SYJC – FEB' 18
PRELIMINARY PAPER
ECONOMICS SOLUTION

(80 Marks)
Date:27-12-2017

Q. 1.(A).

Ans.
1. Slicing
2. Fall
3. J.M. Keynes
4. 1935
5. A Capitalist

Q.1. (B)

Ans.
1. Non tax revenue
2. Bills of exchange
3. Transfer Income
4. Creating Utility
5. Rightward shift in supply curve

Q. 1. (C)

Ans.
1. True
2. True
3. True
4. True
5. True
6. False

Q.2.(A).

Ans.1. The term "Micro Economics" was first used by Swedish Economist, Ragnar Frisch in 1933. It is derived from the **Greet** work "Mikros" which means 'small'. Micro Economics was developed and popularized by Dr. Alfred MarshalL Prof. K.E Boulding defined Micro Economics as "Micro Economics is the study of particular firms, particular households, individual prices, wages, incomes, individual industries and particular commodities".

Ans. 2. Labour is a human and basic factor of production. It is a living and most active factor of production. In general terms, labour refers to work or effort directed towards producing goods or rendering services. This work or effort may be physical or intellectual.

According to Marshall, "Labour refers to any exertion of mind or body undergone partly or wholly with a view to earning some good other than the pleasure derived directly from the work".

Ans. 3. By the Banking Act, commercial banks have to maintain a certain amount of cash with Central Bank (for e.g. RBI) as reserves against their demand and time deposits. Under the RBI Act of 1935 every commercial bank has to keep certain minimum cash reserves with the RBI. It can vary C.R.R. between 3% and 15% of total time and demand deposits.)

This amount cannot be used by banks for lending activities. Therefore, the amount available for lending gets reduced to the extent of Cash Reserve Ratio. This reserve ratio is charged to regulate credit. It directly affects the lending capacity of banks and the rate of interest charged by banks.

Ans. 4. 'Mono' means single and poly means 'seller'. Thus monopoly means single seller who has complete control over the supply of the commodity. There is no close substitute of the commodity. Due to absence of competition, monopolist is a price maker and not a price taker.

According to H.L. Ahuja, "Monopoly is said to exist when one firm is the sole producer or seller of a product which has no close substitute."

Ans. 5. When estimated government receipts are less than the estimated government expenditure, then the budgets is termed as Deficit Budget. In modern economies most of the budgets are of this nature. That is, estimated Government Receipts < anticipated Government Expenditure.

A deficit budget increases the liability of the government or decreases its reserves.

A deficit budget may prove useful during the period of depression. During the period of depression, economic activities are at low level. It results in unemployment, business losses etc. The Government can borrow money and increase the expenditure on public works, through deficit financing. This will increase employment, and total effective demand for goods and services which would then encourage investment. Thus, a Deficit Budget is useful for removing depression and unemployment.

Ans. 6. It is the approach in which the economy entire economy is taken into for intensive consideration for extensive analysation.

It is applied in the field of macro economics which deals with the behaviour of aggregates like national income, total investment, general price level etc...

It analyses over all performance of the economy and provides the clear pucture of the whole economy.

Can also be called as Inductive Method.

Q. 3(A).

Ans. 1. Micro Economics and Macro Economics

Micro Economics	Macro Economics
Meaning	
The word micro has been derived from the Greek word mikros which means small. It is concerned with the study of individual units such as individual firms, industries and individual markets. E.g. Alfred Marshall's book "principles of economics" was mainly Theory of Employment interest based on micro economics.	The word macro has been derived from the Greek word makroswhich means large. It is concerned with the study of aggregates like national income, aggregate demand, aggregate supply etc. E.g. Keynes' book "The General and Money" is based on macro economics
Price theory/income theory	
Micro economics is known as price theory which explains how the prices of goods and factors are determined.	Macro economics is known as income theory which explains the determination of national income and causes ofits fluctuations.
Partial / general equilibrium	
It is based on partial equilibrium which explains the equilibrium of an individual, a firm, an industry etc.	It is based on general equilibrium which explains the equilibrium of all consumers, all firms and all industries in an economy

Ans. 2.

Output Method	Income Method
Meaning	
Under production method national income is viewed as the total value of final goods and services produced annually in a nation. Other name Product Method	Under income method, National Income is viewed as the sum of total of money income received by all the factors of production including land, labour, capital and organisation during a given year. Other name Factor Cost Method
Items included	
(i)Consumer goods and services (b)Gross domestic private investment, (iii)government purchases, (iv)Net foreign earnings.	(a)Wages and salaries, rent, interest, profits from private and government sector, (b)The mixed income, (c)The net factor income from abroad.
Main determinant	
The total value of final goods and services act as the main determinants of national income	Factor payments act as main determinant of national income.

Ans. 3.

Ans. 4.

Direct tax	Indirect tax
1. Meaning : A direct tax is a tax which is paid by a person on whom it is legally imposed. E.g. Income tax, wealth tax etc.	An indirect tax is a tax which is imposed on a person but paid partly or wholly by other person. E.g. Sales tax, excise duty, import duty etc.
2. Impact and incidence : Impact and incidence are on the same person, i.e. the tax payer is also the tax-bearer.	The impact and incidence are on different persons i.e. there is a shifting of the tax.
3. Determinant : Generally direct tax is linked to income and wealth.	Generally indirect taxes are linked to expenditure.
Direct tax are more just and equitable	**Indirect tax are unjust and unequitable**

Ans.5.

Fixed Capital	**Variable Capital**
Meaning	
Fixed capital is that capital which is invested on the fixed assets like machinery, building, tools, factory plant etc. It can be used again and again for a long period.	Circulating capital or variable capital is that capital which is investedby the firm on raw material, electricity, fuel etc. It is used once for all.
Variable. Fixed capital remains constant in the short run irrespective of changes in the output. However, in the long run, fixed capital is variable.	Variable capital changes with change in the output.
When. Fixed capital arises even when there is no production.	Variable capital is required only when the production is on.
FC remains constant in short run	Variable Capital varies with the level of Production.

Ans. 6.

Stock	**Supply.**
Meaning	
Stock refers to the total quantity available as reserves. It is the potential supply of the producer. For example, if a producer produces 1000 pens in a day, the total production 1000 pens becomes the stock.	Supply refers to that part of stock which is offered for sale at particular time at different prices. For example, if the producer prefers to sell only 400 pens out of 1000 available as reserves, the supply is 400 pens
Nature	
Stock is a reservoir. It is the source of supply.	Supply is a flow. It is part of stock.
Inter relationship	
Stock can exceed supply.	Supply cannot exceed stock. In some cases it may be equal to supply
Dependence	
Stock depends upon production.	Supply depends upon stock.

Q. 3.(B)

Ans. 1. Types of Monopoly

1) **Natural monopoly**

Natural monopoly emerges due to availability of natural resources. A particular type of natural resource is available, therefore that region enjoys monopoly in the product which requires that natural resource. Natural advantages like good location, old establishment, involvement of huge investment, business reputation, etc. confirm natural monopoly of many firms. e.g., tea from Assam.

2) **Public monopoly**

Public monopoly refers to sole ownership of the supply of goods or services by the government. Such monopoly functions with the primary motive of providing maximum welfare to the society, thus, it is also known as welfare monopoly. It is not based on profit motive, e.g., Indian Railway.

3) **Private monopoly**

Private monopoly refers to sole ownership of the supply of goods or services by the private firm or individual. The main objective of private monopoly is profit maximization, for e.g. Tata group and Reliance group.

4) **Legal monopoly**

When monopoly is created by law, it is known as legal monopoly. Legal provisions like patents, trademarks, copy rights etc. give rise to legal monopolies e.g. some producers use a particular trademark for their product and they take legal permission from the government for that brand, thus law forbids the potential competitors to imitate the design form and shape of product. If any firm tries to violate the rights action can be taken again them e.g., Parle-G etc.

5) **Simple monopoly**

It is that organization which charges a simple uniform price for all consumers. There is no price discrimination among the consumers.

6) **Discriminating monopoly**

When different prices are charged to different (customers for the same product or services, it is | known as price discrimination or discriminating monopoly, e.g., a doctor or a lawyer may charge different fees to the people.

7) **Voluntary monopoly**

When number of big business companies acquire monopoly through voluntary agreement, business firms join together through trusts, cartels, syndicates etc. They are called joint monopolies. Mergers and amalgamations may also lead to monopoly e.g., OPEC (Oil Producing and Exporting Countries). This is also known as Joint Monopoly.

Ans. 2. Types of Government Budget

In a modern society and, especially, in a welfare state, the activities of the governments are fast expanding, and they are tending to cover almost all aspects of the social and economic life of the nation. Government is now an agency for promoting the general welfare of the citizens by positive acts. Government budgeting is one of the major processes, by which the use of the public resources are planned and controlled to attain certain objectives. Budgetary actions of the government affect production, size and distribution of income an utilization of human and material resources of the country.

So, the government should prepare different budget for various situations is the economy. Public expenditure should be varied according to the requirement and urgencies of the business situation. Accordingly, government budget is of three types.

1. Balanced Budget
2. Surplus
3. Deficit Budget

1) Balanced Budget

A government budget is said to be balanced when its estimated revenue and its anticipated expenditure are equal. That is, Government Receipts = Government Expenditure.

It implies that the governments raises funds in the form of taxes and other means. A balanced budgets was considered an effective check on extravagant expenditure of the government.

Government must exercise financial discipline and should keep its expenditure within the available income.

The concept of balanced budget has been evocated by classical economists like Adam Smith. A balanced budget was considered by them as neutral in its effect on the working of the economy and, hence, they regarded it as the best.

However, modern economists believe that the policy of balanced budget may not always be suitable for the economy. For instance, during the period of depression, when economic activities are at a low level, resulting in unemployment, the government may come to the rescue people. It can borrow money and spend it on public works. This will increase employment and total demand for goods and services encourage investment.

2) Surplus Budget:

When estimated government receipts are than the estimated government expenditure it is termed as Surplus Budget. When government spends less than the receipts the budget become surplus. That is, estimated Government receipts > anticipated Government expenditure.

A surplus budget is used either or reduce governments public debt (its liabilities) or increase its savings.

A surplus budget may prove useful during the period of inflation. In periods of inflation, although there is greater employment, there is also a tendency for prices to rise rapidly. This has to be checked, particularly in the interest of those who have a more or less fixed income. This inflationary gap can be corrected by lowering the level of effective demand in the economy. It can be corrected by increasing taxes. This would increase the revenue of the government; but reduce the purchasing power of the people. As a result, the aggregate demand will fall. This inflationary gap can be corrected by lowering the level of public expenditure.

When government reduces its expenditure on public works and other infrastructure, the revenue with the government is in excess of its expenditure.

The surplus budget should not be used in situation other than the inflationary gap, as it may lead to unemployment and low levels of output in an economy.

3) **Deficit Budget:**

When estimated government receipts are less than the estimated government expenditure, then the budgets is termed as Deficit Budget. In modern economies most of the budgets are of this nature. That is, estimated Government Receipts < anticipated Government Expenditure.

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Ans. 3.

Ans. 4.

Factors Affecting Demand :Memory Key [3 - PRICE FACTORS IT]

Demand is influenced by the following factors.

(1) **PRICE OF THE COMMODITY**

Out of all the factors which affect demand, price is the most important factor Price is the most influential factor which affects demand a lot. Generally is observed that when the price of a commodity rises, the demand for the commodity falls and when the price falls, the demand for the commodity rises. In simple words, higher the price. Lower the demand and lower the price, higher the demand.

(2) PRICE OF SUBSTITUES

The demand for a particular commodity may change if there is a change in the price of its substitute. If price of a commodity increases then consumers may prefer a chepar substitute of that commodity.

For eg : If the price of colgate toothpaste increases then the demand for colgate will fall and the demand for pepsodent / close-up/ Babool will increase.

(3) PRICE OF COMPLEMENTARY GOODS

Complementary goods refer to goods which are always used together orjointly for Eg. Car and petrol, TV and Setop box (Tata Sky), tea and sugar. If the price of one of the goods increase, then the demand for the other will fall and vice versa.

For Eg: If the price of sugar increase then demand for tea will fall (because sugar is used in making tea)

(4) FASHION

Fashion and trends change quickly. Products which are not in fashion or out of trend have less demand. Goods which are in fashion have higher demand.

For Eg: Ripped (cut) Jeans are more in demand as compared to regular Jeans

(5) AGE STRUTURE AND SEX RATIO

The demand for goods useful to a particular age group will be high if major buyer in the market belong to that age group.

For eg: A country having large size of production in the age group of 2-10 years will demand more of children goods like toys, diapers, school-bags, books. etc. Similarly, demand for goods also depends on the sex ratio in the country.

For Eg: In India, the male population is higher as compared to the female population therefore, demand for products used by males like shaving cream. male clothes. men’s perfume etc. will be more.

(6) CLIMATE

The demand for certain commodities will depends on climatic conditions.

Foe Eg: Sweaters have higher demand in winter.

(7) TAXATION POLICY

If the government charges higher tax, then people have to pay more tax and they are left with little disposable income. As a result, their demand in general, will reduce. On the other hand, a lower tax rate will lead to an increase in demand.

(8) OVERALL POPULATION

If the size of the population is large, there will high demand for various goods. A country will have a relatively low demand for various goods.

(9) REGULAR ADVERTISEMENT

Consumers get influenced by regular advertisement on television, in newspapers on radio etc. There is a higher demand for goods which are advertised strongly on various media.

For Eg: People get influenced when their favourite superstar or sportstar endorses a soap brand or watch brand.

(10) SPECULATION REGARDING PRICES

People generally speculate regarding price of goods in the future. This speculation affects their current demand. If people feet that the price of a commodity will fall in the future, they will postpone their demand to the future and demand less now.

For Eg: People expect the prices of “ Samsung Note II ” to fall in the future. As a result, they will demand more in the future and demand less now.

(11) INCOME

When the income of a person increases, he is able and willing to spend more. This leads to a general increases in demand. Similarly, a fall in income can lead to decrease in demand.

(12) TASTES AND HABITS OF CONSUMERS

The taste and habits of consumers affect the demand for products. The taste of consumers keep changing while habits tend to remain constant.

For Eg: Demand for Pizza. burger, Vada pav , chocolates, etc, depend on a person’s taste. Demand for cigarettes, alcoholic beverages, paan etc is a matter of habit.

Q. 4.

Ans. 1. TYPES OFMONEY-

1. COMMODITY MONEY

In the initial stages of human development different commodities were used as money. E.g. cattle, feathers, tusks, animal skin, salt, shells etc. The commodity chosen to serve as money (by common consent) depended upon various factors like climatic conditions, location, culture, economic development etc, e.g. people in the cold continents used skins and furs of animals as money. Whereas people living by the seashore used shells as a medium of exchange.

This commodity money had certain limitations, like, the perishable nature of commodity, the indivisibility of certain goods, problem of storage, etc.

These problems of commodity money gave rise to introduction of Metallic money.

2. **Metallic Money**

Introduction of metallic coins made of silver, gold, copper, iron etc., is considered as an important stage in the evolution of modern monetary system. Various defects of commodity money like perishability, heterogeneity, indivisibility gave rise to introduction of metallic money. Some characteristics of metals like continuity of supply, high and stable price, scope for division etc., made these metals serve as an excellent medium of exchange.

In early days, rulers of various kingdom minted metallic coins. Later it was minted by private bankers. They used to put their seal on these coins, certifying the weight and purity of the metal. After a certain period of time the monetary system was taken over by the government authorities with a view to give uniformity and legal status to the coins. Metallic coins can be divided into two categories.

a) Standard or full-bodied coins
b) Token coins.

a) **Standard or full bodied coins** – Full bodied coins are those whose face value is equal to their intrinsic value. Face value indicates the exchange value, fixed by the issuing authority and which is embossed on it. Intrinsic value is the value of the metal content present in the coin. These coins were made out of standard metals like gold and silver.

b) **Token coins** – Token coins are those whose face value is higher than their intrinsic value. These coins are made out of cheaper metals like aluminium, nickel etc. These coins are of lower denomination and generally used for settling small transactions. In India all coins in circulation today are token coins.

c) **Paper Money or Paper Currency** – Paper currency had its origin in the form of deposit receipts issued by private bankers in olden days. Paper money was a substitute for metallic money. In course of time, note issue was monopolized by the Central Bank. Paper money consists of the currency notes issued by the Government or Central Bank of the country. In India one rupee currency notes and all coins are issued by the Government of India and all other currency notes are issued by the Reserve Bank of India.

Following factors gave rise to the introduction of paper money.

1) Difficulty in transferring large sums of metallic money.
2) Supply of gold and silver lagging far behind the demand for money.
a. Loss of weight and value of coins due to wear and tear, etc.

Ans. 2.

Determinants of Market Supply : Memory Key [2 PRICE – DETERMINN]

The important factors that determine the market supply are as follows:

1) **Price of a commodity:** Price is an important factor influencing the supply of a commodity. More is supplied at a higher price and less is supplied at a lower price.
2) **Prices of other Goods:** An increase in the prices of other goods makes them more profitable in comparison to a given commodity. As a result, the firm shifts its limited resources from production of a given commodity to the production of other goods. For example, an increase in the price of wheat will induce the farmer to use his land for the cultivation of wheat instead of rice. So supply of rice decreases.'
3) **Development OR Cost of Production:** If the factor price increases the cost of production also increases. Thus, supply decreases.
4) **Expectations of seller's :** If the prices are expected to rise in the near future, the producer may with hold the stock. This will reduce the supply.

5) **Technology:** Technological improvements reduce the cost of production, which leads to an increase in production and supply.
6) **Exports and Imports:** Exports reduce the supply of goods within the country. Whereas imports increase the supply of goods.
7) **Reserve of Stock :** when the seller has more stock, he is able to offer more quantity for sale and he is also willing to after more quantity for sale as he wants to clear his stock. However, when the seller has limited stock, the supply also will be limited.
8) **Measures of the Government:** Government Policies like taxation, subsidies, industrial policies, etc., may encourage or discourage production and supply, depending upon government policy measures.
9) **Infrastructure Facility:** Infrastructure in the form of transport, communication, power, etc., influences the production process as well as supply. Shortage of these facilities decreases the supply.
10) **Nature of Market:** In a competitive market, the supply of goods would be more due to large number of sellers. But in monopoly, i.e., single seller market, supply would be less.

Ans. 3.

Labour: Meaning and Features : Memory Key : [LABRS HPL]

Labour is the most active and living factor of production, without which production process is not possible.

According to Marshall, "Any exertion of mind or body undergone partly or wholly with a view to earning some return other than the pleasure derived directly from the work."

In other words, any exertion of human body and mind with a view to earn money is labour. E.g. when students play football, it involves operation, but it is not labour, for it has no economic motive. But a football coach who teaches them the game, does it for his livelihood so his exertion is labour.

1) **Labour and labourer are inseparable** -
   Labourer and his work always goes together. Hence, labourer must be present himself where he suppose to render his services.
2) **Human and active factor of production -**
   Labour being a human factor has feelings, likes and dislikes. Therefore, he cannot be treated as a machine. Other factors become productive only after the application of labour. So labour is the most active factor of production.
3) **Less bargaining power -** Individual worker has weak bargaining power. They are helpless to accept the low wages offered to them, rather than remaining unemployed. However, in modern days trade unions fights for the rights of the labour. Labour can form a trade union, and through trade union they can put forward their demands for better working conditions, higher wages etc.
4) **Restricted mobility:** According to Adam Smith, "Of all the luggages, the labour is the most difficult to be transported." Labour can move from one country to another country in the same way. Labour can change his business easily, but due to the family attachment, housing problems, climate etc., restricts geographic mobility of labour.
5) **Inelastic Supply of labour** -Supply of labour is relatively inelastic during the short period of time this is because working population is between the age group i.e. 15-59. Supply of labour cannot be quickly increased or decreased to meet the changes in the demand for it..
6) **Hetrogeneous Factor -**Efficiency of labour differs from worker to worker. These differences are on account of a number of factors such as training, education, surrounding, culture, physical strength etc. Thus, labour is a heterogeneous factor of production, that's why labour is categorized under different classes such as skilled labour, semi-skilled labour and unskilled labour.

7) **Perishable factor :**Labour is perishable in nature. If a worker is absent for a day, the days labour has gone. The amount of labour lost is lost forever. Labour cannot be stored and used for future.

8) **Labour sells his labour and not himself -As quoted** by Alfred Marshall, the worker sells his labour, but he himself remains his own property." The worker does not sell himself. He sells his labour only.

Ans. 4.

Historical Review of Macro Economies

Macro approach to study economy is comparatively new and is of a recent origin. Though it is a modern approach, this does not mean that it did not exist in the past. It is true that Macro-Economics did not exist as a separate branch of economic analysis in the past, but this approach did prevail even before the evolution of Micro-Economics.

In the 16th and 17th century, advisors advocated policies to the government which were based on macro approach. These people were the followers of merchantilist (a group of English merchants) school of thought. In the 18th century Physiocrats (French Thinkers) tried to analyse the concept of national income and wealth, and discussed relative share of landlords, tillers of the soil and unskilled workers in the flow of income. Even the Classical economic theory of Prof. Adam Smith, Prof. Ricardo and Prof. J.S. Mill also discussed the determination of national income and wealth, and the division of national income into total wages, total rent and total profit. But their macro analysis was combined with micro analysis.

Thus, from the beginning, some thinking was being done on macroeconomic level.

The neo-Classical economists, Specially Dr. Marshall and Pigou, relegated Macro-Economics to the background. There micro analysis ruled the world of economics till the great depression of 1930's.

After the great depression, we find revolutionary and fundamental changes in economic thinking. Lord John Maynard Keynes published his very famous book "General Theory of Employment, Interest and Money" published in 1936. Keynes used macro approach to analyse economic problems. After the publication of Keynesian theory, macro economic analysis became more important and popular approach to economic analysis. Hence, credit for the development of Macro-Economic approach goes to Lord Keynes. Besides Keynes, Malthus, Karl Marx, Wicksell, Walrus, Irving Fisher are the other economists who have participated in the development of macro economics. After Keynes, Harrod and Domar used macro analysis to develop Theory of .Growth and many post Keynesian economists developed it as a policy oriented science.

Ans. 5.

Ans. 6.EFFECTIVE DEMAND

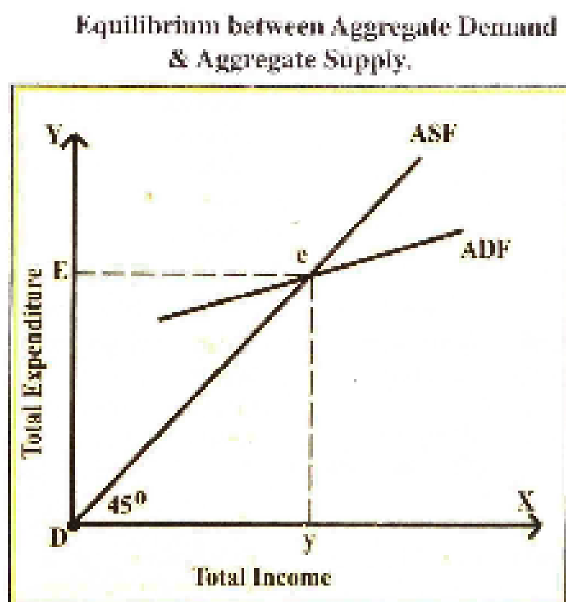
Effective Demand is also called macro-economic equilibrium.

According to Keynes effective demand is determined with the intersection of aggregate demand and aggregate supply in the economy.

The aggregate demand consists of consumption demand, investments demand, government demand, and foreign demand. Similarly aggregate supply depends on natural resources, labour, capital and technology.

The equilibrium point of effective demand is that point, where aggregate demand function equals to aggregate supply function.

Effective Demand can be shown in the following diagram.



The diagram indicates.

ASF = Aggregate Supply Function Curve

ADF =Aggregate Demand Function Curve

e = Point of effective demand (Equilibrium point) is a point at which total expenditure is equal to total income i.e. ADF intersect ASF at this point.

Q. 6.
Ans. 1.
Law of Demand
Law of demand is one of the important laws of consumption. Dr. Alfred Marshall, I book "Principles of Economics", has explained law of demand as follows.

"Other things being constant the higher the price of the commodity, smaller is the quantity demanded and lower the price, of the commodity larger is the quantity demanded.

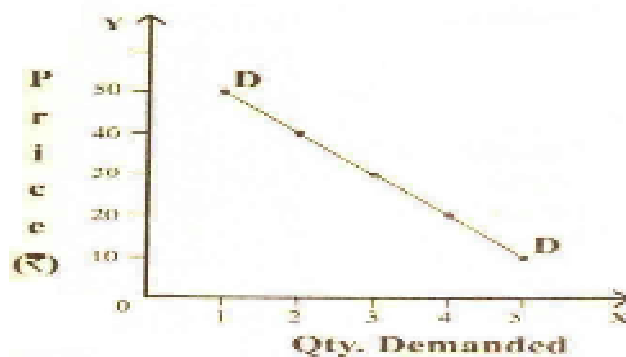
The law of demand explains change in the behaviour of consumer demand due to various changes in price. Marshall's Law of demand describes functional relation between demand and price. It can be expressed as D = f (P) that is demand- function of price. The relation between price and demand is inverse, because larger quantity is demanded when price falls and smaller quantity will I demanded when price rises. The law of demand explained with the help of the following schedule diagram.

Demand Schedule

Price of Mangoes Per Kg.(₹)	Demand for Mangoes (Kg.)
50	1
40	2
30	3
20	4
10	5

As shown in the schedule when price of mangoes is ₹ 50/- per kg demand is 1kg. when price falls to the level of ` 40 /- per kg and demand rises to 2 kg. Similarly, at the price ₹ 10./- per kg. demand of mangoes is 5 kg., whereas 4 kg, of mangoes are demanded at price ₹ 20/- per kg. This shows inverse relation between price and demand.

In this diagram X axis represents demand for mangoes, whereas Y axis represents price of mangoes. DD is demand curve which slopes.



Downwards from left to right. In other words, its slopes is negative because of inverse relationship between price and demand

Assumptions of the Law of Demand: Memory Key [No change in "PRICE FACTORS IT"]

The law of demand is based on following assumptions.

1. **No change in price of related goods :** The prices of substitute and complementary goods should remain constant. For instance, if price of tea rises its demand will fall. but demand for coffee will increase.

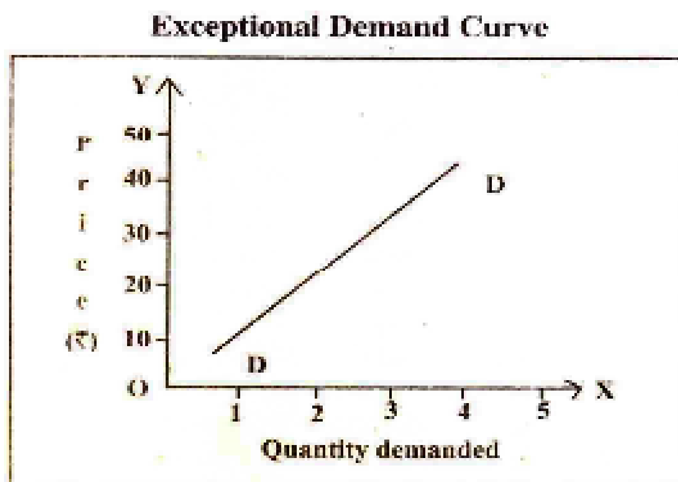
2. **No change in fashion :** The law of Demand assumes that fashion will not change because, if there is a change in fashion, demand for the latest product will increase without a change in price.
3. **No Change In Age Structure And Sex Ratio :** It is assumed that the age structure and sex ratio of the population remains the same.
4. **No change in Climate:** The law of demand assumes that the climate and weather conditions remain the same.
5. **No Change in taxation policy:** Taxation and fiscal policy of government should not change. A change in income tax. for instance, may cause changes in consumer's disposable income and hence demand.
6. **No change in overall population size:** An increase or decrease in size of population will lead to an increase or decrease in demand respectively. Hence it is assumed that there is no change in population size.
7. **No change in Regular Advertisements:** An Aggressive promotion campaign for a certain product may lead to a surge (increase) in its demand irrespective of the change in price similarly. If the advertisements are reduced, the demand for that product may decrease marginally . As a result, the law of Demand assumed that there in no change in regular advertisement.
8. **No change in speculaton about future price changes:** There should not be any change in the expectations about the prices of .goods in future. If consumers expect that price will rise or fall in future, they will change their present demand though price is constant.
9. **Income of the consumer remains constant**:
   Income of consumer should remain constant. If there is any change in income, demand tends to change even though price is constant. For . example, if income increases people will demand more quantity of a commodity even at a higher price.
10. **No change in : Taste and Habits of Customers :**
    The Law Demand assumes establishes that demand and price have an inverse relation However, it neglects other things or it assumes that other things remain constant which is not practical.

Exception of Law of Demand : Memory Key [Giffen HIDDEN PF]

The Law of Demand explains an inverse relationship between the price of a commodity and the quantity demanded of it. Sometimes however we see a direct relationship between price and quantity demanded of a commodity.

Under exceptions to the Law of Demand, the demand curve slopes upwards from left to right which shows a direct relationship between price of quantity demanded. It can be shown in the following diagram

Exceptional Demand Curve



Following are the exceptions to the Law of Demand.

1. **Giffen goods:** Certain inferior goods are called Giffen goods, when the price falls, quite often less quantity will be purchased than before because of the negative income effect and people's increasing preference for a superior commodity with the rise in their real income. Sir Robert Giffen observed the situation related to demand for bread & meat in England. When price of bread was decreasing, less bread was purchased. Here surplus money was transferred to purchase meat, as a result demand for meat increased.

   This behaviour is known as Giffen's paradox. Thus Giffen goods are inferior goods which have a direct. relationship between price and quantity demanded. In this case the demand curve slopes upwards from left to right as shown in the above diagram.

2. **Habitual Goods:** Due to habit of consumption certain goods like tobacco, cigarettes etc. are purchased even if prices are rising. Thus it is an exception.
3. **Ignorance:** Sometimes people do not have proper market knowledge. They may not be aware of the fall in price, of a commodity and thus they tend to purchase more at a higher.
4. **Demonstration effect:** The tendency of low income group to imitate the consumption pattern of high income groups is known as Demonstration effect. For example demand for I consumer durables such as washing machine, latest mobile etc.
5. **Demand for Prestige goods**: Diamonds, high priced motor cars, luxurious bungalows are prestige goods. Such goods have a snob appeal". Rich people consume such goods as status symbol. Therefore, when the price of such goods rises I their demand also rises. **6.expection regarding Prices :** When people speculate a change in price of a commodity in the future, they may not act according to the Law of demand. People I may tend to buy more at rising price, when they anticipate further price rise. For example, in the stock market people tend to buy more shares at rising prices. Even if prices of some goods like sugar, oil etc. are rising before Diwali, people go on purchasing more of these things at rising prices because they think that prices of these goods may increase, further during Diwali. "
7. **Necessities :** The demand for certain necessities like basic foodstuffs (wheat , salt, dal, etc.) and basic clothing (one pair of clothes) will not change due to a change in price.
8. **Price illusions or Consumers Psychological bias:** Consumers have illusion that high priced goods are of a better quality. Therefore the demand for such goods tends to increase with a rise in their price. e.g. Branded products which are expensive are demanded at high price.
9. **Fashion :** A product which is out of fashion (for Eg : Nokia 3310) will have a less demand even if the price is decreased. A product which is in fashion (for Eg : Android smart phones) will have a high demand even if the price is increased. Thus it is an exception to the Law.

Ans. 2.

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 or Psychological Factors : Memory-Key [PF – CEIIMM]

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 dependants, 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 Enterprise**: Undertakings business in future, providing for capital investment in future, which can be achieved through current savings i.e. to start a business and earn.
5. **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.
6. **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.
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.

(B) OBJECTIVE OR INSTITUTIONAL FACTORS: Memory – Key [DDF- WIRES]

These factors are called exogenous or external factors as they are external to the individual's behavior, which, in turn, has a strong bearing on their consumption expenditures.

These are:

1) **Change in Disposable Income**: Consumption expenditure depends upon disposable income. If there is a change in disposable income there will be a change in expenditure on consumption.
2) **Changes in Depreciation Allowances**: Increase in depreciation allowance would reduce income of shareholders and consequently, their consumption may decrease.
3) **Fiscal Policy**: Changes in fiscal policy of the governments affected consumption. Certain type of changes in fiscal policy adversely affect consumption. For example, increase in income tax, capital gains tax, estate duty etc. On the other hand, increase in government spending in various ways (including deficit financing) would increase propensity to consume.
4) **Change in Capital Value (Windfall Gains or Unexpected Gains):** Capital gains are due to sudden change in money value of wealth. The consumption expenditure of wealthy classes is likely to be extremely susceptible to unforeseen change in the value of their wealth. During the period of prosperity, huge unexpected gains or windfall gains may accrue to the capitalist class, and as a results their consumption may increase. Some examples of windfall gains are unexpected rise in profits caused due to unexpected upswing in business. Unexpected rise in the rate of return on investment in some company's shares or

debentures is also an example of windfall gain. All these windfall gains may cause increase in consumption.

5) **Changes in Income** : If income in terms of wage rate increases, consumption expenditure increases. A change in income distribution will cause change in expenditure on consumption.
6) **Change in the Rate of Interest**: Change in the rate of interests is likely to affect consumption function. An increase in the rate of interest may have a dampening impact on consumption. On the others hand, a fall in the rate of interest may encourage people to consume more.
7) **Expectations about the Future Income**: If Future income is expected to increase people are likely to save less and consume more. On the contrary, if future income is expected to fall, people may save more for the future and spend less on present consumption.
8) **Size of Family** : Size of population, family size would affect consumption.

Keynes, who was concerned with the problem of unemployment, was of the opinion that the above subjective and objective factors will not have very great influence on saving function in the short period. Keynes, therefore, believed that in the short period of time, consumption function and the saving function would be fairly stable.

Ans. 3.

Law of Equi-marginal Utility

Introduction

The law of equi-marginal utility is an extension of the law of diminishing, marginal utility. It explains consumer equilibrium, when he spends his income on various goods to maximise satisfaction.

The law of equi-marginal utility is also known as the law of maximum satisfaction.

(The law of equi-marginal utility is based upon following assumptions:-

1. Utility can be measured cardinally.
2. Consumer's behaviour is rational and he aims at maximum satisfaction.
3. Income of a consumer is fixed
4. A consumer spends his entire income on commodities - A, B & C respectively.
5. All units of each commodity are homogeneous
6. Prices of commodities are constant.
7. MU of money is constant.
8. A consumer knows marginal utility schedule and prices of commodities - A, B & C

Statement of law

According to Prof. Alfred Marshall, other things being equal, a consumer will distribute his money income on different goods in such a way the ratio of marginal utilities and their prices tends to be equal.

In other words, a consumer gets maximum total from spending his income, when the marginal derived from the last unit of money, spent on commodity tends to be equal.

If a consumer spends his given income on three consumer's equilibrium can be presented as follows:

$$\frac{\text{MUA}}{\text{PA}} = \frac{\text{MUB}}{\text{PB}} = \frac{\text{MUC}}{\text{PC}}$$

Where, MUA, MUB and MUC refer to marginal utility derived from commodities A, B and C, respectively. MUm = marginal utility of money spent.

It can be explained with the help of the above schedule.:

The above given schedule indicates marginal utility derived from commodities A, B, and C.

The price of commodity A= ₹ 2/-, commodity B = ₹ 3/- and commodity C= ₹ 4/-
Let us suppose that, an individual has limited income of ` 25/-. A consumer will equate MU of money spent on various commodities with price.
In this case, rational consumers will purchase-
4 units of commodity A
+ 3 units of commodity B
+ 2 units of commodity C
So he will spend-

Commodity	Units	Price	Amount spent (Units X axis)
A	4	2	₹ 8
B	3	3	₹ 9
C	2	4	₹ 8
		Total	₹25

According to the law, a consumer is in equilibrium when

$$\frac{MUA}{PA} = \frac{MUB}{PB} = \frac{MUC}{PC} = MU$$

In this case $\frac{12}{2} = \frac{18}{3} = \frac{24}{4}$

$\therefore$ 6 = 6 = 6

TU derived = TUA ⟶ 24+ 20 + 16 + 12 = 72
TUB ⟶ 30+ 24 + 18 = 72 units
TUC ⟶ 32 + 24= 56 units
Total utility 200 units

Thus, a consumer obtains maximum TU from various commodities with limited income of ₹ 25/- . No other combination of commodities A, B, and C can give him more than 200 units of TU. Hence, the law of equi- marginal utility guides the consumer to get maximum satisfaction from the given income , while arranging his total expenditure therefore, the law has great practical significance.

Ans. 4.

DIFFICULTIES IN THE MEASUREMENT OF NATIONAL INCOME:

The calculation of the national income of a country is a task full of difficulties and complexities. The following difficulties generally arise while estimating national income.

i) Theoretical difficulties
ii) Practical difficulties.

i) Theoretical difficulties:

This is also known as conceptual difficulties.

1) Income of foreign firms:

According to IMF view-point, income of a foreign firm should be included in the national income of the country, where the firm actually undertakes production work. However, profits earned by foreign firms are credited to the parent concern.

2) Incomes from illegal activities:

Income earned through illegal activities such as gambling, black marketing, theft, smuggling etc., is not included in national income. Such goods and services do

have value and meet the needs of the consumers. Thus to that extent national income is underestimated.

3) Government Services :

Government provides a number of public services like defence, public administration, law and order etc. Measuring the market value of such government services is difficult, as the real value of these services is not known, therefore it has become a convention to treat all such services as final consumption. Hence, it is included in national income.

4) Unpaid services:

National income is always measured in money, but there are a number of goods and services which are difficult to be assessed in terms of money. For example, painting as a hobby by an individual, the bringing up of children by the mother, these services are not included in national income as remuneration is not given to them.

Also services of housewives and the services provided out of love, affection, mercy, sympathy and charity are not included in national income, as they are not paid for. By excluding all such services from it, the national income will work out to be less than what it actually is.

5) Required to adjust :

The difficulty of price changes arise in the national income estimate, when the price level in the country rises, the national income also shows an increase even though the production might have fallen and when price level falls, National Income may show a decrease even though production may have increased.

6) Estimation of self consumption:

Goods produced for self consumption such as food grains, vegetables and other farm products do not enter in the market. But the value of such goods should be estimated at the rate of market price that have been marketed and should be included in national income.

7) Transfer payments:

Individuals get pension, unemployment allowance, but whether these should be included in national income is difficult problem. On one hand, these earnings are a part of individual income and, on the other, they are government expenditure. Therefore, these transfer payments are ignored from national income.

ii) Practical difficulties/statistical: Memory- Key [VIDEO- CID]

In practice, a number of difficulties arise in the collection of required statistics in estimating national income, some of these are:

1) Valuation of inventories:

Raw materials, intermediate goods, semi-finished and finished products in the stock of the producers are known as inventory. All inventory changes, whether negative or positive, are included in the gross national product. Any mistake in measuring the value of inventory, will distort the value of the final production of the producer. Therefore, valuation of inventories requires careful assessment.

2) Illiteracy and Ignorance:

Majority of the small producers in developing countries are illiterate and ignorant, and are not in a position to keep any account of their productive activities. So they cannot give information about the quantity or value of their output. Hence, the estimates of production and earned income are simply guesses.

3) Depreciation:

The calculation of depreciation on capital consumption is one more difficulty. Depreciation refers to wear and tear of capital assets, due to their use in the

process of production. Depreciation of capital assets will depend on technical life of the asset, the intensity of its use, nature of the asset, regular and careful maintenance etc. There are not uniform, common or accepted standard rates of depreciation applicable to the various capital assets. In case of depreciation, one has to make many reasonable assumptions, which involve an element of subjectivity. So it is difficult to make correct deductions for depreciation.

4) Existence of non-monetized sector:

There is a large non-monetized sector in the developing economy like India. Agriculture, still being in the nature of subsistence farming in the developing countries, a major part of the output is consumed at the farm itself and a part of production is partly exchanged for other goods and services. Such production and consumption cannot be calculated in national income.

5) occupational specialization:

There is the lack of occupational specialization, which makes the calculation of national income by product difficult. For instance, besides the crop, farmers in a developing country are engaged in supplementary occupations like dairy farming, poultry farming, cloth makings etc. But income from such productive activities may not be revealed and thus is not included in the national income estimates.

6) Capital gains or losses:

Capital gains or losses, which accrue to the property owners by increases or decreases in the market value of their capital assets or changes in demand, are not included in the gross national product, because these changes do not result from current economic activities.

7) Inadequate and unreliable data:

Adequate and correct production and cost data are not available in a developing country, such data relate to crops, fisheries, animal husbandry, forestry, the activities of petty shopkeepers, construction workers, small enterprises, etc. That is why, national income of a country will not show at its actual.

For estimating national income by income method, data on unearned incomes and on persons employed in the service sector are not available. Data on consumption and investments expenditures of the rural and urban population are also not available for the estimation of national income. Moreover, there is no machinery for the collection of data in such countries.

8) Problem of double counting:

The greatest difficulty in calculating the national income is of double counting. It arises from the failure to distinguish properly, between a final and an intermediate product. It so happens, the national income would work out be many times the actual. For example, flour used by a bakery is an intermediate product and that by a household the final product.