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SYJC

SUBJECT- ECONOMICS

Test Code – SYJ 6121 B

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ANSWER : 1(A)

1. (a) partial
2. (b) negative
3. (b) Autonomous
4. (c) Current
5. (d) annually

(B)
1. Necessary goods – Inelastic demand
2. Production – Creating utility
3. Plan expenditure – Irrigation
4. Commercial bank – Credit creation
5. Decrease in supply – Leftward shift in supply curve

(C)
1. False
2. True
3. True
4. True
5. True
6. True

ANSWER : 2(A)

(1) **Ceteris paribus:** Micro Economic analysis is a partial equilibrium analysis. Partial equilibrium analyses equilibrium position of individual consumer individual firm, individual industry etc. 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.

(2) **Marginal revenue :** Marginal revenue refers to the net addition made to the total revenue by selling an additional unit of output. Thus, **MR** = $TR_n - TR_{n-1}$. The marginal revenue can also be calculated by the ratio of change in the total revenue to change in the total quantity of output.

Thus, MC = $\frac{\Delta TR}{\Delta TQ}$

(3) **Natural monopoly :** Natural monopoly emerges due to the availability of natural resources. Due to the availability of the natural resources a particular region enjoys monopoly in the product which requires that natural resource Similarly, the natural advantages like good location, old establishment, involvement of huge investment, business reputation, etc. also results in natural monopoly. For example, tea from Assam.

(4) **Sunk Capital :** Capital which is used for a specific purpose is called sunk capital. It cannot be used easily from one business to another business. For example, Xerox machine, road roller, railway lines, etc.

(5) **Aggregate supply :**

(1) Aggregate supply refers to the minimum amount of sales proceeds which entrepreneurs expect to receive from the sale of output at any given level of employment in a year. It essentially refers to the total national product or national income.

(2) The determinants of aggregate supply are symbolically expressed as O = f ($\overline{N}$, L, $\overline{K}$, $\overline{T}$).

(6) **Repo Rate :** Repo Rate or Purchase Rate, i.e. Liquidity Adjustment Facility (LAF) is that rate at which commercial banks borrow money from the Central Bank for short period by selling their securities to the Central Bank with an agreement to repurchase them at a future date at predetermined price. To control inflation, the repo rate is increased and to control deflation, the repo rate and bank rate is decreased.

ANSWER : 2 (B)

1. Microeconomics is a study of individual economic unit

Ans.:

(1) Microeconomics studies particular households, particular firms or industries, etc. It studies how a particular **consumer attains efficiency in consumption** and how a particular producer attains efficiency in production.

(2) Microeconomic does not study the aggregates of economy such as total consumption, national output, aggregate investment, etc. Thus, microeconomics is individualistic in nature. Therefore, microeconomics studies individual economic unit.

2. Utility depends upon intensity of want

Ans.:

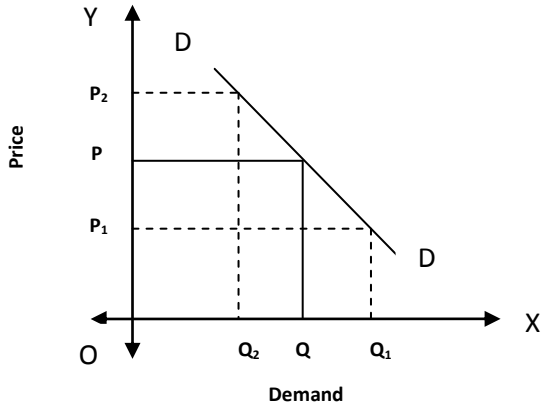
Utility has direct relation to intensity of want. Individual finds more utility in a commodity if his want is more intense and vice versa. For example, hungry individual finds more utility in food than a person who is not so hungry.

3. Demand curve slopes downward

Ans.:

(i) According to the Law of Demand propounded by Dr. Alfred Marshall, "Other things being equal as price falls demand tends to rise and as price rises demand tends to fall".

(ii) This statement can be explained with the help of the following diagram :



From the diagram it can be seen that as price rises from OP to OP_2, demand falls from Q to Q_2. Similarly, as price falls from OP to OP_1, demand rises from OQ to OQ_1. Demand curve, i.e. DD indicates this inverse relationship between the price and the quantity demanded of a commodity.

Therefore, demand curve slopes downward from the left to the right.

4. Unpaid services are not included in national income

Ans.:

(1) The services provided out of love, affection, mercy, sympathy, etc. are not paid for. Therefore, it becomes difficult to determine the market value of these services.

(2) The services that are provided with the motive of earning monetary returns are considered productive in nature. Their market value can be easily determined. Therefore, paid services are included in national income.

5. Many subjective factors determine consumption function

Ans.:

(1) The subjective motives such as motive of precaution, motive of foresight, motive of calculation, motive of improvement, motive of independence, motive of enterprise, motive of pride, motive of avarice, etc. affects consumption function.

(2) For example, high motive of enterprise and high motive of independent results in decrease in the consumption and increase in savings and vice versa.
Thus, there are many subjective factors determining consumption function.

6. The Central Bank acts as a lender of last resort

Ans.:

(1) The commercial banks operate on the basis of low cash reserve system. If there is a great demand for cash by depositors, even a well – managed commercial bank can run into difficulty.

(2) In such a financial crisis, the Central Bank is the ultimate source of financial assistance to commercial banks. Commercial banks gets loans from the Central Bank to overcome their financial crises.
Thus, the Central Bank acts as a lender of the last resort.

ANSWER : 3(A)

1. Increases in demand and decrease in demand

Point	Increase in Demand	Decrease in Demand
1. Meaning	A rise in demand caused by favourable changes in other factors than price is called increase in demand.	A fall in demand caused by unfavourable changes in other factors other than price is called decrease in demand.
2. Causes	Increase in demand is caused by : (i) Rise in income (ii) Increased liking for a commodity (iii) Decrease in taxes	Decrease in demand is caused by : (i) Fall in income (ii) Decrease liking for a commodity (iii) Increase in taxes

2. Income Elasticity of Demand and Cross Elasticity of Demand

Point	Income Elasticity of Demand	Cross Elasticity of Demand
1. Meaning	Income elasticity of demand can be defined as the percentage change in the quantity demanded of a commodity in response to a change in the income of the consumer.	Cross elasticity of demand can be defined as the percentage change in the quantity demanded of one commodity (say 'x') in response to the change in the price of another commodity (say 'y').

2. Formula	$E_y = \frac{\Delta Q}{\Delta Y} \times \frac{Y}{Q}$ Where, (i) ΔQ = change in demand (ii) (ii) Δ Y = Change in income (iii) Y = Original income (iv) Q = Original Demand	$E_c = \frac{\Delta Q_x}{\Delta P_y} \times \frac{P_y}{Q_x}$ where, (i) ΔQx = change in demand for commodity x (ii) Δ Py = Change in price of commodity y (iii) P_y = Original price of commodity y (iv) Q_x = Original demand for commodity x.

3. Utility and Usefulness

Point	Utility	Usefulness
1. Meaning	The want satisfying capacity of a commodity is called utility.	A quality of commodity benefiting a consumer is called usefulness.
2. Interrelationship	A commodity possessing utility may not be possessing usefulness.	A commodity possessing usefulness definitely possesses utility.

4. National income at market price and National income at factor cost.

Point	National Income at Market Price	National Income at Factor Cost
1. Meaning	National income at market price means the sum of the market values of all goods and services produced in a particular time period. It includes the indirect taxes and excludes the subsidies.	National income at factor cost means the sum of all incomes earned by resource suppliers for their contribution in land, labour, capital and entrepreneurial ability. It excludes the indirect taxes and includes the subsidies.
2. Formula	$NI_{(MP)}$ = $NNP_{(FC)}$ + Indirect Taxes – Subsidies.	$NI_{(FC)}$ = $NNP_{(MP)}$ – Indirect Taxes + Subsidies.

5. Primary functions of money and Secondary functions of money

Point	Primary functions of Money	Secondary Functions of Money
1. Meaning	The functions of money that are fundamental and comparatively more important are called primary functions of money.	The functions of money that are additional to the fundamental functions are called secondary functions of money.
2. Examples	Medium of exchange and measure of value or unit of account are the primary functions of money.	Standard of deferred payments, store of value and transfer of value are the secondary functions of money.

6. Direct taxes and Indirect taxes.

Point	Direct tax	Indirect Tax
1. Meaning	A tax which is paid by the person on whom it is levied is called direct tax.	A tax which is paid by a person on whom it is not actually levied is called indirect tax.
2. Examples	Income tax, wealth tax, etc. are the examples of direct tax.	Sales tax, Excise duty, etc. are the examples of indirect tax.

ANSWER : 3 (B)

1. Assumptions of microeconomics :

Micro economics is based on the assumption such as full employment, pure capitalism, laissez – faire policy, perfect competition, etc. in an economy. But in reality, an economy with such conditions does not exist. Most of the theories of microeconomics are based on the 'Ceteris Paribus' assumption, i.e. 'other things being constant.' But by this assumption many of the microeconomic theories become static and they neglect the reality of dynamic world.

2. Income elasticity of demand :

Income elasticity of demand may be defined as the "degree of responsiveness of quantity demanded to change in income only, other factors including price remain unchanged." It is written as –

$$Ey = \frac{Percentage\ change\ in\ quantity\ demanded}{Percentage\ change\ in\ income}$$

Symbolically, $Ey = \frac{\%\Delta\ Q}{\%\Delta Y}$ (Here Q means quantity demand, Y means income, Δ delta stands for a change).Income elasticity of demand is positive, when demand increases with increasing income. Income elasticity of demand is negative when, quantity demanded decreases with increase in income. In case of normal goods income elasticity of demand is positive, whereas in case of inferior goods, income, elasticity of demand is negative. Income elasticity of demand can be zero, one greater than one and less than one.

3. Features of land :

(1) Free gift of nature : Land is material source which nature has provided as a free gift to mankind. Land is not created with human efforts, thus supply price of land is zero from the society point of view. Thus land has no cost of production.

(2) Passive factor of production : Land is a passive factor of production. Land becomes productive when the other factors of production such as labour, capital etc., are used with it.

(3) No geographical mobility : Land cannot move from one place to another, but it has occupational mobility, that it can be put into some other alternative uses, e.g., agricultural land can be used for construction of houses. Therefore it is the least mobile factor of production.

(4) Inelastic supply : The total land surface is determined by nature and is fixed in supply. Man cannot increase or decrease the total volume of land. Man can try to improve the quality of land. The availability of land at any time is fixed. Thus, supply of land is perfectly inelastic.

(5) Permanent and indestructible factor : Land is a indestructible factor. It cannot be destroyed completely. Fertility of land may diminish but its existence remains forever.

(6) Heterogeneity : Land is a heterogeneous factor and nota homogeneous factor. Land differs in quality and there are different grades in Land. As a result superior land commands a higher rent as compared to inferior land.

(7) Diminishing marginal returns : Land is subject to the Law of Diminishing Returns. As more and more units of labour and capital are added to the same piece of land, the total output increases but at diminishing rate.

(8) Derived demand : The demand for land is indirect. Demand for land depends on the demand of other goods and services. E.g., the demand for agricultural land is derived from the demand for agricultural products.

(9) Site value : Land is a natural factor, value of land depends upon location. Land situated near urban area fetch higher price than the land located near rural area.

4. Equilibrium price determination under perfect competition

Equilibrium price : Equilibrium price is the price at which quantity demanded is equal to quantity supplied. The price of a the product under perfect competition, is influenced by both buyers and sellers and equilibrium price is determined by the interaction of demand and supply forces.

According to Marshall, demand and supply are like two blades of a pair of scissors. Just as cutting of cloth is not possible with the use of one blade, the equilibrium price of a commodity cannot be determined, either by the forces of demand or by supply alone. Both together determine the price.

We can study this with the help of the following table and graph.

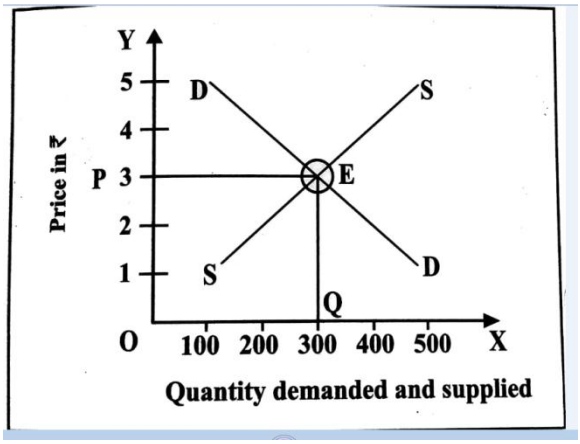
Demand and supply Schedule

Price (Rs.) Per unit	Quantity Demand (Units)	Quantity supplied (Units)
5	100	500
4	200	400
3	300	300
2	400	200
1	500	100

Above table shows the effect of price on market demand and market supply. The table shows that when price of the commodity is Rs. 5, quantity demanded is 100 units and quantity supplied is 500 units. Since supply is more than demand, price falls to Rs. 4/- and Rs. 3/-, respectively and quantity demanded extends to 200 and 300 units whereas supply contracted to 400 to 300 units, respectively. It is seen that quantity demanded and that quantity supplied both are equal at Rs. 3 where quantity demanded is 300 units whereas quantity supplied is 300 units. Thus, Rs. 3 will be an equilibrium price.

If further price falls to Rs. 2 and Rs. 1, quantity demanded will expand to 400 and 500 units, respectively and quantity supplied will contract to 200 and 100 units respectively. Since demand is more than supply, competition among buyers will increase and price

will rise up to Rs. 2 and Rs. 3. Thus equilibrium price will be Rs. 3 per unit because demand and supply both are equal at this price.



E – Equilibrium point

OP – Equilibrium price

OQ – Equilibrium quantity demanded and supplied

On the 'x' axis we measure quantity demanded and quantity supplied and on the 'y' axis we measure price of the commodity. In the above diagram 'DD' is a downward slopping demand curve indicating inverse relationship between price and quantity demanded. 'SS' is an upward slopping supply curve indicates direct relationship between price and quantity supplied. Both the curve intersects each other at point 'E'. At this point the equilibrium price is Rs. 3/- and equilibrium demand and supply is 300 units.

ANSWER : 4

1. **Types of utility :** Various types or forms of utility are as follows –

(i) **Form utility -** When utility increase due to the change in the shape or structure of existing material, it is called form utility.

(ii) **Place Utility –** When utility of a commodity increases due to the change in the place of utilization, it is also created with the transfer of goods from the place of production to the place where they are consumed. E.g. Sea sand has more utility in construction work than along the sea shore.

(iii) **Time utility –** When utility of a commodity increases with a change in the time of utilization, it is called time utility. E.g. Umbrellas have greater utility during rainy season than in winter.
Time utility also refers to storing of goods and using at the time of need or scarcity.

(iv) **Service utility -** It arises when personal services are rendered by various professionals in the society to others. Services provided by doctors to patients, knowledge given by teachers to students, suggestions by lawyers to his clients, etc., are examples of service utility. In this case, production and consumption both take place at the same time.

(v) **Knowledge utility –** It increases when a consumer acquires knowledge about a particular product. e.g. utility of a mobile phone or computer increase when a person knows about its various functions.

(vi) **Possession Utility -** It arises when the ownership of goods is transferred from one person to another. E.g. Possession utility is enjoyed by the consumers when they purchase goods from sellers.

2. Features of monopolistic competition

The following are the important features of monopolistic competition:

(1) Fairly large number of buyers: In this market, there is a fairly large number of buyers. Consequently, no single buyer can influence the price of the product.

(2) Fairly large number of sellers: Although the number of sellers in a monopolistic competition is large, it is still smaller than that in a perfectly competitive market. Since number of sellers is large, each seller has a limited control over the market supply. However, each seller has monopoly over his brand. This is possible because of patents, trademarks, copyrights, etc. that the producer possesses. Thus, each producer enjoys an element of monopoly on one hand and on the other they have to face competition from sellers selling close substitutes.

(3) Product differentiation: Product differentiation is the most important feature of monopolistic competition. Each product in this market is different from every other product in some form or the other. These differences are in the case of in its colour, shape, wrapper, after – sales services, etc. Their products though different are close substitutes to one another. In this market, the producers also adopt various techniques such as discounts, gifts, advertisements, etc. to attract consumers. In this market producers compete with each other on the basis of product differentiation and not on the price differentiation. Therefore, monopolistic competition is also called non – price competition.

(4) Close substitute: In monopolistic competition goods are close substitute to each other. For example, Hamam is close substitute to Lux.

(5) Selling cost : Selling cost is yet another important unique feature of monopolistic competition. Product differentiation leads to the emergence of selling cost. Thus, the cost that producer has to incur in order to differentiate his product is known as selling cost. In monopolistic competition, the mediums such as television, radio, newspapers, magazines, exhibitions , incentives and salaries of sales representatives, etc. are used by the firm to increase the sales. Thus, under monopolistic market, the firms have to incur selling cost (advertisement cost) in addition to cost of production. The price of the product includes cost of production as well as selling cost.

(6) Free entry and exit: Under monopolistic competition there is freedom of entry and exit to a firm without any restrictions. Thus, firms are free to enter the market if there is supernormal profit. Similarly, they can leave the market if they find it difficult to survive.

(7) Demand curve of product of a seller: Due to product differentiation and availability of close substitute, demand curve of a product of every seller is highly price elastic and downward sloping. It means a slight change in price of the product brings a great change in quantity demanded.

(8) **Concept of group:** Prof. E. H. Chamberlin introduced the concept of group as the substitute for industry concept. In perfect competition, the firms producing an identical product are clubbed together in one industry. On the other hand, in monopolistic competition, the firms producing differentiated products are clubbed together in one group.

3. Important features of Macroeconomics

(1) **Study of aggregates :** Macro – Economics deals with the study of nations economy as a whole. It is a study of very large, economy wide aggregates such as national output or income, total employment, aggregate demand, aggregate supply, total investment, total consumption, general price level etc.

(2) **Lumping method :** Macro analysis deals with the behavior of aggregates i.e. total values of economic variables related to whole economy. It uses method of lumping to deal with macro variables, such as aggregate demand, aggregate supply, national output etc.

(3) **A General equilibrium analysis :** Macro – Economics analysis is based on General Equilibrium Analysis. This analysis deals with entire economy in the context of equilibrium. It studies the behavior of number of economic variables at a time and takes into consideration their functional relationship and interdependence in doing so.

This approach assumes "Everything depends on everything else."

Since this approach deals with whole economy, it has to explain how aggregate supply and aggregate demand are brought into equality, and how equilibrium between these forces determine, not only price level, but also level of income and employment. This whole analysis involves the study of number of variables and their interactions.

(4) **Income analysis :** Macro – Economics is also known as the theory of income and employment or simply income analysis. Because, basis subject matter of Macro – Economic analysis is to explain what determines the level of national income and employment and what causes fluctuations in them. Further, it explains the growth of national income over a long period of time.

(5) **Policy – oriented :** Macro – Economics, according to Keynes' is a policy – oriented science. Macro – Economics analysis helps in formulating suitable economic policies to promote economic growth, to generate employment, to control inflation, to pull the economy out of depression etc.

(6) **Dynamic science :** Macro – Economics studies the changes in aggregate economic variables and analyses dynamic nature of the economy. It enables us to study progress of an economy over a period of time.

(7) **Based on interdependence :** Macro analysis takes accounts of interdependence between aggregate economic variables, such as income, output, employment, investment, price level etc. E.g., it explains how change in level of investment will finally change the level of national income, output and employment and eventually the level of economic growth.

4. Subjective determinants of Consumption function :

The consumption function depends upon the income level. According to Keynes, consumption function is affected by certain subjective (psychological) factors and objective (Institutional) factors. These factors can be briefly described as follows :

(A) Subjective of Psychological Factors : These factors are internal factors. They are dependent on the psychological characteristics of human nature, institutional

pattern and social practices. Basically, they are human behavioural factors, which have an influence on individual's consumption decisions and are fairly stable during the short period.

According to Keynes, individual's nature compels them not to spend their entire income. Hence, they save part of their income. Following are the motives which induce people to save and hence influence consumption levels.

(1) Motive of Precaution : Generally, people save a large part of their income as a precaution against future unforeseen contingencies and thus, to that extent, the current consumption is reduced.

(2) Motive of Foresight : Individual has to provide for the future needs like higher education of children, maintenance of dependents, maintenance during old age etc. Hence, individual is likely to reduce his or her present consumption in order to save more.

(3) Motive of Calculation : In order to earn income, people invest in shares, debentures or other income earning assets. This is likely to reduce their present consumption. Investment decisions depend on future expected trends in the prices of income earning assets.

(4) Motive of Improvement : Generally, people have the desire to enjoy improved standard of living and also higher status in the future. Such a motive for improvement reduces current consumption.

(5) Motive of Independence : In order to attain some measure of independence and power in man's life, man intends to save more. This motive is likely to dampen present consumption.

(6) Motive of Enterprise : Undertaking business in future, providing for capital investment in future, which can be achieved through current savings i.e. to start a business and earn.

(7) Motive of Pride : Individual takes pride in leaving substantial wealth to his or her children. Also, a person may like to give donations. Such a motive of pride may dampen present consumption.

(8) Motive of Avarice : The desire to satisfy pure miserliness i.e. unreasonable but insistant abstinence from expenditure.

5. Types of deposits accepted by commercial banks

Commercial Bank accepts following types of deposits.

(a) Demand deposits

(b) Time deposits

(a) Demand deposits : Deposits, which are withdrawable on demand, are known as demand deposits. They are in two forms : (i) current account deposits (ii) savings account deposits.

(i) Current account deposits: They are usually opened by businessmen, corporations, industrial enterprises, public bodies, trustees etc. The account facilitates them to carry out their transactions with minimum cash at hand, as the deposits are withdrawable any time by the depositor by means of cheques.

Usually, there are restrictions on the amount of deposits. At the same time depositors can withdraw any number of times from this account. Overdraft facilities and agency services are provided by the bank to the current account holders. Very low interest or no interest is paid on the current account deposits. Banks may charge a nominal rate of interest for providing this facility.

(ii) Savings account deposits : Saving bank deposits are opened by a large number of people who wish to save a small portion of their income and deposit the same with the bank. They are opened mainly by salaried class, middle income group, small traders. Bank accept saving deposits with a view to encourage the saving habits among the people. Normally, a small rate of interest is paid on this account. Money can be withdrawn subject to some restrictions.

(b) Time Deposits :

Deposits, which are repayable after a certain period of time, are known as time deposits.

They are in two forms :

(i) Recurring Deposits : In order to encourage customers to make regular savings, banks receive deposits in recurring accounts. A customer is required to deposit a fixed sum of money for a specified period of time.

(ii) Fixed Deposits : Deposits under this account are made for a fixed or a specified period. It is a time bound deposit. The money can be withdrawn only after the stipulated or specified time period. Rate of interest is relatively high on these deposits.

The rate of interest on fixed deposits varies with the period of time for which money is deposited. If the account holder wishes to withdraw, before the expiry of the specified time, he receives a lower rate of interest.

6. Sources of revenue to the government

(1) Revenue Receipts : revenue receipts of the government refer to those money receipts which neither create any liability nor cause any reduction, in the assets of the government. They are regular and recurring in nature.

Revenue receipts of the government are generally classified under two heads.

(i) Tax Revenue

(ii) Non – Tax Revenue

(i) Tax Revenue : Tax revenue refers to sum total of receipts from taxes and other duties levied by the government of India. Tax revenue is the main source of regular receipts of government. Tax is a compulsory payment made by people and organization to the government without references to anything in return. Tax receipts are spent by the government for the benefit of people in the country.

Tax revenue is collected from two types of taxes, that is, direct taxes and indirect taxes. Following are the sources from which tax revenue is collected by the government.

(a) Direct Tax

Taxes which are paid by the person on whom they are levied.Taxes on income and expenditure, such as personal income tax, corporate tax, wealth tax, interest tax or property tax etc.

(b) Indirect Taxes

Indirect taxes consists of taxes on commodities and services, such as sales tax, service tax, VAT, Execise duty, custom duty etc.

(ii) Non – Tax Revenue :

Non – tax revenue refers to receipts of the government from all sources other than those of tax receipts. The main sources of non – tax revenue are :

(a) Interest and dividend on investments :
Government receives interest on loans given to state governments, union territories, private enterprises, which is an important source of non – tax revenue. Dividends are received by the government from its investment in other companies.

(b) Fees, License Fee : Fees refer to charge imposed by the government to cover the cost of recurring services provided by it. It is also a compulsory contribution. For example, registration fees, court fee etc.

(c) Gifts and grants : Government receives gifts and grants from international organizations and foreign governments. Sometimes individuals and companies voluntarily gift money to the government during natural calamities, such as earthquake, flood, famine, tsunami, ware etc.

(d) Fines and penalties : Fines and penalties are levied on defaulters to maintain law and order. This generates revenue for example fine for jumping a signal etc.

(e) Escheats : It refers to claim of the government on the property of a person who dies without leaving behind any legal heir or a will.

ANSWER : 5

1. **The law of Diminishing Marginal Utility is based on no assumptions.**

No I disagree,

Reason :

The assumption of Law of DMU are as follows :

(1) Homogeneity : The law of DMU assumes that units of a commodity consumed by a consumer are identical.

(2) Single Use : The law of DMU assumes that the commodity is used to satisfy only a single want, i.e. a want of consumption.

(3) Cardinal measurement : The law of DMU assumes that utility can be measured in numbers.

(4) Rationality : The law of DMU assumes that a consumer is a rational person.

(5) Continuity : The law of DMU assumes that all units of consumption are consumed in quick succession, one after another.

(6) Reasonability : The law of DMU assumes that the size of unit of commodity of consumption is reasonable.

(7) Constancy : The law assumes that income, taste, habits, preferences, likings etc. of a consumer as well as the price of commodity remains constant throughout the period of consumption.

(8) Divisibility : The law assumes that the commodity consumed by the consumer is divisible.

(9) Constant marginal utility of money income : The law assumes that when the consumer spends his income on a commodity, the utility of the remaining money income remains same as his total income.

2. Total outlay method is one of the methods of measuring elasticity of demand

Yes, I agree with this statement.

Reasons :

(1) Dr. Alfred Marshall has explained the expenditure method of measuring elasticity of demand. This method is also called as total revenue method. In this method, the elasticity of demand is measured by comparing the change in the total expenditure on a commodity in response to a change in the price of a commodity. This method can be explained with the help of the following schedule :

Example	Price (Rs.) (per day in units)	Demand	Total Expenditure (Rs.)	Elasticity of Demand
A	1 2	6 5	6 10	Inelastic ($E_d < 1$)
B	3	4	12	Unitary ($E_d = 1$)
C	5 6	2 1	10 6	Elastic ($E_d > 1$)

(2) Inelastic Demand : When a fall in the price of a commodity also leads to a fall in a total expenditure on a commodity and vice a versa, then the demand is said to be inelastic. For example, in the above schedule in the case of example A, it can be seen that, as a commodity's price falls from Rs. 2 to Rs. 1, the total expenditure on it also falls from Rs. 10 to Rs. 6. In the case of inelastic demand, the price of commodity and the total expenditure on a commodity are directly related to each other.

(3) Unitary Elastic Demand : When a fall or a rise in the price of a commodity leads to no change in the total expenditure on a commodity, then the demand is said to be unitary elastic. For example, in the above schedule in the case of example B, it can be see that, as a commodity's price falls from Rs. 4 to Rs. 3, the total expenditure on it remains same, i.e. Rs. 12.

(4) Elasticity Demand : When a fall in the price of a commodity leads to a rise in a total expenditure on a commodity and vice a versa, then the demand is said to be elastic. For example, in the above schedule in the case of example C, it can be seen that, as a commodity's price falls from Rs. 6 to Rs. 5, the total expenditure on it rises from Rs. 6 to Rs. 10. In the case of elastic demand the price of a commodity and the total expenditure on a commodity are inversely related to each other.

3. Rare articles is the only exception to the law of supply

No I disagree, with this statement.

Reasons :

(1) Rare articles : The seller shows less willingness to sell the rare and precious articles even though their prices are high. Thus, the supply of rare articles remains unchanged though their prices are high. Therefore, rare articles are exceptions to the Law of Supply.

(2) Labour supply : In the initial stages, labour supply increases as wage rate increases. However, at a later stage, workers would prefer leisure to work. They prefer to earn same amount of income by working less hours. Therefore, in the initial stages the labour supply curve slopes upwards, from the left to the right. However, in the later stage, the labour supply curve bends backward.

(3) Saving : Some people save money to receive a fixed and regular amount of income in the form of interest. Such people save less money at higher interest rates and more money at low interest rates to maintain their fixed income level. Similarly, people never save the entire part of their income even though the rate of interest is quite high. Therefore, in the initial stage, saving increases with an increase in the rate of interest. However, after a certain point, saving diminishes even if the rate of interest is high. So saving is an exception to the Law of Supply.

(4) Need for cash : If a seller needs cash urgently he is forced to sell more even at less prices. Therefore, the sale of goods influenced by the need for cash is considered as an exception to the Law of supply.

(5) Agricultural goods : Agricultural goods require suitable climatic conditions and sufficient period for growth. Therefore, the supply of agricultural goods cannot be increased overnight though their price rise. Therefore, in the case of agricultural goods the law is inapplicable. Therefore, agricultural goods are exception to the Law of supply.

(6) Future expectation about price : If a seller expects the price of a commodity to rise in the near future, he may not supply more of that good even though its current price is high and vice versa. Thus, future expectations regarding the change in the price makes the law inapplicable. Therefore, the sale of goods influenced by the future expectations is considered as the exception to the law of Supply.

4. Anything can act as money

No, I do not agree with this statement.

Reasons :

(1) The thing which possesses qualities such as general acceptability, divisibility, durability, cognizability, portability, homogeneity and stability of value can only function as money.

(2) A thing which is not accepted generally as a medium of exchange cannot function as money.

(3) Similarly a thing which is indivisible, less durable or less portable cannot function as money.

(4) For example, if individual A is ready to accept a particular commodity for exchange and if individual B is not ready to accept the same commodity for exchange, then that commodity cannot function as money. In such a case no exchange can take place between A and B.

Therefore, anything cannot function as money.

5. A commercial bank performs many agency functions

Yes, I agree with this statement.

Reasons :

(1) Commercial banks collect money in the form of cheques, drafts, etc. Commercial banks also make periodic payments such as electricity bills, telephones bills, etc. on behalf of their customers. Commercial banks also sell and purchase shares for their customers.
(2) For all such services, commercial banks charge nominal commission to earn profit.

Thus, commercial banks provide agency functions to earn profit.

6. Central Bank having monopoly of note issue is most appropriate institute of the government.

Yes, I agree with this statement.

Reasons :

(1) The Central Bank has the sole power of issuing notes which are legal tender. The notes acquire more prestige, when they are issued by a single bank, i.e. Central Bank than when they are issued by many banks.
(2) The Central Bank brings uniformity in the currency notes and makes it easy for people to identify currency notes. People develop more confidence in the currency notes that are issued by the Central Bank.
(3) Central Bank having monopoly in note issue, avoids over issue of currency and it becomes easy to control the total quantity of notes issued. Thus, it helps in maintaining the price stability.
(4) It is also convenient to the government to supervise and regulate the issue of paper currency be Central Bank.
Therefore, Central Bank having monopoly of not issue is most appropriate institute of the government.

ANSWER : 6

1. The determinants of demand :

(1) Price : Price is one of the most important factors that affect demand. When price rises demand falls and when price falls demand rises.

(2) Income : Income is yet one more important factor that affects demand. Demand depends upon income of individuals in the society. Normally, Demand rises with increasing income of the society.

(3) Population : An increase in population leads to increase in market demand for goods and services.

(4) Tastes, Habits and Fashions : Some factors such as taste, habit of consumers affect demand, in the market.

(5) Prices of substitute and complementary Goods : Demand changes due to changes in the price of substitute and complementary goods. For example demand for tea changes because of change in the price of coffee. Similarly, demand for motor cars changes because of change in the price of petrol.

(6) Distribution of Income : Unequal distribution of income and wealth would lead to less demand for goods and services i.e. demand depends on the distribution of National Income and Wealth.

(7) Expectation about Future Prices : If consumers expect a fall in the price of a commodity in the near future, they will demand less at present price and vice versa. It shows that expectations about the future prices affect demand.

(8) Advertisement : The goods which are advertised powerfully on radio, television and newspapers, etc., push up demand. Advertisement is an important factor today that affects demand.

(9) Taxation Policy : Government's taxation policy affects demand. For example, a change in income tax will change consumer's disposable income and therefore demand.

(10) Other Factors : Change in any climatic conditions, traditions, political and social factors also affects demand.

2. Price elasticity of demand : Prof. Marshall has defined price elasticity of demand as below: "Price elasticity of demand is a ratio of proportionate change in the quantity demanded of a commodity to a given proportionate change in its price."

Thus, price elasticity is responsiveness of change in its price."

Thus, price elasticity is responsiveness of change in demand due to a change in price only. Other factors such as income, population, tastes, habits, fashions, prices of substitute and complementary goods are assumed to be constant. Therefore, price elasticity of demand is written as :

$$Ed = \frac{Percentage\ change\ in\ quantity\ demanded}{Percentage\ change\ in\ price}$$

$$Ed = \frac{\frac{\Delta Q}{Q}}{\frac{\Delta P}{P}} \text{ OR } e = \frac{\Delta Q}{Q} \times \frac{P}{\Delta P}$$

Where Q = Original demand.

P = Original price

Δ Q = Change in quantity demanded. It is measured as the difference between new quantity demanded (Say Q1) and old quantity demanded (Q)

Thus $\Delta Q = Q\,1 - Q$

ΔP = Change in price. It is measured as the difference between new price (PI) and old price (P)

Thus Δ P = PI – P

Price elasticity of demand may have five value infinite, zero, unit, greater than one and less than one.

❖ **Importance :**

(1) **Monopoly and Elasticity of Demand :** The objective of a seller in monopoly market is profit maximization. Since he is a single seller in monopoly, market having total control over supply and price, he can take decisions about price policy and get more profit. If demand is inelastic for the product sold by monopolist, he will raise the price of that commodity and earn more profit.

(2) **Taxation Policy and Elasticity of Demand :** The concept of Price Elasticity of Demand is useful to the government in the determination of taxation policy. The finance minister considers the Elasticity of Demand, while selecting goods and services for taxation. If government wants more revenue, those goods will be taxed more, for which demand is inelastic. Therefore, generally heavy taxes are imposed on goods like cigarettes, liquors and habitual goods for which demand is inelastic.

(3) **Fixation of Wages and Elasticity of Demand :** The concept of Elasticity of Demand is useful to trade unions in collective bargaining, for wage determination. When trade union leaders know that demand for the product produced by labour is inelastic, they will insist for more wages to workers.

(4) **International Trade and Elasticity of Demand :** The concept of Elasticity of Demand is useful to determine norms and conditions is international trade. The countries exporting commodities for which demand is inelastic can raise their prices. For instance, Organization of Petroleum Exporting Countries (OPEC) has increased the prices of oil several times. The concept is also useful in formulating export and import policy of a country.

(5) **Public Utilities :** In case of public utilities like railways which have an inelastic demand, government can either subsidise or nationalize them to avoid consumer's exploitation.

2. Output method of measuring national Income

(1) Output Method : This method of measuring national income is also known as product method or inventory method.

This method approaches national income from the output side. According to this method, the economy is divided into different sectors, such as agriculture, mining, manufacturing, small enterprises, commerce, transport, communication and other services. The output or product method is followed either by valuing all the final goods and services, produced during a year, at their market price or by adding up all the values at each higher stage of production, until these products are turned into final products.

While using this method utmost care must be taken to avoid multiple or double counting. To avoid double counting this method suggests two alternative approaches for the measurement of GNP.

(i) The final Goods Approach / the Final Product Approach :

Final goods are those goods which are ready for final consumption. According to this approach value of all final goods and services produced in primary, secondary and tertiary sector are included and the value of all intermediate transactions are ignored. Intermediate goods are involved in the process of producing final goods, that is, the final flow of output purchased by consumers. Hence, the value of final output includes the value of intermediate products.

For example, the price of bread includes, the cost of wheat, making of flour, etc., wheat and flour are both intermediate goods. Their values are paid up during the process of production. In the value of the final product, bread, the values of intermediate goods are already included.

Thus, a separate accounting of the values of intermediate goods, along with the accounting of the value of final product, would mean double counting. To avoid this, the value of only the final product must be computed.

(ii) The value Added Approach / The value Added Method :

In order to avoid double counting value added approach is used. According to this approach, the value added at each stage of the production process in included. The difference between the value of final output and inputs, at each stage of production is called the value added. Thus, GNP is obtained as the sum total of the values added by all the different, stages of the production process, till the final output is reached in the hands of consumers, to meet the final demand. This can be illustrated with the help of the following table

Production Stages	Value of Output	Value of Input	Value Added
	(Rs.)	(Rs.)	(Rs.)
Wheat (Farmer)	7.00	0	7.00
Flour (Flour mil)	10.00	7.00	3.00
Bread (Baker)	13.00	10.00	3.00
Retailer (Merchant)	14.00	13.00	1.00
Total Value			14.00

Here, we have assumed a much simplified model of an economy, producing only a single final product, bread. It is assumed, that there are four productive stage in production of bread. E.g. production stages of single bread.

In the given example farmer produces and sells wheat for Rs. 7.00/- to the miller. Miller sells flour for Rs. 10.00/- to the baker. Baker sells bread for Rs. 13.00/ - to the retailer/ merchant. Retailer sells bread for Rs. 14.00/- to the consumers. So the value added by farmer (Rs. 7.00), miller (Rs. 3.00), baker (Rs. 3.00) and retailer (Rs. 1.00) that is , total of Rs. 14.00 should be included in the national income.

To avoid double counting, either the value of final output or the sum of value added should be taken in the estimate of GNP.

Precautions :

While estimating national income by output method, the following precautions should be taken:

(1) To avoid double counting, only the value of final goods and services must be taken into account.

(2) Goods used for self consumption by farmers should be estimated by a guess work that, is imputed value of goods produced for self consumption, is included in national income.

(3) Indirect taxes included in the market prices are to be deducted and subsidies given by the government to certain products should be added for accurate estimation of national income.

(4) While evaluating output, changes in the price level between different years must be taken into account.

(5) Value of exports should be added and value of imports should be deducted.

(6) Depreciation of capital assets should be deducted.

(7) Sale and purchase of second hand goods should be ignored as it is not a part of current production .

The output method is widely used in the underdeveloped countries. However, it is less reliable because of the margin of error. In India, this method is applied to agriculture, mining and manufacturers, including handicrafts. But it is not applied for transport, commerce and communication sectors in India.

3. Determinants of aggregate demand

i. The determinants of aggregate demand are symbolically expressed as follows:

$AD = C + I + G + (X – M)$

The determinants of aggregate demand can explained as follows:

(1) Consumption Expenditure: Consumption expenditure refers to the expenditure incurred on those goods and services which satisfy the wants of private individuals and institutions directly. A rise in the consumption expenditure increases the aggregate demand and a fall in the consumption expenditure decreases the aggregate demand.

The consumption expenditure may be partly autonomous (a) and partly induced (b). Thus, total consumption expenditure can be expressed as : $C = a + b$.

Autonomous consumption expenditure refers to the expenditure which a person has to incur irrespective of his income. Thus autonomous consumption expenditure is income inelastic. Induced consumption expenditure refers to the expenditure that is directly related to the income.

(2) Investment Expenditure (I) : An addition to the country's physical stock of capital like new factory building, plant and machinery, tools, equipment, etc. is called investment. It is also known as capital formation. A rise in the investment expenditure increases the aggregate demand and a fall in the investment expenditure decreases the aggregate demand.

Saving is the starting point of capital formation. According to Lord Keynes, the volume of investment undertaken by private entrepreneurs in an economy depends upon Marginal Efficiency of Capital (MEC) or Marginal Efficiency of Investment (MEI) and rate of interest.

In an economy, the investment made by the private sector will increase only if the MEC or MEI is greater than the market rate of interest and vice versa.

The higher investment will result in more employment, more production and more income generation in the economy and vice versa.

(3) Government Expenditure (G) : In a modern economy, government incurs expenditure for the purpose of maximizing welfare and promoting maximum growth and development. Government's expenditure may be either for consumption purposes or for investment purposes. A rise in the government expenditure increases the aggregate demand and a fall in the government expenditure decreases the aggregate demand.

Government's consumption expenditure includes expenditure on defense, police, maintenance of law and order, public utilities such as water, electricity, parks, etc.

Government's investment expenditure includes the expenditure on economic and social overheads such as transport and communication, banking, finance and insurance, irrigation facilities, education, health, etc.

(4) Net Earnings from Foreign Transactions (X – M) : In modern times, due to the development in science and technology, means of transport and communication, etc. almost all countries export as well as import a variety of goods and services. The net earnings from the foreign transactions can be obtained by using the following formula:

Net Earnings from foreign transactions = (X – M)

When a country's export is more than the import, the value of net earnings is found to be positive. The positive net earnings increases the national income and the aggregate demand. When a country's import is more than the export, the value of net earnings is found to be negative. The negative net earnings decreases the national income and the aggregate demand. When a country's export is exactly equal to import, the value of net earnings is found to be zero. The zero net earnings does not affect the national income and the aggregate demand