

Marks : 50	SYJC March' 19 Subject : Economics Micro Economics /Consumer Behaviour / Producers Behaviour (Supply)	Duration : 1.5 Hours Solution
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Q.1. Define/ Explain: (04)

1. Microscopic Approach.

Ans: Microeconomics is microscopic in approach. It splits economy into small individual units and analyze the behaviour of every unit in detail.

2. Price Theory.

Ans: Microeconomics is called price theory because it is primarily concerned with determination of prices of goods and factors of production.

Q.2. Answer the following: (Attempt All) (06)

1. Explain the meaning of micro economics with the help of few important definition.

Ans: Ragnar Frisch has classified economics into two broad categories: 'Microeconomics and Macroeconomics'.

The term 'micro' is derived from the Greek word "Mikros" which means small. Microeconomics thus deals with the behaviour of individual economic units.

e.g. a consumer, a producer, a market.

The following are some important definitions of microeconomics which help us to understand its meaning, nature and subject matter.

(a) According to Kenneth Boulding, "Microeconomics is the study of particular firms, particular households, individual price, wages, incomes, individual industries, particular commodities."

It means microeconomics is a study of economic activity of households as a consumption unit, individual firms and industries as production unit and individual prices, wages, incomes and their determination.

(b) In the words of Maurice Dobb, "Microeconomics is in fact a microscopic study of the economy".

It means in microeconomic analysis each individual unit is examined separately in detail.

2. Write a note on Theory of Economic welfare.

Ans: Theory of welfare basically deals with efficiency in the allocation of resources. Efficiency in the allocation of resources is attained when it results in maximization of satisfaction of people. Economic efficiency involves three efficiencies :

(A) Efficiency in production:

Efficiency in production means producing maximum possible amount of goods and services from the given amount of resources.

(B) Efficiency in consumption:

Efficiency in consumption means distribution of produced goods and services among the people for consumption in such a way as to maximize total satisfaction of society.

(C) Efficiency in the direction of production i.e. overall economic efficiency:

(a) Efficiency in the direction of production means production of those goods which are most desired by the people.

- (b) Microeconomic theory shows under what conditions these efficiencies are achieved.
- (c) Thus, one may conclude that microeconomics is mainly concerned with price theory and allocation of resources. It seeks to examine the following basic economic questions:
 - (i) What goods are produced and in what quantities?
 - (ii) Who will produce them and how?
 - (iii) To whom and how the wealth so produced shall be distributed?
 - (iv) How shall resources be allocated to production and consumption in an efficient manner?

3. What are the features of micro economics.

Ans: Features of microeconomics:

(1) Study of Individual Units:

- (a) Microeconomics is the study of individual units. It is concerned with the study of particular firms, households, commodities and industries.
- (b) It focuses attention on the study of the behaviour of micro variables. Thus, it studies only the part of the economy and not the whole of economy.

(2) Price Theory:

- (a) Microeconomics is called price theory because it is primarily concerned with determination of prices of goods and factors of production.

(3) Slicing Method:

- (a) Microeconomics splits the economy into small individual units and then studies each unit separately in detail.
- (b) Thus, it is said that microeconomics uses slicing method.

(4) Partial Equilibrium:

- (a) Microeconomics analysis is a partial equilibrium analysis. Partial equilibrium analyses equilibrium position of individual consumer, individual firm, individual industry, etc.
- (b) Partial equilibrium analysis isolates an individual unit from other forces and proceeds with the assumption, "other things remaining the same" (*Ceteris paribus*). This approach neglects the interdependence between economic variables.

(5) Microscopic Approach:

- (a) Microeconomics is microscopic in approach. It splits economy into small individual units and analyze the behaviour of every unit in detail.

(6) Analysis of resource allocation and economic efficiency:

- (a) Microeconomics deals with the allocation of resources among competing groups.
- (b) Microeconomics explains how relative prices of commodities and factors of production determine the allocation of resources, this in turn determines:
 - (i) What goods will be produced and in what quantities?
 - (ii) How will they be distributed?

It means microeconomics also deals with the problem of income distribution.

Microeconomics also examines whether the given allocation of resources is efficient i.e. whether it results in the economic welfare of the society.

(7) Use of marginalism principle:

Marginal analysis helps to study a variable through the effects of minor changes, e.g. what will happen to satisfaction if a consumer increases or decreases consumption by small levels.

The theories like consumers, surplus, law of Diminishing Marginal Utility, law of Equi Marginal Utility (EMU) are based on marginal analysis.

(8) Based on certain assumptions:

- (a) Microeconomics assumes laissez faire policy, pure capitalism, full employment, perfect competition, etc. which do not exist in reality. Also most of the theories are based on the 'Ceteris Paribus' assumption i.e. other things being constant.
- (b) The assumption makes the analysis simple but at the same time it neglects the interdependence between economic variables. The assumption makes the theories static and neglects changing the economic world.

(9) Limited Scope:

Microeconomics studies individual economic units and not the whole economy. It does not deal with the nation-wide problems like unemployment, inflation or depression, poverty, balance of payments situation, economic growth, etc. So, its scope is limited.

(10) Analysis of market structures:

Microeconomics analyzes different market structures i.e. perfect competition, monopoly, oligopoly, monopolistic competition, etc. and describes how prices and quantities are determined in different markets.

Q.3. Define/ Explain:

(04)

1. Place utility.

- (a) When utility of a commodity increases due to the change in the place of utilisation, it is called place utility.
- (b) It is also created with the transfer of goods from the place of production to the place where they are consumed.
 - (i) e.g. Utility of water increases when it is transferred from river to farm.
 - (ii) Fisheries and mining also imply creation of place utility.
 - (iii) Transport services are involved in creation of place utility.

2. Service utility.

- (a) It arises when personal services are rendered by various factors in the society to others.
- (b) Services provided by doctors to patients, knowledge given by teachers to students, suggestions by lawyers to his clients etc. are examples of service utility.
- (c) In this case, production and

Q.4. Answer the following:

(08)

- 1. Explain the relationship between TU & MU?

Ans: The concept of TU and MU are the basic concepts in the basic cardinal measurement of utility. TU and MU are two inter-related but distinct concepts.

(1) Total utility (TU):

- (a) Total utility refers to the sum of utilities derived by the consumer from all units of a commodity consumed at a given point of time.
- (b) It is an aggregate of utilities from all successive units of a commodity.

$$TU = \sum MU$$

(2) Marginal utility (MU):

- (a) Marginal utility refers to the additional utility derived by a consumer from an additional unit of a commodity consumed.
- (b) It is the utility from the last unit of a commodity. In short, MU is the addition made by last unit to TU.

$$MU_n = T U_n - TU_{(n - 1)}$$

- (c) Prof. Alfred Marshall constructed schedule of MU and TU which could be measured in imaginary units called 'utils'. He called these 'Utility Schedules'.
- (d) The utility schedule given in the following table shows the relationship between the total utility and the marginal utility of a commodity, say oranges.

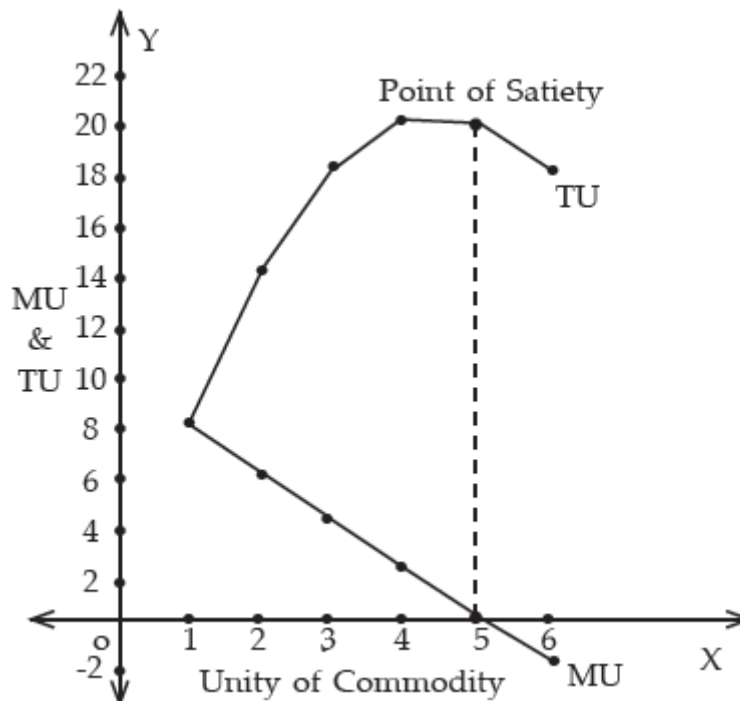
Utility Schedule

Units of Commodity	TU Units	MU Units
1	8	8
2	14	6
3	18	4
4	20	2
5	20	0
6	18	- 2

The above given schedule indicates MU and TU.

From above utility schedule we conclude:

- (a) As a consumer consumes first unit of orange TU and MU derived is same i.e. 8 units.
- (b) As the consumer continues to consume more of oranges, TU increases at diminishing rate i.e. 8 to 14 and MU diminishes from 8 to 6 units.
- (c) As he still continues to consume more oranges, he reaches the point of satisfaction i.e. in above schedule when he consumes 5th unit of orange, TU is constant i.e. 20 and MU is 0.
- (d) If the consumer still continues to consume he experiences disutility so by 6th unit of consumption, TU falls i.e. it comes to 18, MU is negative i.e. -2.



The above diagram explains that:

- (a) Initially both MU and TU are same.

- (b) As more and more units of the commodity are consumed, the TU increases but the MU decreases.
- (c) Increase in TU depends on MU.
- (d) Since MU diminishes, TU increases at a diminishing rate.
- (e) When MU is zero, TU is maximum. This is called point of “satiety” (i.e. the point at which the consumer is fully satisfied). In our schedule $MU = 0$ and $TU = 20$ at the 5th unit is the point of satiety (maximum satisfaction).
- (f) When MU becomes negative, TU falls.
- (g) Thus, while TU is always positive, MU is positive, zero and negative.

2. Explain the features of utility.

(1) Relative concept:

Utility is related to time and place. It differs from time to time and place to place.

e.g.

- (a) Cotton clothes in summer and woollen clothes in winter have greater utility.
- (b) Similarly, woollen clothes have more utility in Kashmir than in Mumbai.

(2) Subjective concept:

Utility of a commodity cannot be same for all individuals. It differs from person to person, due to differences in taste, preference, choice, liking, etc. of the people. Utility depends upon the existence of the want.

e.g.

- (a) Vegetarian has no utility for meat.
- (b) Non-smoker has no utility for cigarettes.

(3) Ethically neutral:

The term utility is morally colourless concept. A good may be harmful or bad, but as long as it satisfies somebody's want, it has utility even though it satisfies a bad or an immoral want.

e.g. Knife has utility for a housewife to cut vegetables and for a killer to stab somebody.

(4) Utility and usefulness are not same:

A commodity may have utility, but it may not be useful to the consumer.

e.g.

- (a) A cigarette has utility for a smoker, but it does not have usefulness as it is injurious to health.
- (b) Liquor has utility from the point of view of a drunkard, but it is useless, undesirable and bad for health.

(5) Not same as pleasure:

Utility and pleasure are different. A commodity may have utility but its consumption may not provide pleasure or happiness.

e.g. An injection has utility for a patient but it is painful, so it does not give pleasure.

(6) Utility differs from satisfaction:

Utility and satisfaction though interrelated, are not same in the strict sense. Utility is the capacity of a good to satisfy a human want before consumption but satisfaction is derived only after consumption of that good. Thus while, utility anticipates (comes before) satisfaction, satisfaction is the end result of consumption.

(7) Not easily measurable:

Utility is a psychological concept. It is invisible and intangible. Utility being the feeling of the

consumer, cannot be expressed in numerical terms. It cannot be measured cardinally i.e. in numbers. However, one can ordinally measure it.

e.g. when a thirsty person drinks water, he derives utility, by realising higher or lower level of satisfaction.

(8) Depends upon the intensity of want:

The more intense and urgent the want, the greater is the utility and vice versa. As the urgency of want declines, utility diminishes.

e.g.

(a) Utility of food is initially higher for hungry person and utility declines with the satisfaction of hunger.

(b) When a person is thirsty, he will derive a great amount of utility from the first glass of water and the amount of utility from the successive glasses of water would be less. This is because, the more of a thing we have, the less we want of it.

(9) It is the basis of demand:

Utility forms the basis of demand. If a commodity does not give any utility, a person may not demand it. He will demand a commodity only if, it gives him utility.

e.g.

(a) Demand for pen is more for students because utility of pen is greater for them.

(b) Rotten eggs has no utility, so it will not be demanded.

(10) Utility of a good can be multi-purpose:

The utility of good changes according to the use to which it is put to. e.g. Electricity used for lighting has greater utility than for ironing.

(11) Utility increases with knowledge:

With the advancement of technology, knowledge and research; new uses of a commodity may be discovered and its utility increases.

e.g. Cell phone, computers, etc.

Q.5. Answer the following in detail.

(08)

1. Explain the law of Diminishing Marginal Utility (DMU).

(1) Introduction of the law:

(a) The law explains economic behaviour of a rational consumer. It is a common experience that, the more we have of a commodity, less we desire to have more of it. This fact is expressed by the law of Diminishing Marginal Utility (DMU).

(b) It was first proposed by Mr. Gossen. So this law is known as Gossen's first law.

(c) However, it was further explained in detail by Prof. Alfred Marshall in his book 'Principles of Economics' in 1890.

(2) Statement of the law:

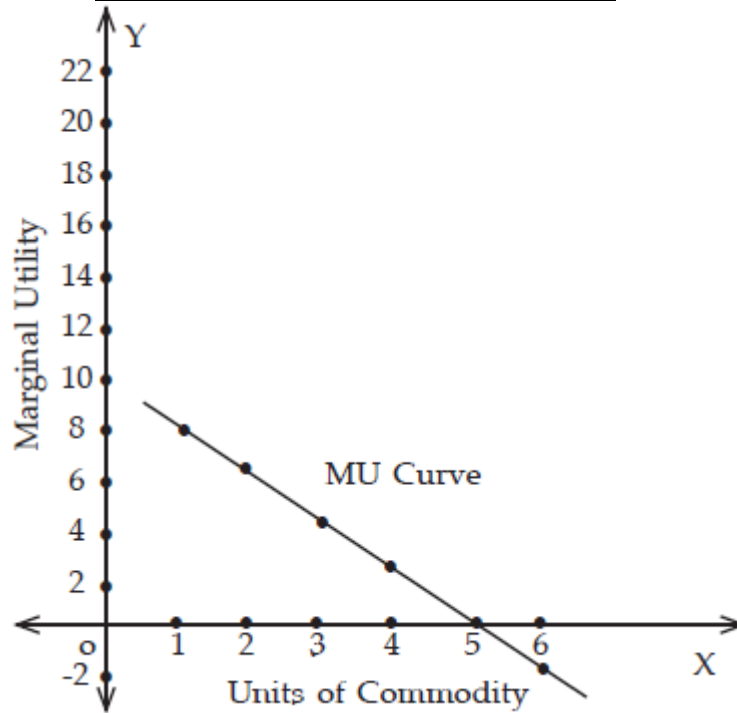
(a) According to Prof. Alfred Marshall, other things being constant, "the additional benefit which a person derives from the increase in the stock of a thing diminishes with every increase in the stock that he already has."

(b) In simple words, the law explains that marginal utility goes on diminishing with an increase in the successive units of a commodity consumed.

(c) It can be graphically represented with the help of the following schedule and diagram:

Utility Schedule

Units of Commodity	MU Units
1	8
2	6
3	4
4	2
5	0
6	-2



(3) Explanation of the diagram:

- (a) In the above diagram, 'X' axis indicates units of commodity and 'Y' axis measures MU. Various points of MU are plotted on the graph as per the given schedule. We get MU curve, by joining these points.
- (b) MU curve slopes downward from left to right. It shows that MU goes on falling with every successive increase in the consumption of a commodity.
- (c) In this case, when a consumer consumes fifth unit, MU becomes zero. So MU curve intersects 'X' axis. It indicates full satisfaction level. It is called the point of satiety.
- (d) Beyond the point of satiety, further consumption of a commodity brings disutility. It is shown by negative marginal utility. The MU curve enters the negative region.
- (e) Thus, it explains that, MU diminishes with every increase in consumption of commodity.

Q.6. Define/ Explain:

(04)

1. Stock.

- (a) Stock is the source of supply. Without stock supply is not possible.
- (b) Stock is the total quantity of commodity available for sale with a seller at a particular point of time.
It is potential to supply by increasing production, supply can be increased.
- (c) Generally, stock is more than supply because total stock consists of current stock and previous stock.
- (d) In case of durable goods, the entire stock of the goods may not be offered for sale. If its

market price is low, a part of it is stored.

- (e) But in case of perishable goods like vegetables, fish, etc. the stock may be equal to the supply because they cannot be stored for a long time.
- (f) Hence, stock may be equal or more than supply. Stock can exceed the supply, but supply cannot exceed the stock.

2. Distinguish between Individual Supply and Market Supply

Individual Supply	Market Supply
(1) Individual supply is the supply of an individual seller.	(1) Market supply is the supply of all the sellers taken together.
(2) Individual supply schedule refers to a table showing various quantities of a commodity offered by single seller for sale at different prices during a given period of time.	(2) Market supply schedule refers to a table which shows a commodity, offered for sale by all sellers in the market at different prices during a period of time.

Price (₹)	Quantity demanded
1	10
2	20
3	30
4	40
5	50

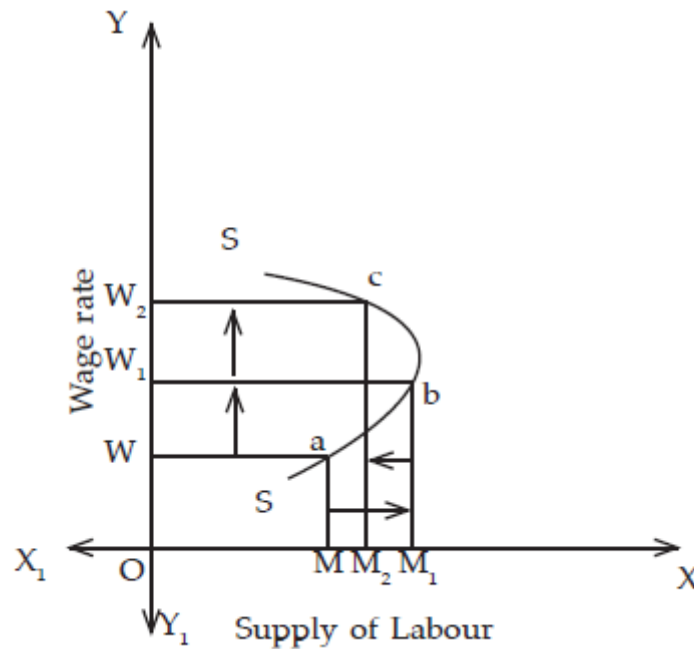
Price (₹)	Quantity of commodity X Supplied per week		Total or Market Supply A + B
	Seller A	Seller B	
1	10	1000	1100
2	200	2000	2200
3	300	3000	3300
4	400	4000	4400
5	500	5000	5500

Q.7. Answer the following:

(08)

1. Write a note on backward bending labour supply curve.

Ans: When the wage rate in the industry rises, the supply of labour (i.e. hours of work) rises upto a certain limit.



- (b) Beyond certain limit with further rise in wages, supply of labour tends to fall.
- (c) This is because the labour prefers leisure to work i.e. he substitutes work with leisure.
- (d) Also, with an increased wage rate he is able to satisfy his needs.

2. Explain Determinants of Supply.

- (a) Supply of commodity means the quantity that is offered for sale by a seller (firm) over a particular period of time at a certain price
- (b) It shows the various amounts of a commodity which a seller is willing and able to offer for sale at all possible prices during a given period of time.
- (c) According to Paul Samuelson, supply refers to "The relation between market prices and the amount of the goods that producers are willing to supply".
- (d) In short, supply implies both willingness and ability to offer the commodity for sale. The willingness of a seller depends on the prevailing market price.

Likewise, the ability of a seller depends upon the stock of goods available for sale at a point of time. When a farmer produces say 1000 kg of wheat, it is his stock. At ₹25/- per kg. if he offers 500 kg., wheat for sale at a given period of time, it becomes his actual supply.

- (e) As with demand, supply is always at a price and a particular period of time. Thus, $S = f(P)$ where S = supply of a commodity, f = functional relationship and P = price. This relationship is direct, that is, supply varies directly with price. It follows that at a higher price, more is offered for sale and vice-versa.
- (f) It follows from above, that the concept of supply has four essential elements:
 - (i) Quantity of commodity.
 - (ii) Willingness to sell.
 - (iii) Price of the commodity.
 - (iv) Period of time.

Q.8. Answer the following in detail.

(08)

1. Explain the law of supply with its assumptions.

Ans: Introduction to Law of Supply

- (a) The Law of Supply was introduced by Dr. Alfred Marshall in his book ‘Principles of Economics’ which was published in 1890.
- (b) The law explains the functional relationship between the price and quantity supplied.

Statement of Law:

- (a) According to Dr. Alfred Marshall, “Other things being constant the higher the price of the commodity, greater is the quantity supplied and lower the price of the commodity, smaller is the quantity supplied.”
- (b) The law states that other things remaining the same, the seller will supply more quantity of goods at a higher price and less quantity of goods at a lower price.

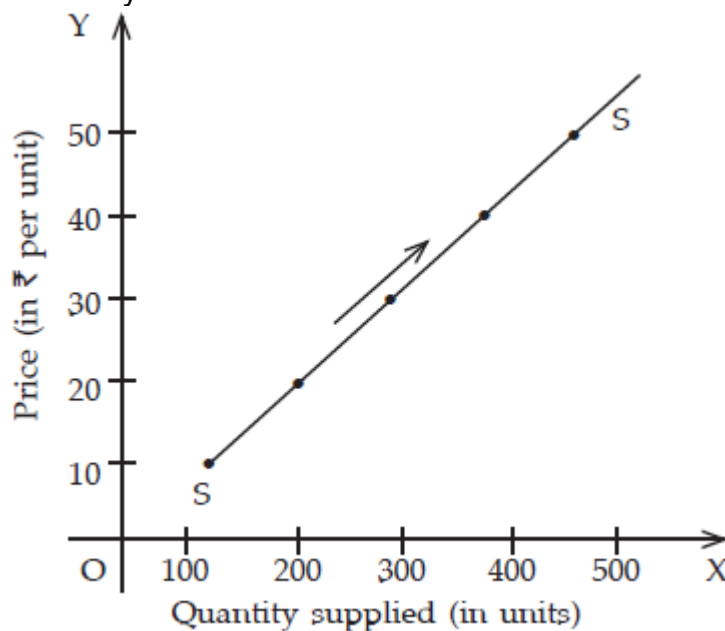
Explanation of Law of Supply:

- (a) Law of supply can be better understood with the help of following schedule and diagram:

Supply Schedule

Price (₹)	Quantity Supplied (in Units)
10	100
20	200
30	300
40	400
50	500

- (b) Supply schedule clearly shows that more units of the commodity are being offered for sale as the price of the commodity increases.



- (c) In the above given diagram, the quantity supplied is shown on the X-axis and the price on the Y-axis.

Supply curve SS slopes upward from left to right, indicating direct relationship between the price and the quantity supplied.

Assumptions of the Law of Supply:

The law of supply is conditional, since we assume that price alone changes while all other factors determining supply remain constant. These assumptions are as follows:

- (i) **Cost of production is unchanged:** It is assumed that there is no change in the cost of production.
- (ii) **No change in technique of production:** It is assumed that there is no change in the method or technique of production.
- (iii) **Government’s policies remain unchanged:** It is also assumed that Government policies like taxation policy, trade policy, etc. remain unchanged.

- (iv) **No change in transport cost:** It is assumed that there is no change in the condition of transport facilities and transport costs.
- (v) **No future expectations:** The law also assumes that the sellers do not expect future changes in the price of the product.
- (vi) **No change in the weather conditions:** It is assumed that there is no change in the weather conditions. There are no natural calamities like floods, earthquake, etc.
- (vii) **Prices of other goods remain constant:** The prices of other goods are assumed to remain constant. If they change, the law of supply may not hold true because the producer may transfer resources to other products.
- (viii) **Constant scale of production:** It is assumed that the scale of production remains constant during the given period of time.

