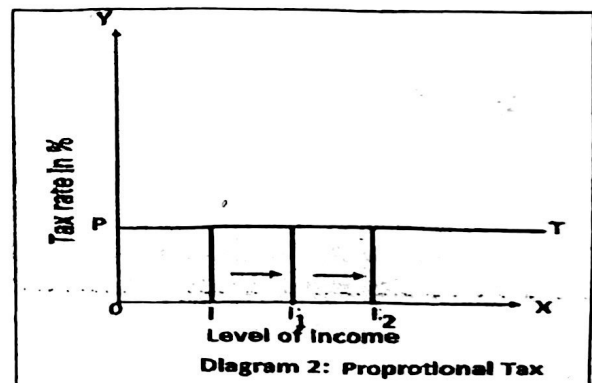
1. Progressive Tax: When the tax rates increases with increase in the level of income and vice-versa, it is progressive tax. The tax rates imposed are high on rich and low on poor people. It can be explained with the help of diagram as:

In the diagram, tax rates in % are shown on the Y axis and the level of income in rupees is shown in the X axis. OP is the Progressive tax curve, which is positively sloping. It indicates that the tax rate increases with an increase in the level of income and vice-versa.



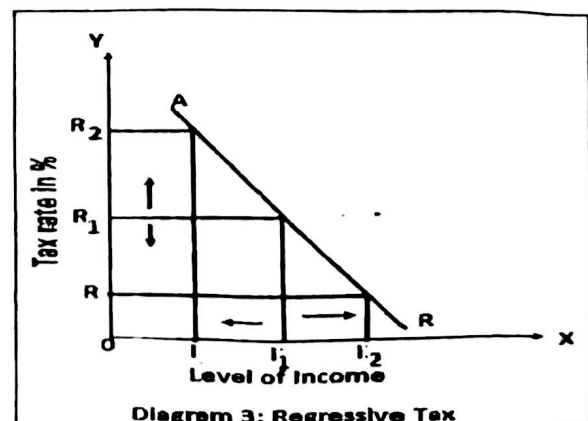
2. Proportional Tax: When the tax rate remains constant at all levels of income, it is proportional tax. The amount of tax increases with increase in income but the tax rate remains the same at all levels of income. It can be explained with the help of diagram as:

In the diagram, the tax rate in % is shown in the Y axis and the levels of income in rupees are shown in the X axis. PT is the proportional tax curve which is a horizontal straight line and parallel to the X axis. It indicates that the tax rate remains constant at all levels of income.



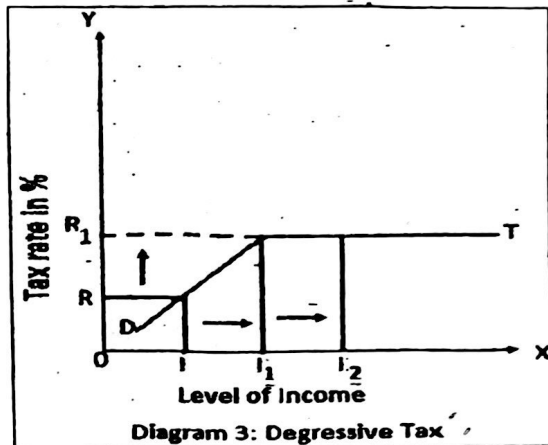
3. Regressive Tax: When tax rate falls with an increase in income and rises with a decrease in income, it is regressive tax. The taxes rates imposed are high on poor and low on rich people. Such tax increases inequality and the social injustice. Regressive tax can be explained with the help of diagram as:

In the diagram, the tax rate in % is shown in the Y axis and the level of income in rupees is shown in the X axis. AR is the regressive tax curve which is negatively sloping. It indicates that there is an inverse relation between tax rate and levels of income.



4. **Digressive Tax:** Digressive tax is a mixture of both progressive and proportional tax. The tax which is mildly progressive up to a certain limit of income and then proportional afterwards, is digressive tax. It can be explained with the help of diagram as:

In the diagram, the tax rate in % is shown in the Y axis and the level of income is shown in the X axis. DT is the digressive tax curve which is positively sloping in the beginning and then is a horizontal straight line afterwards. This indicates that the tax rate increases in the beginning and then remains constant.



15. Explain the sources of government borrowing.

Internal Borrowing: The revenue collected by the government from individuals, financial institutions and other enterprises within the country is known as internal borrowing. There are two types of internal borrowing:

1. **Market borrowing:** It is the type of borrowing in which the government collects loans by selling government securities like treasury bills, bills of exchange, currency, government bonds, etc. The borrowing is voluntary in nature. The government pays a good rate of interest which is more than the market rate of interest.

2. **Non-market borrowings:** If the government collects loans without selling its securities, it is non-market borrowings. Under this, the government collects loans from public and private organizations like insurance companies, Provident Fund, Citizen Investment Trust, Agricultural Development Bank, other private and public institutions of the country.

External Borrowings: The loans taken from foreign/international individuals, governments, international institutions are called external borrowings. The external borrowings can be:

1. **Bilateral borrowing:** If the government borrows loan from the countries of the world, it is bilateral borrowing. For example: loan taken from the USA, Japan, China, etc.

2. **Multilateral borrowing:** If the government borrows loans from international organizations, it is multilateral borrowing. For example the loan borrowed from the IMF, World Bank, ADB, etc.

16. What is a budget? Explain the process/phases/steps of budget formulation in Nepal.

Answer: The word 'budget' has been derived from the French word '*bougette*' which means leather bag or purse. Budget is a document of financial planning for upcoming fiscal year that contains estimation of government income and expenditure.

Budget is almost formulated by the Ministry of Finance. The process of budget formulation begins a few months before the commencement of the new fiscal year. The process of budget formulation can be explained below as:

1. **Estimation of income and expenditure:** The primary step of budget formulation is to collect the estimate of expenditure and the possible incomes from ministries, departments, provincial, district and local offices.
2. **Determination of Priorities:** The planning unit then fixes the priority on main sectors of the government. It then sends directions to all ministries, departments and other offices to submit the projects to be included in the coming fiscal year.

3. **Discussion:** After that a thorough discussion takes place among the representatives of the budget unit, finance ministry, experts, economists, etc. The conclusion of such a discussion will be most useful guideline for budget.
4. **Selection of Projects:** The budget unit of the finance ministry submits the list of projects to be the planning commission for feasibility study. The planning commission makes the review, analysis of the proposed budget and gives positive decision on economically feasible projects.
5. **Proposal of new taxes:** If the revenue of the government estimation is less than the expenditure, new taxes and tax rates, government borrowing will be proposed in upcoming budget.
6. **Final Budget:** After all these processes, the final budget is prepared and the Finance Minister makes it public through "Budget Speech". The necessary changes can be made in the budget after discussion with different parties in the parliament.
7. **Authorization:** The final step is the authorization of the budget by the parliament. Both the houses of the parliament will pass the budget by a majority, after voting, if need be. It then goes to the President and when s/he endorses it, it is authorized budget of the country.

Short answer questions

Give very short answers (1 mark)

1. **What is foreign/international trade?**

International trade is the exchange of goods and services between countries of the world. It involves the export of products to another nation and the import of goods from others.

2. **Define Balance of Trade (BOT).**

Answer: The situation of the value of exports and imports of a country with other countries in a particular period of time is the balance of trade. There are three types of BOT:

Balanced BOT ($X=M$), deficit BOT ($X<M$), surplus BOT ($X>M$)

BOT can be calculated as: $BOT = X - M$

Where, X = Value of exports and M = Value of imports

3. **Define Balance of Payment.**

Balance of payments is the sum of current account and capital account of a country to the foreign countries. There are favorable BOP (Total Receipt > Total Payment) and Unfavorable BOP (Total Receipt < Total Payment). BOP can be calculated as:

$BOP = BOT + \text{Invisible items}$

Where, Invisible items refer to non-physical transactions that do not involve the exchange of tangible goods like remittance income, services, foreign reserves, etc.

Long/short answers questions (8/5 marks)

4. **Explain the role/importance of international trade.**

Answer: The importance of international trade are explained as:

1. **Benefit of specialization:** Due to international trade, a country engages in the production of those goods which it can produce efficiently and at lower cost. This is specialization and it will lead to the improvement in quality and enables large scale production of goods and services.

2. **Benefit of technological progress:** Through international trade, countries get access to new and better technology. Developing countries like Nepal can import new and advanced technologies from advanced countries and accelerate their economic development.

3. **Availability of varieties of goods:** All goods needed cannot be produced in any country. Through international trade different varieties and quality of goods will be available in the markets of the country. This will enable the people to make a choice from among the variety of goods.

4. Availability of raw materials: The foreign trade makes it possible to import the raw materials necessary for the industries from foreign countries. This enables production and hence economic development.

5. Widens the market: The international trade will help to widen the market as the goods can be sold even in the international markets besides the home market.

6. Creates more employment opportunities: Increase in international trade increases the development of more export-oriented industries. Similarly, more people will be employed in export and import of goods. This creates more job opportunities.

7. Increase in government revenue: Due to increase in international trade, more goods will be exported and imported. This will help the country to earn more revenue through export as well as import taxes, sales tax, etc.

5. Explain the causes of trade deficit and suggest the remedies to correct it. (8 marks)

The causes of trade deficit can be explained as:

1. Importing More Than Exporting: When a country purchases more goods and services from other nations (imports) than it sells to them (exports), it results in a trade deficit.

2. Consumer Preferences: If consumers in a country prefer imported goods over domestically produced ones, it can contribute to a trade deficit as the demand for foreign products rises.

3. Exchange Rates: Unfavorable exchange rates can make a country's exports more expensive for foreign buyers and imports cheaper for domestic consumers, leading to an imbalance.

4. Economic Growth: Rapid economic growth may boost domestic consumption and demand for imports, potentially outpacing the growth of exports and causing a trade deficit.

5. Foreign Competition: Intense competition from foreign producers, especially those with lower production costs, can lead to increased imports, affecting the trade balance unfavorably.

6. High Borrowing and Spending: If a country relies on borrowing to finance its consumption and investment, it may contribute to higher imports, exacerbating the trade deficit as it borrows to fund its economic activities.

The measures to increase export and reduce trade deficit of Nepal can be explained as follows:

1. Promote Exports: Encourage and support domestic industries to increase production and exports, boosting the country's sales in the international market.

2. Currency Management: Monitor and manage exchange rates to ensure that the country's currency remains competitive, making exports more attractive and imports relatively more expensive.

3. Invest in Innovation: Foster technological advancements and innovation to enhance the competitiveness of domestic industries, making them more appealing in the global marketplace.

4. Trade Agreements: Negotiate and enter into trade agreements to open up new markets and reduce trade barriers, facilitating easier access for domestic goods and services.

5. Reduce Import Dependency: Develop strategies to substitute imports with domestically produced goods, thereby decreasing reliance on foreign products.

6. Fiscal Policy: Implement fiscal measures, such as tax incentives or subsidies, to support export-oriented industries and discourage excessive imports, promoting a more balanced trade position.

6. Differentiate between Balance of Trade and Balance of Payments.

Balance of Trade (BOT)	Balance of Payments (BOP)
1. It is a narrower concept of international trade	It is a broader concept of international trade.
2. It is the volume of exports and imports of a country with the rest of the world.	It is the comprehensive record of all economic transactions of a country with the rest of the world.
3. It includes only the visible and tangible items of trade.	It includes both the visible as well as non-visible items of trade.
4. Unfavorable BOT can be recovered from favorable BOP.	Unfavorable BOP cannot be recovered from favorable BOT.
5. It is only a part of the economic transaction. So, cannot show the real economic performance of a country.	It is the total economic transaction. So, it shows the real economic performance of a country.

7. What are the invisible items included in the Balance of Payments? Explain.

Answer: The invisible items in the balance of payments refer to non-physical transactions that do not involve the exchange of tangible goods. Some of invisible items can be contrasted here as:

1. **Services:** This includes transactions related to services such as tourism, transportation, financial services, and consulting that cross international borders.
2. **Income:** It comprises earnings from investments, including dividends, interest, and profits earned by a country's residents from their investments abroad and vice versa.
3. **Transfers:** This category involves unilateral transfers of money between countries, including foreign aid, remittances, and grants.
4. **Investment Income:** This includes returns on investments such as dividends and interest earned by foreign investors in a country and by residents on their foreign investments.
5. **Official Flows:** These are transactions involving the government, such as foreign aid, grants, and loans.
6. **Miscellaneous Items:** This category covers various transactions, including non-market and non-financial transactions, which do not fit into the other categories.

8. Explain the structure or components of balance of payment (BOP).

Answer: The account of balance of payment (BOP) can be divided into three types: current/capital/cash account. They can be explained as:

1. **Current Account:** The current account includes the income received from exports and the payments made to imports related on remittance, premium of insurance companies, foreign investments, banking services, transport and communication services, etc.
2. **Capital Account:** It includes the transaction of capital like exchange of financial assets, borrowing/lending and repayment of capital, purchase and sell of foreign securities like shares, bonds, the foreign exchange reserves, etc. If the inflow of capital is more than the outflow, it is surplus balance and if the outflow is more than inflow of capital, it is deficit balance.
3. **Cash Account:** It is the record of foreign exchange reserve. Cash reserve of foreign exchange increases when current and capital accounts are positive but when there is deficit in current and capital account, the foreign currency reserve decreases.

9. Define the concept of foreign exchange rate and explain its types.

Answer: Foreign exchange rate is the price of a currency in terms of another currency. The foreign currencies are exchanged or transferred in foreign exchange market. For example, if

the rate of exchange between US Dollar and Nepali Rupees is \$1 = Rs. 133 in 2024 AD, it tells that we give up rupees 133 for each US dollar.

The different types of exchange rate can be explained as follows:

1. **Flexible (Floating) exchange rate:** The rate of exchange is determined by the market forces of demand and supply in the flexible exchange rate system. There is no any government interference in this exchange rate. For example, the exchange rate between Nepal and USA.
2. **Fixed (Pegged) exchange rate:** The rate of exchange is fixed in terms of another currency in the fixed exchange rate system. It does not fluctuate with change in demand and supply of foreign currency. For example, the exchange rate between Nepal and India.
3. **Forward exchange rate:** The rate of exchange at which future contract for foreign currency is made is called forward exchange rate. The exchange rate settled currently but the actual sale and purchase of currencies occur in the future.
4. **Multiple exchange rate:** The system in which a country adopts more than one exchange rate for its currency is called multiple exchange rate. Different exchange rates are fixed for importers, exporters, and for different countries.
5. **Two-tier exchange rate:** It is a form of multiple exchange rate system. In this system, a country maintains two exchange rates like a higher rate for commercial transaction and lower rate for capital transactions.

10. What is free trade? Explain the advantages/ disadvantages of free trade.

Answer: The concept of free trade was first introduced by Adam Smith and David Ricardo. Under free trade policy, the government does not impose any kinds of restrictions but imposes some taxes on exports and imports of legal goods.

The advantages of free trade are as follows:

1. **Benefits of specialization:** Free trade encourages specialization in the product with production efficiency at lower cost. It enables large scale production and thereby exports leading to increase in government revenue.
2. **Benefit to consumers:** Due to free trade consumers get a choice of various and better quality goods of the world at cheaper prices in the markets.
3. **Expansion of markets:** Free trade will increase the size of markets. The products of a country will find markets all over the world and goods from all over the world will come to home markets.
4. **Gain in technology:** Free trade helps the developing countries to import new and advanced technology from the advanced countries. It also helps the advanced countries to make investments in the developing countries, benefitting both.
5. **Maximum utilization of resources:** Due to free trade, there will be free movement of resources, labour and capital without restrictions. This will lead to maximum utilization of resources which increases the production and exports.
6. **Promotion of friendly relations:** Due to free trade and fair competition, there develops goods trade relation among the countries of the world.

Disadvantages of free trade: There are a lot of disadvantages of free trade as discussed below:

1. **Danger to the domestic industries:** The domestic industries of developing countries feel insecure due to free trade. There is an influx of better and cheaper foreign goods into the home markets which may result to the closure of home industries.