

**SYJC – MARCH 2016**  
**SOLUTION OF PRELIMINARY**  
**SOLUTION**  
**ECONOMICS**

(3 hrs)  
(80 Marks)  
Date: 25.12. 2015

- Ans. 1. (A)**
1. Partial
  2. Expands
  3. Decreasing
  4. Autonomous
  5. Deposit

**(B)**

Group A	Group B
1. Deficit Budget	1. Government expenditure
2. Government Budget	2. One year
3. Fees, licence fee	3. Non-tax revenue
4. Borrowings	4. Capital Receipts
5. Plan expenditure	5. Irrigation

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

**Ans. 2.(A) 1. Partial Equilibrium :-**

Micro Economics studies a small part of the economy through partial equilibrium. When an equilibrium is related to the behaviour of a single variable, it is called partial equilibrium. For e.g. equilibrium of a consumer, equilibrium of an individual firm, equilibrium of an industry or equilibrium of a particular sector are called partial equilibrium.

**2. Price discrimination :-**

This implies charging different prices for the same product to different buyers. The monopolist succeeds in increasing his profit by adopting the technique of price discrimination.

**3. Land :-**

In ordinary language the word 'land' refers to the surface of the earth. But in Economics the word land is a wider concept. Land is primary, natural and original factor of production. Land is a free gift of nature.

According to Dr. Alfred Marshall, "By land we mean not merely land in the strict sense of the word but the whole of materials water, air, light and heat."

**4. Reporate :-**

"Repo Rate or Repurchase Rate 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."

**5. Budget :-**

“A state budget is a statement of the states estimated income and expenditure in a commencing period usually one year”.

**6. Selling Cost :-**

The uniqueness of this market lies in the fact that a difference is made between cost of production and selling cost. Product differentiation leads to emergence of selling cost. Thus, the cost that producer have to incur, in order to differentiate their product is known as selling cost. Hence, medium such as television, radio, newspaper, magazine, exhibitions, incentives and salaries of sales representatives etc., are used by firms to increase the sales. The price of the product includes cost of production as well as selling cost.

- Ans.2.(B) (1) a. Assumption of ceteris paribus:** The assumption called 'ceteris paribus' (other thing being equal) is used to simplify the complexity of the real world. For example, in the analysis of law of demand, only price is allowed to change while all other factors influencing demand are assumed to be constant.
- b. Assumption of rationality.** Micro economic analysis is also based on rationality assumption. It refers to the rational behaviour of an individual consumer or producer. Both of them can maximise satisfaction or profit only when they behave rationally.
- c. Assumption of laissez fair policy and pure capitalism:** Institutional assumptions too act as the basis for micro economic theories. Assumptions like laissez fair policy, pure capitalism etc. are institutional assumptions.
- d. Structural assumptions.** Assumptions relating to static economy or dynamic economy are structural assumptions which are useful in explaining growth theories.
- (2) a. Subsidies are added to national income.**  
Subsidy is the grant provided by the government. As a result of subsidy, the price of the product becomes lower than factor cost. Therefore subsidies are added to arrive at factor cost.
- b. Subsidy keeps the market price less than factor cost.**  
Government supply goods like sugar, edible oil at a price which is lower than factor cost. If sugar cost Rs. 25 per kilo at the factory, government supplies at Rs. 15 in the market. The subsidy Rs. 10 is granted to support people below the line of poverty. However subsidies are included when we convert national income at market price into national income at factor cost.  
 $NI_{fc} = NI_{mp} - \text{Indirect taxes} + \text{subsidy}$
- c. Exclusion of subsidy amount to under estimation.**  
Inclusion of subsidy provides the clear picture of the cost of the given product or factor. If subsidy is not included, it results in underestimation of national income.
- (3) a. Longer waiting period.**  
Fixed deposit generally carries high rate of interest depending upon the length of the] period. Larger the period higher the interest rate. Since it carries a higher waiting period banks reward them with high rate of interest.
- b. Lump sum amount.**  
Under fixed deposit people pay a lump sum amount once for all for a specific period. Such lump sum deposits become major source of loan able funds. Therefore banks are ready to pay higher rate of interest.

**c. Earns more than saving and current accounts.**

Being a time deposit, the amount once paid under fixed deposit cannot be withdrawn) before the time of maturity. Demand deposits like saving and current accounts are held! only for transaction purposes and money can be withdrawn anytime. Eventually fixed) deposit earns higher interest.

**d. Source of motivation.**

Customers can be motivated to keep fixed deposit only by declaring high rate of interest. Therefore high rate of interest is given on fixed deposits. People keep saving deposit even at a lower interest rate but not fixed deposit.

**(4) a. Desire is only an idea.**

Mere desire cannot become demand unless it becomes effective demand. A desire is simply an idea. It becomes effective demand when it is backed by ability and willingness of a person to pay.

**b. Ability to pay.**

The desire of a beggar to become the owner of a five star hotel will remain a mere desire for he lacks ability (purchasing power) to buy the same.

**c. Willingness to pay.**

The desire of a miser to buy a Maruti car may remain a desire as he is not willing to spend money.

**d. Availability of the product.**

More than desire, what is important is the availability of the commodity. There can be no demand in the absence of availability, even if the consumer is willing and able to buy.

**(5) a. Lack of storage facilities.**

Agricultural goods are generally perishable or semi perishable. They can not be stored for a long time. Sellers like small traders can not build cold storage facility. Therefore supply remains limited.

**b. Perishable in nature.**

In case of perishable goods like flowers, fruits and vegetables, the sellers do not want to take the risk. If they are not sold, they get rotten and bring heavy losses. Therefore the sellers supply limited quantity. They cannot increase supply even price rises. Therefore supply is inelastic.

**c. Seasonal supply.**

Agricultural goods cannot be cultivated throughout the year. The supply is seasonal in nature and therefore it is in limited. Even if price rises, supply cannot be increased immediately.

**d. Local market.**

Due to poor infrastructure like transport, communication and storage, the market for agricultural goods is confined to local area. Therefore sellers do not take the risk of expanding supply.

**(6) a. Avoids direct settlement.**

Clearing house system avoids direct settlement of claims and counter claims between different banks. Thus it avoids use of cash in settlement of claims.

**b. Single process of debiting and crediting.**

Central bank enjoys access to all commercial banks. It facilitates the settlement o claims and counterclaims by debiting and crediting. Thus it economizes use of cash.

**c. Avoid payment in cash.**

In the absence of clearing system, all commercial banks have to keep huge amount of cash to settle claims. Central bank adjusts such claims between commercial banks through clearing system. Thus it economizes the use of cash.

**d. Avoids risk of movement of cash.**

Cash movement from one bank to another bank involves risk. Clearing house system avoids risk of cash movement.

**Ans.3(A) (1) Revenue Expenditure & Capital Expenditure**

<b>Revenue Expenditure</b>	<b>Capital Expenditure</b>
1. An expenditure which does not create any asset or cause reduction in liability of the government is called as revenue expenditure.	1. An expenditure which either create an asset or causes reduction in liability of the government is called as capital expenditure.
2. It is recurring in nature.	2. It is non-recurring in nature.
3. It can be developmental as well as non-developmental.	3. It is generally developmental or productive in nature and helps to increase productive capacity of the nation.
4. For e.g:-expenditure on defense, judiciary, health, education, interest payments etc.	4.For e.g:-expenditure on land and building, machinery, loan to state governments, investment in shares etc.
5. Revenue expenditure has to be met out of revenue receipts.	5. Capital expenditure has to be met out of capital receipts.

**(2) Current Account & Recurring Deposit Account.**

<b>Current Account</b>	<b>Recurring Deposit Account</b>
1. A current account is usually operated by the business community, companies, corporations, trusts, etc.	1.In this type of account a fixed amount is deposited in the bank at regular intervals for a fixed period of time.
2. There is no restriction on number of deposits or withdrawals.	2. Amount is generally deposited once in a month or a regular interval. However, it can be withdrawn only after the end of the stipulated period.
3. Generally, no interest is paid on balance in current account.	3. Banks pay a high rate of interest on recurring deposit account. However, it is less than interest on fixed deposit account
4. The main purpose of operating a current account is to facilitate regular transactions.	4. The main purpose of recurring deposit account is regular saving and to get a lumpsum amount on maturity.

### (3) Consumption Function & Saving Function.

<p>1. Meaning ; The consumption function or the propensity to consume is defined as the amount of expenditure spent out of given level of income.</p> <p>It is the functional relationship between income and consumption.</p> <p>2.Symbolic expression : Symbollically, <math>C= f(y)</math></p> <p>3. Determinants : Factors like income, wealth, prices of goods, taste and preference, rate of interest etc. determine consumption function.</p>	<p>Saving function or propensity to save refers to the functional relationship between saving and income.</p> <p>It shows that saving depends upon income.</p> <p>Symbollically, <math>S= f(y)</math></p> <p>Factors like income, rate of interest, taxation policy, social security, price level etc. determine saving function.</p>
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### (4) Insurable Risk & Non Insurable Risk

Insurable Risk	Non Insurable Risk
1. Those business risks which are covered by insurance are called insurable risks.	1. Non-insurable risks are unexpected risks in business which cannot be insured.
2. The losses which happen on materialization of insurable risk is reimbursed by insurance company.	2. the losses which happen on materialization of non-insurable risk is to be borne by the entrepreneur.
3. Insurable risk can be envisaged or foreseen.	3. Non-insurable risk cannot be envisaged or foreseen.
4. For e.g. Risk of loss due to fire, theft, flood etc.	4. For e.g. Risk of loss due to change in government policy, war between nations etc.

### (5) Demand Curve & Supply Curve.

Demand Curve	Supply Curve.
1. Demand curve is a graphical representation of a demand schedule.	1. Supply curve is a graphical representation of a supply schedule.
2. Demand curve is negative because there is an inverse relationship between demand and price.	2. Supply curve is positive because there is a direct relationship between supply and price.
3. Demand curve slopes downward from left to right.	3. Supply curve slopes upward from left to right.
4. Refer Q.1 of chapter 3A diagram.	4. Refer Q.2. of Chapter 4v for diagram.

## (6) Total Utility & Marginal Utility

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

### (B) (1) Types of Demand

- a. **Direct Demand:** When a commodity, demanded to satisfy human wants directly is direct or conventional demand. For example» the demand for food, clothes have direct demand. Consumer goods have direct demand.
- b. **Indirect Demand:** Indirect demand is known as derived demand. When good is demanded indirectly, i.e., to produce consumer goods, it is indirect demand. For example demand for factors of production, is indirect demand.
- c. **Joint Demand:** When two or more goods are demanded jointly to satisfy a single need it is known as joint demand for example, to get tea, water, sugar, tea powder, milk etc. is demanded. The demand for complementary goods is joint demand.
- d. **Composite Demand:** The demand for commodities, which is used to satisfy several wants at a time, is composite demand. For example, the demand for electricity is composite demand.
- e. **Competitive Demand:** Competitive demand is when demand for a commodity is with its substitutes. For example tea and coffee have competitive demand.

### (2) Types of Capital

The capital can be classified mainly into four groups:

- a. **On the basis of ownership:**
  - 1) Private capital
  - 2) Public capital
- b. **On the basis of durability:**
  - 1) Fixed capital
  - 2) Working capital
- c. **On the basis of mobility:**
  - 1) Sunk capital
  - 2) Floating capital

**d) On the basis of nature**

- 1) Real capital
- 2) Money capital

**1] On the basis of Ownership:**

**a) Private or Personal Capital:**

It is that capital which is owned by individual or institute that is group of individuals. E.g., a firm owned by individual, machinery etc.

**b) Public or Social Capital:**

When capital is owned collectively by the society or the government, it is public or social capital. E.g., municipal school, municipal hospital, railways etc.

**2] On the basis of Durability:**

**a) Fixed Capital:**

It is that capital which is used in a production . process again and again. It is durable in nature. E.g., machinery, factory building etc.

**b) Working or Circulating Capital:**

It is that type of capital which is used in a production process only once. It is also known as variable capital. E.g. raw material, power fuel.

**3] On the basis of Mobility:**

**a) Sunk Capital:**

When the capital is used for specific purpose, it is sunk capital. E.g. xerox machine, road rollers, railway lines. It cannot be used for any other purpose.

**b) Floating Capital:**

It is that capital which has several alternative uses. E.g. electricity, coal, petrol, etc.

**4] On the basis of Nature:**

**a) Real Capital:**

It is a physical capital used in the production process. E.g. machinery, raw material, equipment's etc. It is used to produce other goods.

**b) Money Capital:**

It is a capital in the form of money. Real capital like raw material, machinery can be purchased with the help of money capital.

**(3) Point elasticity method or geometric Method**

The proportional method and total outlay method enable us to measure elasticity of demand at a given point on the demand curve. Therefore, Dr. Marshall has developed yet another method to measure elasticity of demand, which is known as Point or Geometric method. At any point on demand curve elasticity of demand is measured with the use of the following formula.

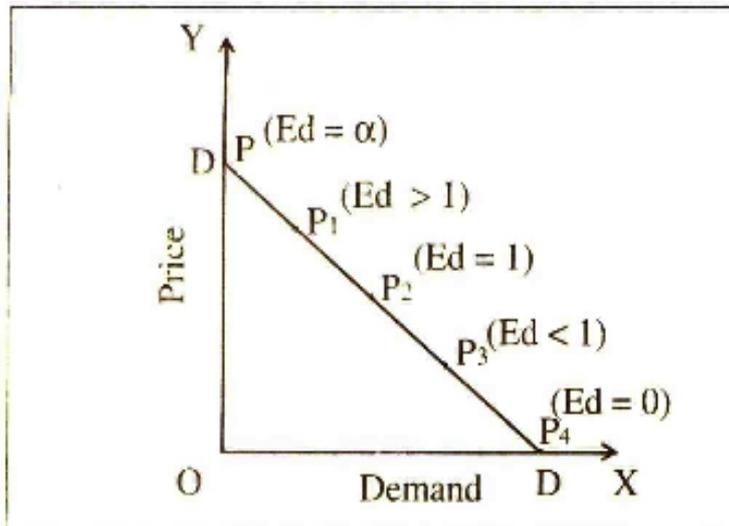
$$\text{Point of Elasticity of Demand} = \frac{\text{Lower segment of the demand curve below the given point}}{\text{Upper segment of the demand curve above the given point}}$$

$$\text{Or Price elasticity of demand} = \frac{L}{U}$$

$$\text{Or point } Ed = \frac{L}{U}$$

With the help of the following example, we can understand how to measure elasticity of demand at a point on linear demand curve.

### Linear Demand Curve

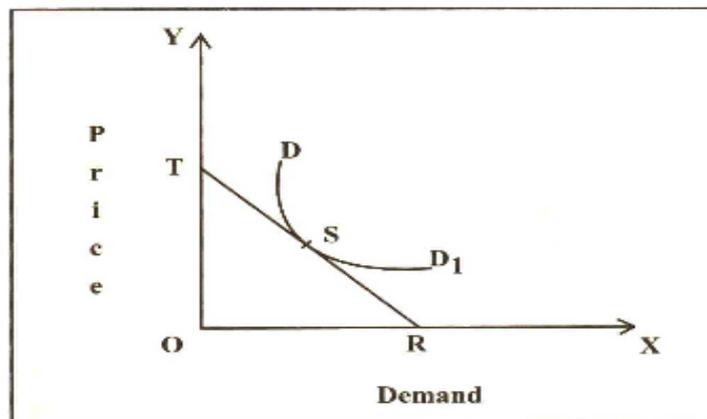


In the above figure, DD is, demand curve and we assume that its length is 6 cm. at point P demand is infinite elastic, whereas at point P<sub>4</sub> elasticity of demand is zero. Therefore, we have to measure elasticity of demand on points, P<sub>1</sub>, P<sub>2</sub> and P<sub>3</sub>

At point P , elasticity of demand = lower segment of the demand curve below the given point P<sub>1</sub>P<sub>4</sub> ÷ Upper segment of the demand curve above the point is P<sub>1</sub>P. Therefore,  $Ed = \frac{P_1P_4}{P_1P}$ .  $Ed > 1$ . It means demand is elastic or elasticity of demand is greater than one at point P<sub>1</sub>

Similarly, by using the above given formula, we can measure elasticity of demand at point P<sub>2</sub> and P<sub>3</sub>. At point P<sub>2</sub> , demand is unitary elastic. It means elasticity of demand is equal to one, whereas at point P demand is less than one.

### Non-Linear Demand Curve.



If the demand curve is non-linear, then a tangent is drawn to the demand curve at the given point. The tangent should touch both the axes - OX axis and OY axis. The price elasticity is measured by the ratio of lower segment to the upper segment.

$$\text{Elasticity} = \frac{SR}{ST}$$

$$Ed = \frac{L}{U}$$

#### (4) GOVERNMENT EXPENDITURE (G):

In the modern economy, government is an important buyer of goods and services on a large scale. Government purchases of goods and services constitute government demand. Government incurs expenditure is done for the purpose of maximizing welfare and having maximum growth and development.

Government's expenditure is done either for consumption purposes or for investment purpose.

Government's **consumption expenditure** includes expenditure on defence, police, maintenance of law and order, public utilities, such as water, electricity, parks, etc. interest on loans, provision of social security measures and public administration.

Government's **investment expenditure** includes the expenditure incurred on increasing the stock of capital assets in the economy,. It includes expenditure on economic and social overheads, such as transport and communication, banking, finance and insurance, irrigation facilities, education, health, etc., and the expenditure on public sector units – such as atomic energy, iron and steel, fertilizers, etc.

All these government expenditures add to aggregate demand in the economy.

**Ans.4. (1) Various types or forms of utility are as follows-**

- a. **Form utility-** When utility increases due to the change in the shape or structure of existing material, it is called form utility.  
Toys made out of clay, making furniture from wood, a dress from fabric, etc., are some examples of form utility.
- b. **Place utility** - When utility of a commodity increases due to the change in the place of utilisation, 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.
- c. **Time utility-**When utility of a commodity increases with a change in the time of utilisation, 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.
- d. **Service utility-** It arises when personal services are rendered by various professionals in the society to others. Services provided doctors to patients, knowledge given teachers to students, suggestions by lawyers to his clients, etc., are examples . service utility. In, this case, production and consumption both take place at the same time.
- e. **Knowledge utility** - It increases when consumer acquires knowledge about particular product, e.g. Utility of a mobility phone or computer increases when a person knows about its various functions.
- f. **Possession utility** - It arises when the ownership of goods is transferred from One person to another. E.g. Possession utility enjoyed by the consumers when they purchase goods from sellers.

(2) **Cost:** When an entrepreneur undertakes an act of production he has to use various inputs like raw material, labour, capital, etc. He has to make payments for such inputs. The expenditure incurred on these inputs is known as the cost of production. Cost of production increases with an increase in output. Cost has three types they are as follows.

- a. **Total Cost:** Total Cost (TC) is the total expenditure incurred by a firm on the factors of production required for the production of goods and services. Total cost is the sum of total fixed cost (TFC) and Total Variable cost (TVC) at various levels of output. Thus,  
 $TC = TFC + TVC$   
TFC = Cost which is incurred on fixed factor of production like land.  
TVC = Cost which is incurred on variable factors like labour, raw material, etc.

- b. **Average Cost:** Average cost refers to total cost of production per unit. It is calculated by dividing TC by total output.

$$AC = \frac{TC}{TQ}$$

Where,

AC = Average Cost

TC = Total Cost

TQ = Total Quantity of output

Suppose the total cost of production of 2 units of commodity is ₹ 80, then the Average cost is

$$AC = \frac{TC}{TQ} = \frac{80}{2} = \text{Rs.}40$$

- c. **Marginal Cost:** Marginal cost is the net addition made to total cost by producing one more unit of output. If TC of producing 2 units is ₹200 and TC of producing 3 units is ₹ 240 Then,

$$MC_n = TC_n - TC_{n-1}$$

$$= ₹ 240 - ₹ 200$$

$$= ₹ 40$$

Where,

n = Number of units produced

MC<sub>n</sub> = Marginal Cost of then n<sup>th</sup> unit

TC<sub>n</sub> = Total Cost of n unit

TC<sub>n-1</sub> = Total Cost of (n-1) units

$$\therefore \text{Marginal Cost} = \frac{\Delta TC}{\Delta TQ} = \frac{40}{1} = \text{Rs.}40$$

ΔTC = Change in total cost

ΔTQ = Change in total quantity of output

**Concept of Revenue: Total Revenue, Average Revenue, Marginal Revenue**

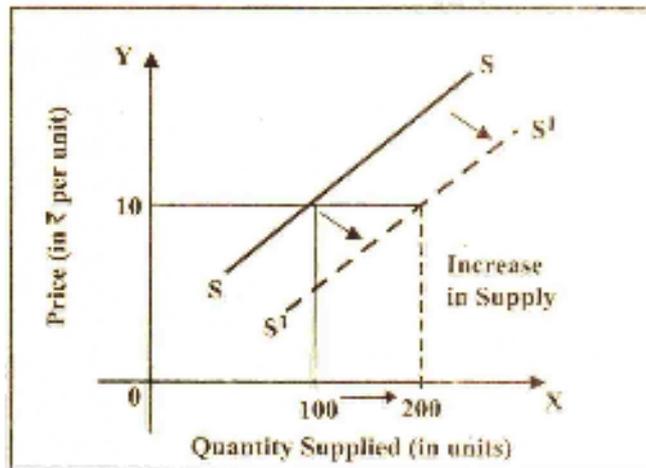
- (3) When supply of commodity changes due to change in other factors at the same price, then it is known as 'Change in Supply'. There are two types of changes in supply. They are -

a) Increase in Supply

b) Decrease in Supply

- a. **Increase in Supply:** Increase in Supply refers to rise in the supply of given commodity due to favourable changes in other factors such as decrease in the prices of inputs, decrease in tax, technological upgradation, etc. price remaining constant. The supply curve shifts to the right of the original supply curve. It can be explained with the help of following diagram.

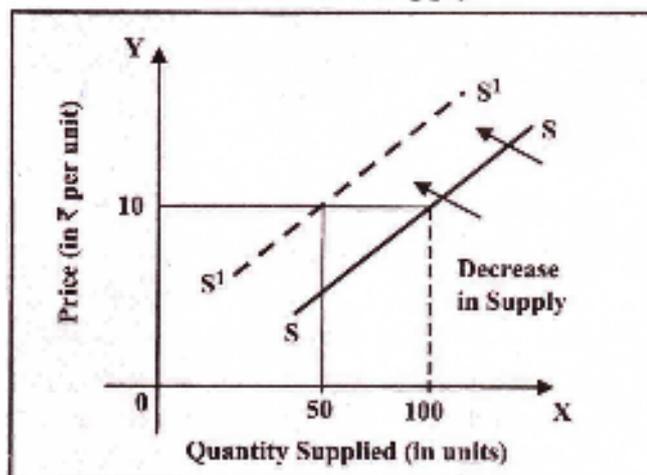
### Increase in Supply



In the above diagram, quantity supplied is shown on the X axis and price on the Y axis. Supply rises from 100 to 200 units at the same price of ₹10, resulting in a rightward shift of the supply curve from SS to S<sub>1</sub>S<sub>1</sub>. It is known as Increase in Supply.

- b. **Decrease in Supply:** Decrease in Supply refers to a fall in the supply- of a given commodity due to unfavourable changes in other factors such as increase in the prices of inputs, increase in taxes, technological degradation, etc. price remaining the same. The supply curve shifts to the left hand side of the original supply curve as shown in the diagram.

### Decrease in Supply



In the above diagram, quantity supplied is shown on the X axis and price on the Y axis. Supply from 100 units to 50 units at the same price of ₹ 10. It results into a leftward shift of the supply curve from SS to S<sub>1</sub>S<sub>2</sub>. It is known as Decrease in supply.

- (4) a. **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.
- b. **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.

- c. **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.
- d. **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.
- e. **Permanent and indestructible factor**  
Land is a indestructible factor. It cannot be destroyed completely. Fertility of land may diminish but its existence remains forever.
- f. **Heterogeneity:**  
Land is a heterogeneous factor and not a 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.
- g. **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.
- h. **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.
- i. **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.

(5) Macro-Economics is a study of very large, economy wide aggregate variables like national income, total employment, general price level, economic growth rate, total investment, etc. It examines the inter-relation among these various aggregates, their determination and causes of fluctuations in them.

Macro-Economics is known as Theory of Income and Employment, because it explains the forces which determine the level of national incomes and employment in an economy and analyses the causes of fluctuations in them. Further, it also explains the determinants, which will bring about increase in national income, output and employment over a long period.

Subject Matter:

i) **Theory of Income and Employment**

Macro-economics analysis explains what determines the level of national income and employment, and what causes fluctuations in the level of income, output and employment.

To understand how the level of income and employment is determined, we have to study the determinants of aggregate supply and aggregate demand and further we have to study consumption function and

investment function. The analysis of consumption function and investment function are the important subjects to Macro-Economic Theory.

[Theory of Business Cycles is also a part parcel of the theory of income.

This theory also examines inter-relation between income and employment, and suggests policies to solve the problems relation to these variables.

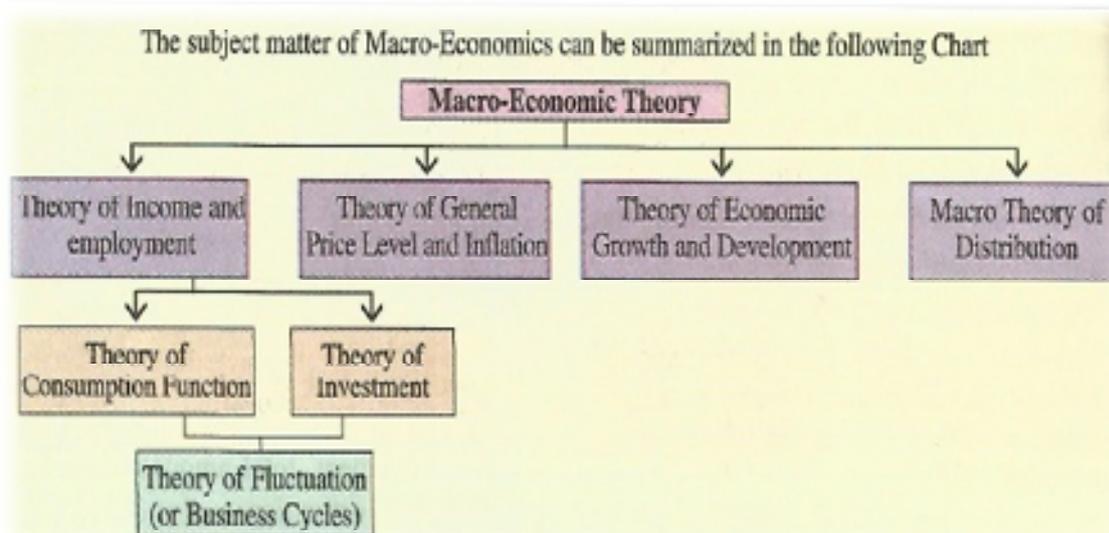
ii) **Theory of General Price Level and Inflation**

Macro-Economics analysis shows how general level of prices is determined further explains what causes fluctuations in

The study of general level of prices significant of account of the problems created by inflation and depression. The problems inflation and depression are the serious economic problems faced these days by mc of the countries in the world. Theory of pri level studies causes and effects of inflation and depression, and suggests economic policies to tackle these problems.

iii) **Theory of Growth and Development:**

Another important subject matter of Macro-Economics is the theory of economic growth and development. It studies the causes of under development and poverty in poor countries and suggests strategies for accelerating growth and development in them. Growth Theory also deals with the problems of full utilization of increasing productive capacity in developed countries and explains how the higher rate of growth with stability, can be achieved in these countries.



iv) **Macro Theory of Distribution:**

Still another important subject matter of Macro-Economics is, to explain what determines the relative shares from the total national income of the various classes, especially a workers and capitalist. Ricardo and Karl Marx propounded theories, explaining the determination of relative shares of various social classes in the total national income. Afterwards, Kalecki and Kaldor also explained determination of relative shares of wages and profits in the national income.

Macro theory of distribution thus deals with the relative shares of rent, wages, interest and profits in the total national income.

In addition to this, study of public finance, international trade, monetary and fiscal policies are also a subject matter of Macro-Economics.

6. **Primary Functions:**

a. **Medium of Exchange** – The fundamental role of money is to serve as a medium of exchange. This is The most important function of money. By

working as a medium of exchange money divides the exchange transactions into two parts, namely sale and purchase. This function of money has solved one of the biggest problems of the Barter System, i.e., lack of double coincidence of wants. Any commodity or service can be bought with and sold for money. Money represents general purchasing power. A person can sell any commodity today for money and can use the money in future to purchase any commodity or service. Some unique characteristics of money like general acceptability, portability, durability etc. have helped money to work as a medium of exchange.

- b. **Measure of Value or unit of account** – the value of all goods and services is expressed in terms of money. It is a unit of account. When the value of a commodity is expressed in terms of money, it is called price. It helps us to compare the value of all commodities. By comparing the prices of different commodities, relative values of these commodities can be calculated. E.g., price of a table is Rs.2,000 and price of a chair is Rs.500. It indicates that the value of a table is equivalent to the value of 4 chairs. Goods and services are quantified in different units. It would have been difficult to express the value of a kilogram of sugar in terms of certain litre of milk or a certain metre of cloth, in the absence of money. This difficulty is overcome when the prices of all these goods are expressed in terms of money which is a unit of account. Every country has a standard money or a monetary unit in terms of which values are expressed and measured e.g. Dollars, Pounds, Yens, etc. In India Rupee is the unit of account. Incomes and expenditures of all kinds, assets and liabilities of all kinds, budgets of the government etc., are stated in terms of money as a unit of account.

**Ans.5.1.** Yes. I agree with statement.

Importance of law of diminishing marginal utility.

**a. Useful to the government.**

The principle of socialism adopted by government to reduce inequality is based on marginal utility of money.

Government imposes land reform measures to take away surplus land from rich and to redistribute the same to poor. The loss of wealth by rich has little impact as their marginal utility of wealth is not so great. When the wealth is transferred to poor, they enjoy greater welfare as the marginal utility is more. This helps in reducing inequality of wealth.

**b. Useful to the consumer.**

The law of diminishing marginal utility guides consumer as how to spend his income effectively so as to ensure maximum satisfaction. Thus it helps consumer to plan his expenditure in a rational manner.

**c. Useful to the monopolist.**

The law is helpful to monopolists to apply the policy of price discrimination. He charges different prices for the same product to different customers on the basis of marginal utility.

**d. Useful to explain paradox of value.**

Modern economists use the concept of marginal utility to explain the difference between value in use and value in exchange. According to them total utility (value in use) of a commodity does not determine the price of a commodity. It is marginal utility (value in exchange) which determines the price of that commodity. Diamond is scarce and its relative marginal utility is high.

Therefore the price of diamond is higher, though its total utility is lower than water.

In case of water, it is available in abundant quantity and the relative marginal utility is very low. Therefore its price is very low or zero, though its total utility is higher than diamond.

**e. Useful to the finance minister.**

"Fife taxation policy of the modern government is based on the concept of marginal utility. The government redistributes income from rich to poor through progressive taxation. Since rich have low marginal utility for money, it is desirable to tax them. The proceeds from taxes are redistributed to poor through welfare programmes. As poor have high marginal utility for money, such expenditure would provide them great welfare.

The gain in utility enjoyed by the poor person is greater than the loss in utility suffered by rich. Thus the general community welfare increases.

**f. Useful to the households.**

The Law of Diminishing Marginal Utility guides households how to plan of their expenditure. It helps them to avoid waste expenditure. They restrict consumption upto certain point beyond which marginal utility declines.

Therefore they stop purchase at a point where marginal utility is equal to price.

**g. Useful to the producer.**

It guides the producer to determine price and sales policy. It helps him taking important decisions to maximise his profit.

**h. Useful to explain the downward sloping demand curve.**

Law of diminishing marginal utility explains why the demand curve slopes downward. The law states that the consumer buys more at a lower price and less at a higher price to adjust equilibrium between price and marginal utility.

**i. Basis of economic laws.**

Some of the very important laws and principles are based on the law of diminishing marginal utility. The law of demand, the law of equi-marginal utility, the concept of consumer surplus have been directly derived from the law of diminishing marginal utility.

**2. Yes. I agree with statement.**

**1. Inverse relationship between labour supply and wage rate.**

In mining industry, initially the rise in wage would induce the workers to offer more hours of work. But at a later stage when the wage rate rises further, the workers prefer to work for lesser hours. They want to have more leisure time. They are happy with whatever income they receive. Following table indicates the same.

Wage rate per hour (₹)	Hours of labour supply	Total Income (₹)
25	8	200
50	10	500
100	8	800

In the of above table, when the wage rate rises from ₹25 to ₹50 at the initial stage, the worker offers more hours of work (i.e) 10 hours . When the wage rate still rises to ₹100 later, worker is ready to work only for 8 hours and like to enjoy 2 hours leisure time. This shows the inverse relationship between wage rate and labour supply. Such a tendency goes against law of supply.

**3. Ans. No. I Disagree with following statement**

- a. Lack of double co-incidence of wants.
- b. Lack of common measure of value.
- c. Difficulty of storage of goods.
- d. Problem of indivisibility.
- e. Problem of making deferred payments.

**a. Lack of double co-incidence of wants –**

Double /co-incidence of wants indicates need of each other's goods and willingness to accept it. Lack of double co-incidence of wants was one of the important limitations of Barter system, e.g. Person 'A' has cloth and he wants rice in exchange and the person 'B' has wheat and he wants milk in exchange. In this case exchange between 'A' and 'B' would not take place as both are not in need of each other's goods.

- b. Lack of common measure of value -** In the absence of common measure of value or a unit of account, it was difficult to calculate the values of the goods exchanged. Exchange became difficult in the case of goods which could not be compared, e.g.. It was difficult to compare 2 litres of milk with 2 kgs of onions. At the same time it was difficult to compare certain units of a commodity with any service.

**c. Difficulty of storage of goods –**

Under barter exchange, it was necessary to store goods for future consumption. Storage of highly perishable goods like fish, vegetables, milk etc. was difficult, besides there were space constraints.

**d. Problem of indivisibility –**

Under barter system, it was difficult to make fractional payments, especially when things to be exchanged were indivisible e.g. Person 'X' had a bag of rice which he wanted to exchange for a plough, with person 'Y', but suppose 'Y' wanted only half a bag of rice, then it would be difficult to offer half of the plough.

**e. Problem of making deferred payments -**

Deferred payments are those which are made in future. When people used to borrow cattle, it was difficult to return the cattle in the same physical conditions, after a certain number of years.

Thus, various difficulties faced under the Barter System gave rise to money. Invention of money is one of the most fundamental invention.

**4. Yes. I agree with following statement.**

The commercial banks also provide following general utility services to the general public.

**a. Safe Deposit Vault:**

Safe deposit vault facility is available to the general public to enable them to keep their valuables, such as shares, gold, silver ornaments etc. There is a separate section in the bank, where lockers are provided in various sizes at payment of a fixed rent.

**b. Remittance of funds/Transfer of money:**

An important function performed by commercial bank is remittance of funds, banks remit money from one place to another or even from one country to another. This facility is more useful to traders. Remittance of funds is done by telegraphic transfer, mail transfer, demand draft etc.

**c. Letters of credit:**

The commercial banks issue letters of credit to enable the traders to buy goods on credit. A letter of credit is a document or order by a banker in one place, authorizing some other banker in some other place, to honour the drafts or cheques of the person whose name appears in the document. The amount is chargeable to the issues of the letter of credit.

A bank's letter of credit helps a businessman, because of the better credit standing of a bank compared with his personal credit.

**d. Reference/Status Report:**

The commercial bank also gives confidential reports on third party about its financial standing, mode and frequency of payments etc.

**e. Underwriter/Underwriting**

The commercial bank also acts as an underwriter for issue of shares and debentures of any public and private limited company.

The banks guarantee the purchase of certain proportion of shares, if not sold in the market.

**f. Dealings in foreign exchange:**

By keeping separate foreign exchange department, bank deals in foreign exchange. Commercial bank offer services for converting one currency into another. Banks make profit in foreign exchange transactions. In India, Reserve Bank of India has a, strict control on this function.

**g. ATM facility, credit card, debit card:**

It is an electronic delivery system. It is a convenient method of withdrawing money from bank without going to the bank through automated / automatic teller machines. It enables people to do their banking transactions at any hour of the day.

**5 Yes. I agree with following statement.**

Central Bank has the sole power of issuing currency notes which are legal tender.

The Central Bank of the country has thus the monopoly of issuing notes or paper currency to the public. The advantages and reasons for granting the monopoly rights to issue notes to the Central Bank are listed below-

- i) It brings uniformity in the currency making it easy for people to identify it.
- ii) The notes acquire more prestige, when they are issued by the single bank, than when they are issued by many banks.
- iii) It avoids over issue of currency as it becomes easy to control the total quantity of notes issued.
- iv) Public has more confidence in the currency.
- v) It helps to maintain price stability, because the Central bank can control the credit creation by commercial banks more effectively.
- vi) It is also convenient for the government to supervise and regulate the issue of paper currency by Central Bank.

Thus, the Central Bank is the most suitable and appropriate agency for the issue of notes and for controlling currency and credit supply according to requirements of the country.

In India, Reserve Bank of India (RBI) has the sole right to issue currency notes of all denominations except one rupee note. The one rupee note and coins of all denominations are issued by the Ministry of Finance of the Government of India, but their distribution is undertaken by RBI.

**(6) Yes. I agree with the following statement.**

**Precautions:**

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

- a. Transfer incomes or transfer payment like scholarships, gifts, donations, Charity, old age, pensions, unemployment allowance etc., should be ignored.
- b. All unpaid services like services of housewife, teacher teaching her/his child, should be ignored.
- c. Any income from sale of second hand goods like car, house etc., should be ignored.
- d. Income from sale of shares and bonds should be ignored, as they do not add anything to the real national income.
- e. Revenue received by the government through direct taxes, should be ignored, as it is only a transfer of income.
- f. Undistributed profits of companies, income from government property and profits from public enterprise, such as water supply, should be included.
- g. Imputed value of production kept for self consumption and imputed rent of owner occupied houses should be included.

In India, the national income committee of the Central Statistical Organization, uses the income method for adding up the income arising from trade, transport, professional and liberal arts, public administration and domestic services.

**Ans.6.1. Assumptions of the (Law of diminishing marginal utility.)**

- a. **Continuity** : All the units of the commodity should be consumed in quick succession. There should be no long time interval between the consumption of one unit and the another. If there is long time interval between the consumption of successive units, the MU will not diminish.
- b. **Uniformity or Homogeneity** : All the units consumed should be identical, i.e. the size, shape, colour, quality of all units should be the same.
- c. **Single use.** It is assumed that the consumer will consume only that commodity which satisfies a single want.
- d. **Measurability:** It is assumed that the utility can be measured cardinally, (i.e.) Numerical measurement of utility is possible.
- e. **Rationality:** The consumer should possess the quality of rationality, i.e. he is assumed to behave rationally and normally at the time of analysing the law. If he wants to consume fruits he must buy fruits with reasonable quality. He should not select rotten fruits because they are cheap.
- f. **Reasonability:** It is assumed that the units consumed should be of normal standard unit. In other words the units should neither be too big nor too small.
- g. **Income, Taste and habit** of the consumer should remain the same throughout. When there is a change, the law becomes invalid.
- h. **Constancy of marginal utility of money.** It is assumed that marginal utility of each unit of money remains the same.

## 2. Law of Supply: Introduction

The Law of Supply is introduced by Dr. Alfred Marshall in his book 'Principles of Economics', which was published in 1890. The law explains the functional relationship between price and quantity supplied.

**Statement of the Law:** According to Dr. Alfred Marshall, "Other things being constant the higher the price of the commodity, greater is the quantity supplied and lower the price of the commodity, smaller is the quantity supplied."

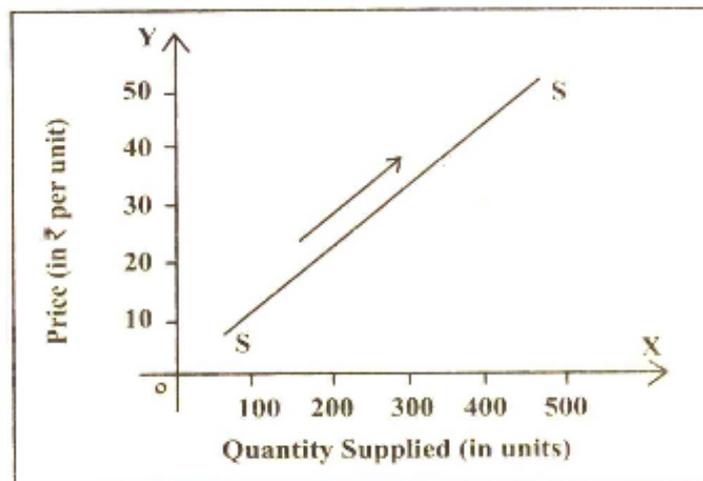
The law states that other things remaining the same, the seller will supply more quantity of goods at a higher price and less quantity of goods at a lower price. Law of supply can be better understood with the help of following schedule and diagram:

**Supply schedule**

Price (₹) (per Unit)	Quantity Supplied of Commodity X (in Units)
10	100
20	200
30	300
40	400
50	500

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

**Supply Curve**



In the above given diagram, quantity supplied is shown on the X axis and price on the Y axis. Supply curve SS slopes upward from left to right, indicating direct relationship between price and quantity supplied.

### **Assumptions of the Law of Supply:**

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

- Cost of Production is unchanged:** It is assumed that there is no change in the cost of production. A change in cost will change profits of the seller and therefore supply at the same price.
- No change in Technique of Production:** It is assumed that there is no change in the method or technique of production. Improved technology may increase supply at the same price.
- Government's Policies remain unchanged:** It is also assumed that Government policies like taxation policy, trade policy, etc., remain unchanged.

- d. **No change in transport cost:** It is assumed that there is no change in the condition of transport facilities and transport costs, e.g. Better transport facility increases supply at the same price.
- e. **No Future Expectations:** The law also assumes that the sellers do not expect future changes in the price of the product.
- f. **No change in Weather Conditions:** It is assumed that there-is no change in the weather conditions. There are no natural calamities like floods, earthquakes which may decrease supply.
- g. **Prices of other goods remain constant:** The prices of other goods are assumed to remain constant. If they change, the law of supply may not hold true because producer may transfer resources to other products.
- h. **Constant scale of production:** It is assumed that the scale of production remains constant during the given period of time.

**(3) 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 is included. The difference between the value of final outputs and inputs, at each stage of production is called the value added. This, 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.

**Value Added Method**

Production Stages	Value of Output	Value of Input	Value Added
	(Rs.)	(Rs.)	(Rs.)
Wheat (Farmer)	700	0	700
Flour (Flour Mill)	1000	700	300
Bread (Baker)	1300	1000	300
Retailer (Merchant)	1400	1300	100
Total Value			1400

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 stages in production of bread.

In the given example farmer produces and sells wheat for Rs.700/- to the miller. Miller sells flour for Rs.1000/- to the baker. Baker sells flour for Rs.1000/- to the baker. Baker sells bread for Rs.1300/- to the retailer/merchant. Retailer sells bread for Rs.1400/- to the consumers. So the value added by farmer (Rs.700), miller (Rs.300), baker (Rs.300) and retailer (Rs.100) that is total of Rs.1400 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.

**(4) FUNCTIONS OF CENTRAL BANK**

- 1) Issue of Currency Notes
- 2) Banker to the Government
- 3) Banker's Bank
- 4) Controller of Credit
- 5) Development and Other Functions
- 6) Custodian of Foreign Currency Reserves of the country and Maintenance of Exchange Rate Stability
- 7) Data Collection and Publicity

We shall now analyze the above functions of the Central Bank in details.

**1) ISSUE OF CURRENCY NOTES**

Central Bank has the sole power of issuing currency notes which are legal tender.

The Central Bank of the country has thus the monopoly of issuing notes or paper currency to the public. The advantages and reasons for granting the monopoly rights to issue notes to the Central Bank are listed below-

- vii) It brings uniformity in the currency making it easy for people to identify it.
- viii) The notes acquire more prestige, when they are issued by the single bank, than when they are issued by many banks.
- ix) It avoids over issue of currency as it becomes easy to control the total quantity of notes issued.
- x) Public has more confidence in the currency.
- xi) It helps to maintain price stability, because the Central bank can control the credit creation by commercial banks more effectively.
- xii) It is also convenient for the government to supervise and regulate the issue of paper currency by Central Bank.

Thus, the Central Bank is the most suitable and appropriate agency for the issue of notes and for controlling currency and credit supply according to requirements of the country.

In India, Reserve Bank of India (RBI) has the sole right to issue currency notes of all denominations except one rupee note. The one rupee note and coins of all denominations are issued by the Ministry of Finance of the Government of India, but their distribution is undertaken by RBI.

