J.K. SHAH CLASSES

SOLUTION

SUB: ECONOMICS DURATION – 1 HR MARKS – 25

SET A

Ans.1. (i) Gossen

(ii) Satiety

(iii) GIffen

(iv) Exceptional

(v) Derived or Indirect

Ans.2.(i)

Demand	**Desire**
<u>Meaning:</u> The demand refers to a desire backed by the purchasing power and willingness to pay for a particular commodity.	The desire refers to a mere wish of a person to own a particular commodity which need not be backed by the ability and willingness to pay.
<u>Formula:</u> Demand: Desire+ purchasing power+ willingness to pay.	Desire Mere wish to own.
<u>Limitations:</u> Demand has a number of limitations like income, fashions, price, etc.	Desire has no limitations. A man can desire anything which he may not buy.
<u>Inclusion in economics:</u> Demand is an economic phenomenon. Therefore, it is studied in economics.	Desire is a purely psychological concept. Therefore, it is not studied in economics.
<u>Relation:</u> Demand has inverse relation with the price. It is always expressed with reference to the price, time and place.	Desire has no relation with the price. It is expressed without reference to the price, time and place.

(ii) **3.** **Total Utility and Marginal utility**

	Total utility	Marginal utility
1.	**Meaning** Total utility means the sum total by consuming one more unit of utilities derived by the consumer from all the units of a commodity.	Marginal utility refers to the net addition made to the total utility utility by consuming one more unit.
2.	**Maximum satisfaction** Total utility remains maximum zero at the time of maximum s satisfaction.	Marginal utility remains at the time of maximum satisfaction.
3.	**Positive/ negative** Though TU declines after maximum, it remains positive.	MU diminishes sharply and turns negative later.
4.	**Formula** Symbolically. $TU_n = MU_1 + MU_2 + ... + MU_n$ Items -TU of (N-1) items.	Symbolically. MU of 'N' th unit=TU of 'N'

Ans.3. (i)

1] To the consumer **2] To the producer**
3] To the monopolist **4] To the government**
5] To the finance minister **5] To understand paradox of value**

1] To the consumer
The law of diminishing marginal utility guides the consumer in planning their budget, so as to achieve maximum satisfaction from the resources available.

2] To the producer
The law is important to the producer in determining price and sales policy. It helps to maximize his profits.

3] Top the monopolist
The law of DMU is helpful to monopolist to practice price discrimination, i.e. charging different prices to different consumers for the same product.

4] To the government
The law of diminishing marginal utility is useful to the government to implement various economic policies like public distribution system, social justice, etc. It helps to improve the welfare of the people in the society.

5] To the finance minister
The law of diminishing marginal utility guides the finance minister to frame progressive taxation policy. It helps to reduce economic inequality. The law is also useful to economic experts, bankers and modern economists.

6] To understand paradox of value
The law explains ‘value paradox’ by showing the difference between value in use and value in exchange. Value-in-use refers to usefulness of a commodity. Whereas value-in-exchange means rate of exchange of one commodity in terms of another.

(ii) Variation of demand refers to, any change in demand due to change in price other things being equal.

Variation of demand is broadly divided into two parts:

1) Expansion of Demand

2) Contraction of Demand

1) **EXPANSION OF DEMAND:** Expansion of demand refers to rise in demand due to fall in price, when other things being equal. Expansion of demand can be explained with the help of diagram.

2) **CONTRACTION OF DEMAND:** Contraction of demand refers to fall in demand due to rise in price, when other things being equal.

Contraction of demand can be explained with the help of diagram.

Ans.4.(i) **No,** I do not agree with the statement.

Reasons: Price is not the sole determinant of demand. Demand is determined by various other factors such as:

a) **Price of Substitute**: If a substitute is available at a lower price, people will demand cheaper substitute goods than costly goods.

b) **Price of Complementary goods**: Complementary goods have joint demand. More than two or more goods are jointly demanded to satisfy a want. For example, Car and petrol paper and pen etc. In such a case, a change in the price of one commodity would also affect the demand for other commodity. If the price of petrol rises, the demand for car would fall and vice-versa.

c) **Utility:** Utility is the basic purpose for demanding a commodity. If a commodity does not provide utility to the consumer, he will not demand it. For example, there is no demand for cigarettes for a non-smoker.

d) **Disposable Income**: Purchasing power or ability to pay is the basic requirement for a demand. Disposable income is the income at the disposal of the people after paying direct taxes such as income tax. Generally, rich consumers buy more goods and services than the poor people do.

e) **Taste, Preference, Habits:** Changes in taste, preference, habits, attitudes, etc. of the consumers would affect the demand for certain goods and services, even if there are no changes in their prices.

f) **Future Price Expectation**: If consumers expect that the price of commodity would still rise in the near future, the demand for that commodity would be more even at higher prices in the current period. Likewise, if they except that the price would still fall in the near future the demand would be less even at lower prices in the current period because people would wait for the price to fall further.

Therefore, price of the commodity is not the sole determinant of demand.

(ii) **No, I do not agree with this statement, because:-**

a) Economic laws are not only universal but also hypothetical. So, the law of diminishing Marginal utility is also conditional and has exceptions.

b) The exceptions to the law of Diminishing Marginal Utility are collection of antiques or rate things, drunkards, hobbies etc.
c) The hobbies like music, poetry and reading give more satisfaction when the experience is repeated.
d) These exceptions do follow the homogeneity or rationality conditions of law of Diminishing Marginal Utility.
e) Thus, it can be said that there are exceptions to the law of diminishing marginal utility.

Ans.5. (i) (A) INTRODUCTION: The law of DMU was introduced by Dr. Alfred Marshall, which is written in his book "Principles of Economics". The law states that the general behaviour of a consumer.

(B) STATEMENT OF LAW: "Other things being equal," with the increase in stock of commodity, its Marginal utility gets diminish.

(C) EXPLAINATION OF LAW: The above law states that "the more we have commodity, the less we want to consume" It means that if a consumer has more of some stock of commodity, the utility from every additional stock gets reduced.

(D) UTILITY SCHEDULE:

UNITS OF MANGOES	MARGINAL UTILITY (M.U)	TOTAL UTILITY (T.U)
1	10	10
2	18	8
3	24	6
4	28	4
5	30	2
6	**30**	**0**
7	28	-2

- From the above schedule upto 5^{th} units of mangoes T.U is increasing, at the same time M.U is decreasing.
- At 6^{th} unit of mangoes T.U becomes constant or maximum while M.U becomes Zero.
- Finally, at 7^{th} unit of mangoes T.U falls at the same time M.U becomes negative.
- From the above diagram, on X-axis units of mangoes are represented & on Y-axis Total utility (T.U) and Marginal utility (M.U) are represented T.U the total utility curve & M.U the marginal utility curve.
- In the beginning T.U curve is increasing while M.U curve is decreasing.
- After certain point T.U curve becomes constant while M.U curve becomes zero, which is shown of line of satiety.
- Finally T.U curve falls, at the same time Marginal utility curves enters in negative.

F) ASSUMPTION TO DMU:

1) Cardinal measurement: Marshall assumes that, utility can be measured in cardinal numbers (imaginary numbers)

2) **Homogeneity:** The commodity whish we consume are same in all respect. Therefore, it is assume that a commodity should be same colour, taste, size, shape, etc.

3) **Reasonability:** The units of commodity consumed should be of reasonable size in other words, the units should neither big nor small. For e.g: a thirsty man cannot experience D.M.U if he drinks water in a spoon.

4) **Continuity:** All units of commodity are to be consumed continuously i.e without any time gap. Therefore, it is assumed that commodity should be consumed continuously.

5) **Rationality (Normal Behaviour):** The consumer should be rational in behaviour. Rationality means a consumer should able to express his satisfaction.

6) **Constant M.U of money:** The M.U of money is assuming to be constant. It means consumer should ignore utility of money while consuming commodity.

7) **Constant Income, Taste & Habit:** It is also assume, that the consumer income, taste, habit, etc should remain constant.

G) EXPECTION TO D.M.U:

The law is not applicable in the following case:

1) **Hobbies:** In case of hobbies like collection of stamps, old coins, antiques, etc. The M.U goes on increasing with the increase in collection but the collection of stamps or coins are not same therefore, hobbies are not exception to D.M.U.

2) **Drunkards:** People addicted to drinking, experience increasing marginal utility as they consume more and more. However, their behaviour is not normal.

3) **Misers:** Misers the people who are very greedy, they enjoy more & more marginal utility by acquiring more 7 more money. However, the behaviour of misers is not normal.

4) **Money:** Since, everyone desires to have more money, it is always experience that every additional money gives more utility. But this is not true. The importance of additional money is not the same for rich & poor person.

5) **Music & Reading:** People who enjoy reading & music get more utility by reading more books and listening to more music. But they do not read the same book or listen to the same music.

(ii) (A) INTRODUCTION: The law of demand was introduced by Dr, Alfred Marshall which is written in his book “Principles of Economics”. The law of demand states relationship between price and demand.

B) STATEMENT OF LAW: “Other things being equal,” Demand varies inversely with price i.e price falls demand rise and as price rise demand falls.

C) EXPLAINATION OF LAW: The above law explains relationship between price and demand i.e as price change demand also change inversely.

Therefore D = F (P) D = demand for commodity F = Functional relationship P = Price of commodity.

D) DEMAND SCHEDULE:

PRICE (RS)	**QUANTITY DEMAND (KG)**
10	1
8	2
6	3
4	4
2	5

- From the above schedule, at a price of Rs.10 quantity demand is 1kg as price falls Rs.10 to Rs.8 quantity demand rise from 1kg to 2kg. Further as price falls from Rs.8 to Rs.6 quantity demand rise from 2kg to 3kg and so on.
- Finally, as price falls to Rs.2 quantity demand rise to 5kg.
- Therefore, there is inverse relationship between price and quantity demand.

(E) DEMAND CURVE:

- From the above diagram, on X-axis quality demand are represented and Y-axis prices are represented
  quantity demand. The demand curve which slopes downward from left to right.

- At a higher price of Rs.10 quantity demand is less i.e 1kg and at a lower price of rs.2 quantity demand is high i.e 5kg.
- It states that as price falls quantity demand rise therefore, there is inverse relationship between price and quantity demand.

F) ASSUMPTION TO LAW OF DEMAND:

1) **No change in income:** It is assumed that the income of consumer should remain constant because if income changes demand also change.

2) **No change in price of related goods:** It is assumed that the price of substitute and complementary goods should remain constant because if their price changes demand also change.

3) **No change in Population:** It is also assumed that the population of a particular country should remain constant because if population changes demand also change.

4) **No change in Advertisement:** It is further assumed that advertisement for a specific commodity should remain constant because more the advertisement more the demand.

5) **No change in climatic condition:** It is also assumed that climatic condition should remain unchanged because with the change in climatic demand also change.

6) **No change in utility:** It is assume that utility from a commodity should always remain constant because higher the utility higher the demand.

G) **EXCEPTION TO LAW OF DEMAND:**

1) **Giffen goods:** Giffen goods are typical type of inferior goods which is purchased less at lower price. The term Giffen goods introduced by Sir Robert Giffen in 19^{th} century. Who observed the behaviour of people towards inferior goods? According to him the people purchase less even the price is less due to poor quality of goods. Therefore, low of demand not apply in this case. Thus there is a direct relationship between price and demand. For e.g: Food grains sold at ration supply This can be explained with the help of diagram:

The above diagram explains the demand curve slopes upwards from left to right.

2) **Snob Appeal:** Rich people are more connected with social status with expensive goods like diamonds. They purchase more when price of such goods are high and purchase less when price are less. Therefore there is a direct relationship between price and demand.

3) **Quality:** Sometimes people are more concerned with quality when they purchase any commodity. In this case even the price is high for high quality demand is also high and vise-versa. Therefore, there is direct relationship between price and demand.

4) **Fashion:** The law of demand may not work or operate in case of those people who are fashion conscious (aware) For e.g: If a people purchase new fashion commodity even though price are high it means at a higher price more the demand . Therefore there is direct relationship between fashion and demand.

5) **Demonstration effect:** It is the tendency of the people to intimate (to copy) the consumption pattern / life style in such case law of demand may not operate because such goods are available at high price. Therefore even the price is high demand is also high. Thus, there is direct relationship between price and demand.