# SYJC – FEB 2016
## ECONOMICS

SET-A

(3 HRS)
(80 Marks)
**Date:**.23/1/ 2016

**Q. 1A) Fill in the blanks with appropriate alternatives given in the brackets [5 Marks]**

1. When MU is _____ , TU decreases.
(positive/negative/zero/high)

**Ans.** Negative

2. The Law of Demand is based on the Law of ______
(Supply/Diminishing Marginal Utility/Production/Interest)

**Ans.** Diminishing Marginal Utility

3. The elasticity of demand of pins is _____.
(elastic/inelastic/perfectly elastic/unitary elastic)

**Ans.** Inelastic

4. Labour is ____ factors of production.
(perfectly mobile/perfectly immobile/imperfectly mobile/perfectly movable)

**Ans.** imperfectly mobile

5. In the case of _____ coins, intrinsic value is less than their face value.
(token/full bodied/representative/standard)

**Ans.** token

**B) Match the following [5 Marks]**

| Group A | Group B |
|---|---|
| **1.** Single price | **a)** Perfect competition |
| 2. Entry barriers | b) Monopoly |
| 3. Monopolistic competition | c) Selling cost |
| 4. Seller in perfect competition | d) Price taker |
| 5. Joint monopoly | e) Cartels |

**C) State whether the following statements are True/False [6 Marks]**

1. MU & TU are equal at the initial stage.

**Ans.** True

2. In monopolistic competition goods have no close substitutes.

**Ans.** False

3. D-mat account is useful to investors who deal in shares.

**Ans.** True

4. During depression, the Central Bank sells government securities to commercial banks.

**Ans.** False

5. Inclusion of value of intermediate goods leads to double counting.

**Ans.** True

6. Credit money is created by Central Bank of the country.

**Ans.** False

**Q.2 A) Define/explain the following concepts (Any 3) [6 Marks]**

**1. 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 den

**2. Average Revenue**

**Average Revenue (AR)**: Average Revenue refers to revenue per unit of output sold. It is obtained by dividing the total revenue by the number of units sold.

$$\textbf{Average Revenue} = \frac{\textbf{Total Revenue}}{\textbf{Total Quantity}}$$

For example, if total revenue sale of 15 tables is ₹ 3000 then average revenue will be

$$\mathrm{AR}=\frac{\mathrm{TR}}{\mathrm{TQ}}=\frac{\mathrm{Rs.3000}}{15}=Rs.200$$

**3. Autonomous consumption**

**Autonomous consumption expenditure refers to the expenditure, which is independent of income** .That is, it is expenditure irrespective of the size of income. It is income inelastic. In order to sustain life, every individual rich or poor, must have minimum of food, water, clothing and shelter. Without these minimum essential things to sustain life, no individual will be alive. In case of India, there are millions of people who do not have any type of job and therefore absolutely no source of income.

The above type consumption expenditure is not dependent on these people's income. Such consumption expenditure is, therefore, called **'autonomous' consumption expenditure**. It should be noted that even this type of autonomous consumption expenditure does, mean demand for various types of goods and services.

**4. Discounting bills**

Discounting bill of exchange means advancing a loan against a promise of repayment in future. The commercial bank charge a commission for discounting bills. When the bill mature, the bank can gets direct payment from the banker of the debtor who originally accepted the bill.

**5. 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.

**6. 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.

**B) Give reasons/explain the following statements (Any 3) [6 Marks]**

**1. Utility is a psychological term**

**Ans.1.** Utility is the feeling of a consumer towards a particular commodity. **2**. Utility does not have physical existence. It is abstract in nature. Therefore, utility is a psychological concept.

**2. Demand for the commodity having multiple use is elastic**

**Ans**.(1) When the price of commodity having multiple uses rises consumers restricts its uses and therefore its demand falls. Similarly when the price of such a commodity falls, consumers use it for various purposes and therefore its demand rises. (2) Thus, the demand for the commodity having multiple uses changes as a response to the change in its price. Therefore, demand for the commodity having multiple use is elastic.

**3. Price discrimination is possible under monopoly**

**Ans.**1) In a monopoly market there is a single seller or a single producer. (2) Therefore, in monopoly, the buyers do not have any other substitute for the product produced by the monopolist, 3) Under monopoly, the entry of other firm is strictly restricted by natural economic, technological or legal barriers. (4) Therefore, in monopoly, the monopolist can charge any price for his product. He can also charge different prices to different consumers for the same product. Therefore, price discrimination is possible under monopoly.

**4. Paid services are included in NI**

**Ans.**(1) The services provided out of love, affection, mercy, sympathy, etc. are not paid for. Therefore, it becomes difficult to determine the market value of these services. (2) The services that are provided with the motive of earning monetary returns are considered productive in nature. Their market value can be easily determined. Therefore, paid services are included in national income.

**5. Saving accounts are usually opened by salaried class**

**Ans.**(1) Savings bank deposits encourage the saving habits among the people. Money can be withdrawn subject to some restrictions. (2) Salaried class, middle income group and small traders open this account to build up savings for future needs. Thus, saving account deposits are usually opened by salaried class.

**6. Revenue receipts and Revenue expenditure are known as revenue budget.**

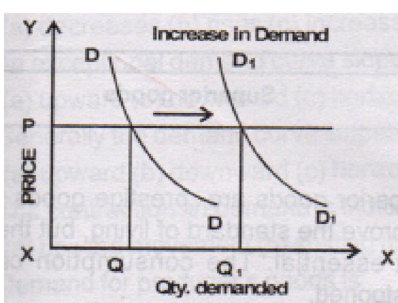
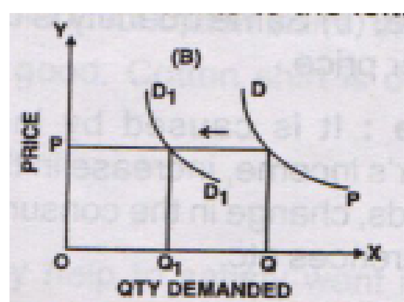
**Ans.1**.A budget which deals with the revenue aspect of the government budget is known as revenue budget. (2) Revenue budget consists of government's estimated revenue receipts in the form of tax revenue and non-tax revenue. It also consists of anticipated revenue expenditure such as expenditure on general services, social and community services, economic services, grants, etc. Thus, revenue receipts and revenue expenditure is known as revenue budget.

**Q.3 A) Distinguish between [Any 3] [6 Marks]**

**1. Utility and satisfaction**

| | Utility | Satisfaction |
|---|---|---|
| 1. | **Meaning**<br>Utility means the capacity of a commodity to satisfy the human wants. For example, pen has the capacity to satisfy the want of writing.<br>This want satisfying power is called utility. | Satisfaction is the amount of pleasure actually realised from the consumption of a commodity. |
| 2. | **Realisation**<br>Utility can be realised before consumption. | Satisfaction of a commodity can be realised only after the consumption of a commodity. |
| 3. | **Nature**<br>Utility is the 'expected satis-faction' of a consumer from the consumption a commodity.<br><br>Utility is the source. | Satisfaction is the 'realised satisfaction'. It may be more or less than the consumer's expectation.<br><br>Satisfaction is the effect. |

2. **Increase in demand and Decrease in demand**

| **Increase in demand** | **Decease in demand** |
|---|---|
| **1. Meaning** | |
| It is a situation when the demand of a commodity rises due to factors other than price, (a) More is demanded at a given price, (b) Same quantity is demanded at a higher price. | It is a situation when the demand of a commodity falls due to factors other than price, (a) Less is demanded at a given price, (b) Same quantity is demanded at a lower price. |
| **2. Cause** | |
| It is caused by increase in consumer's income, increase in the price of other goods, change in the consumer's taste and preferences etc. | It is caused by decrease in consumer's income, decrease in the price of other goods, change in the consumer's taste and preferences etc. |
| **3. Movement/Shifting** | |
| The increase in demand is indicated by shifting of demand curve to the right.  | The demand curve shifts to the left.  |

3. **Relatively elastic supply and Relatively inelastic supply**

| Relatively Elastic Supply | Relatively Inelastic Supply. |
|---|---|
| **1.Meaning** | |
| When a smaller proportionate change in price brings about a larger proportional change in quantity supply, it is called relatively elastic supply. | When a larger proportionate change in price brings about a smaller proportionate change in supply, it is called relatively inelastic supply. |
| **2. Measurement of Es.** | |
| In case of elastic supply, the elasticity is said to be more than one(>1). | In case of inelastic supply, the elasticity is said to be less than one(<1). |
| **3.Supply curve.** | |
| In case of elastic supply, the supply curve appears to be flatter. | In case of relatively inelastic supply, the supply curve appears to be steeper. |

4. **Labour and Entrepreneur**

| **Labour** | **Entrepreneur** |
|---|---|
| **Meaning.** Labour means any mental or physical work which is undertaken with the purpose of earning economic reward. E.g. Coolie (physical labour) and doctor (mental labour). | Organiser is one who collects and combines different factors together. He coordinates the activities of different factors in the process of production. |
| **Reward.** The factor labour receives wages as the reward. | The factor organiser receives profit as the reward for his entrepreneurial services. |
| **Risk.** The labour does not face risk and uncertainty bearing. | The organiser faces risks and uncertainty in business |

5. **NI at MP & NI at FC**

| National income at market price ($NI_{mp}$) | National income at factor cost ($NI_{fc}$) |
|---|---|
| **Meaning** | |
| National income calculated on the basis of prevailing market prices is called national income at market price. | National income calculated on the basis of factor cost (wage, rent, interest and profit) is called national income at factor cost. |
| **Indirect taxes and subsidies** | |
| $NI_{mp} = NI_{fc}$+ indirect taxes – subsidies | $NI_{fc}= NI_{mp}$ – indirect taxes + subsidies. |
| **Primary factor** | |
| Market price is the primary factor influencing the value of goods and services. | Factor cost is the primary factor determining the value of goods and services. |

6. **CRR and SLR**

| Cash reserve Ratio | Statutory Liquidity Ratio. |
|---|---|
| **1. Meaning** | |
| CRR refers to ratio at which all commercial banks have to maintain amount of cash out of their time and demand deposits | In addition to SLR, commercial banks have to keep certain percentage of their total time and demand deposit with the central bank in the form of cash, gold and securities. |
| **2. Mode of Payment** | |
| CRR must be kept only in cash | SLR may be held in gold and securities. |
| **3.** No interest is paid on cash reserves. | Government security earn interest |

**B) Write explanatory notes [Any 2] [6 Marks]**

**1. Assumptions of the Law of equi-marginal utility**

**Ans. 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

**2. GDP at factor cost**

**Ans.** Gross domestic product at factor cost is the gross money value of all final goods and services produced within the domestic territory of a country, during a period of one year.

GDP at factor cost includes amount of subsidy, but excludes amount of indirect taxes paid.

**$GDP_{(FC)}$= $GDP_{(MP)}$-Indirect Taxes + Subsidies**
**$\therefore GDP_{(FC)}$=C+I+G+(X-M)-IT+S**

**3. Marginal Propensity to consume**

**Ans.** The Marginal Propensity to Consume (MPC) is defined as the ratio of the change in the level of aggregate consumption to a change in the level of aggregate income. M.P.C. can be calculated by dividing a change (increase or decrease) in consumption by a change (increase or decrease) in income.

Symbolically.

MPC = $\Delta C/\Delta Y$

Where, $\Delta C$ indicates change in consumption and $\Delta Y$ indicates change in income. $\Delta$(called delta)indicates small change.

The MPC is the ratio of small change in consumption ($\Delta C$) to small change in Income ($\Delta Y$). Thus,

MPC = $\Delta C/\Delta Y$

As per Table

When Aggregate Income is Rs.zero, Aggregate consumption is Rs.500 & when Aggregate Income will increase to Rs.1000, Aggregate consumption will increase to Rs.1200.

If $\Delta C$ is Rs.700 $\Delta Y$ is Rs. 1000

then

$$\Delta C/\Delta Y = \frac{700}{1000} = 0.7$$

Thus, MPC = 0.7

**4. Regulation of margin requirements.**

**Ans.**Margin requirements determine the loan value of a collateral security offered by a borrower. The loan value of a security is the difference between the market value and the margin requirement. For example, if the market value of 10 grams of gold is Rs.30,000/- and the margin requirement is 25%, then the loan value of 10 grams of gold, as a collateral security will be Rs.22,500/- (Rs.30,000/- - Rs.7,500/-). Equity shares, debentures of the joint Stock Companies, precious metals and real assts are accepted by banks as collateral security for granting loans.

Increase or decrease in margin requirements changes the loan value of security. Demand for loans can be discouraged by increasing the margin and vice versa.

Central Bank has the power to determine the margin requirements. It is very effective instrument used to control speculative activities, both in commodity market, as well as money and capital market.

**5. Surplus budget**

**Ans.** 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.

**6. Importance of micro economics**

**Ans.** **1.** To understand the working of free market economy Micro economic theory helps in understanding working of free market economy.

**2.** Explains price determination & allocation of resources

explains how the relative prices of various products & factory are determined and further explains why prices of these various products & factors are found different.

Also it explains the process of allocation of sources for the production of various goods & location of total production among the various consumers.

**3.** It helps businessman in decision making

The knowledge of price theory is useful to businessman in deciding policies regarding the prices, cost of production, investment, attainment of maximum productivity etc. Also, with the help of Micro Economics the businessman can estimate demand for his product.

**4. Useful to government**

It is useful to government in framing economic policies, Micro Economic analysis is useful in determining taxi policy, public expenditure policy, price policy, efficient allocation of resources etc.

**5.Helpful in international trade &finance**

Many aspects of international trade like effects of tariff determination of exchange rate, gains from international trade etc. can be explained with the help of micro economic analysis. It. is useful in public finance to anlyse incidence and effect of particular tax.

**6. Model Building**

Micro Economics builds simple model which helps us in understanding complex economic situations. Development of various terms, concepts.. terminologies, tools of economic analysis is valuable contribution of Micro Economics to the science of economics.

**7. Basis of welfare economics**

Micro Economics examines the conditions of economic welfare. It explains how best results can be obtained through avoidance of wastage of resources.

Thus micro economic analysis has great theoretical and practical importance.

**Q.4 Write short answers for the following questions (Any 3 )** **[12 Marks]**

**1. Explain the scope and subject matter of micro economics.**

**Ans.** Micro Economics basically deals with

i) Theory of product pricing

ii) Theory of factor pricing (Micro theory distribution)

iii) Theory of economic welfare

**1. Product Pricing**

The theory of product pricing explains how the relative prices of cotton cloth, rice, car and thousands of other commodities are determined.

Price of a commodity depends upon the forces demand and supply. Therefore, analysis of demand and supply side is necessary in order to [plain the process of determination of price.

Study of demand side covers the analysis of consumer's behavior and study of supply side, covers the analysis of conditions of production, cost and behaviour of firm & industry.

So, theory of product pricing is subdivided into theory of demand & theory of production & cost.

## 2. Factor Pricing

Theory of factor pricing i.e. Theory of distribution explains how wages (price for the use of labour) rent (payment for the use of land), interest (Price for the use of capital), profits (the reward for the entrepreneur are determined.

## 3. Theory of welfare

Theory of welfare basically deals with efficiency in the allocation of resources. Efficiency allocation of resources is attained when it results in maximization of satisfaction of people.

Economic efficiency involves three efficiencies:

i) Efficiency in production - Efficiency in production means producing maximum possible amount of goods from the given amount of resources.

ii) Efficiency in consumption - Efficiency in consumption means distribution of produced goods & services among the people for consumption, in such a way as to maximize total satisfaction of society.

iii) Efficiency in the direction of production i.e. overall economic efficiency - Efficiency in the direction of production means production of those goods which are most desired by the people.

## 2. Explain the relationship between TU and MU

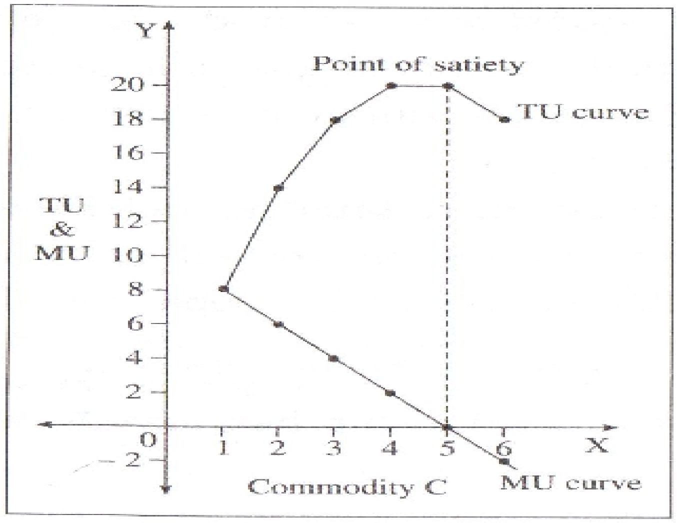
**Ans. (1)** Total utility of a commodity refers to the sum total of the utility derived by a consumer from all units of commodity consumed. 3rginal utility refers to the net addition made to the total utility by consuming one more unit of that commodity.

(2) The relationship between TU and ML) can be explained wit' the help of the following schedule :

| Units of Consumption | Marginal Utility | Total Utility |
|---|---|---|
| 1 | 08 | 08 |
| 2 | 06 | 14 |
| 3 | 04 | 18 |
| 4 | 02 | 20 |
| 5 | 00 | 20 |
| 6 | -2 | 18 |

(3) Initially on the consumption of the first unit, the total utility is the minimum and the marginal utility is the maximum. From the consumption of second unit onwards, the total utility increases with a diminishing rate and the marginal utility diminishes.

(4) When the marginal utility is zero, the total utility is the maximum.
(5) When marginal utility becomes negative, total utility also starts diminishing.




**3.	Explain the variations in supply**

**Ans.	Extension and Contraction of Supply (Variations in Supply)**

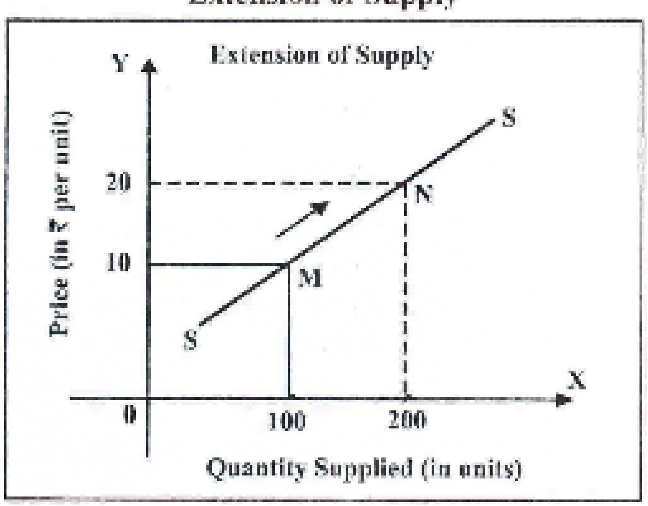
When quantity supplied of a commodity changes due to change in its price, other factors remaining constant, it is known as Variation in Supply. There are two types of Variation in Supply. They are:

i) Extension in supply or Expansion of supply and

ii) Contraction of supply

**i) Extension of supply:** Extension of supply refers to a rise in the quantity supplied due to an increase in price of a commodity, other factors remaining constant. Extension of supply leads to an upward movement along the same supply curve due to rise in price it can be better understood from the from the give diagram.

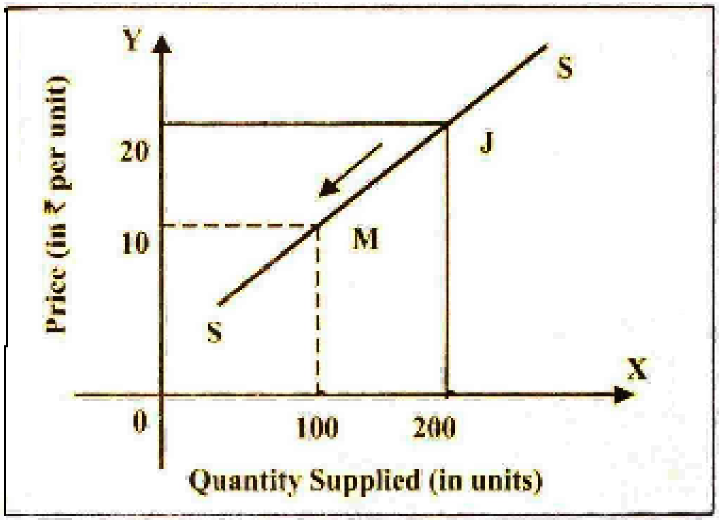
**Extension of Supply**




In the above diagram, quantity supplied is shown on the X axis and price on the Y axis. Quantity supplied rises from 100 units to 200 units. With an increase in price from ₹ 10 to ₹ 20, resulting in an upward movement from M to N along the same supply curve SS. It is known as

**ii) Contraction of Supply:** Contraction of supply refers to a fall in the quantity supplied, due to fall in price of the commodity, other factors remaining constant. In case of Contraction of supply, there is a downward movement along the same supply curve has seen in the given diagram

Contraction of Supply




In the above diagram, quantity supplied is shown on the X axis and price on the Y axis. Quantity supplied falls from 200 units to 100 units with a fall in price from ₹ 20 to ₹ 10, resulting in a downward movement from J to M, along the same supply curve SS. It is known as Contraction of supply.

**4. What are the features of capital**

**Ans. 1. Man-made factor:**

Capital is a man-made factor of production. Man produces the capital in the form of plant, machinery, building, vehicles etc. Hence it is a manmade factor.

**2. Mobile factor of production:**

Capital has highest mobility. It has both geographical as well as occupational mobility; capital of every type can be easily transferred from one place to another or from one country to another country, and from one occupation to another occupation.

**3. Passive factor of production:**

Capital is a passive factor of production. It becomes productive only with the help of labour.

Thus, it cannot produce anything on its own. However it increases the efficiency of other factors of production.

**4. Elastic supply:**

The supply of capital goods is elastic. Depending upon requirements the capital can be increased or decreased. If demand increases, supply of capital can be increased. Thus, supply of capital can be increased by increasing saving and investment

**5. Derived demand:**

Human wants are not directly satisfied by the capital goods. But with the help of capital goods production of consumer goods is possible. Thus, it has derived demand.

**6. Capital is part of wealth:**

Those things in which we find the qualities like utility, scarcity, transferability and externality termed as wealth. All capital is wealth because capital possesses all the characteristic of wealth. But all wealth is not capital. Because all those things which we termed as wealth cannot be used in production process.

**7. Durabiltiy:**

Capital assets like machinery are durable in nature, which contributes to production over a period of time.

**8. Productive factor:**

Capital is more productive as compared to other factors of production; use of capital not only improves efficiency of land and labour, but also increases the total production. Thus, capital is most important factor in a production process, without capital production process is not possible.

**5. Explain the precautions to be taken while using product method of measuring NI.**

**Ans. Precautions:**

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

1. To avoid double counting, only the value of final goods and services must be taken into account.
2. Goods used for self consumption by farmers should be estimated by a guess work that, is imputed value of goods produced for self consumption, is included in national income.
3. Indirect taxes included in the market prices are to be deducted and subsidies given by the government to certain products should be added for accurate estimation of national income.
4. While evaluating output, changes in the price level between different years must be taken into account.
5. Value of exports should be added and value of imports should be deducted.
6. Depreciation of capital assets should be deducted.
7. Sale and purchase of second hand goods should be ignored as it is not a part of current production.

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

**6. Explain the features of labour**

**Ans.** 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) Inseparable from the body of the worker** -

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) 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.

**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) 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.

**6) Efficiency of labour -**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) 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.

**8) 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.

**Q.5 Explain with reasons whether you agree/disagree with the following statements (Any 3) [12 Marks]**

1. Micro economics studies the behaviour of individual units.

**Ans: Yes, I agree.**

**1. Study of individual units:** Micro economics is concerned with the study of individual units of an economy and not the aggregates. It analyses the behavior of individual units such as a household, a firm, an industry, a market etc.

**2. Determination of relative prices of products and factors.** It is concerned with the study of how the price of an individual commodity or the reward of a factor is determined. Macroeconomics is a study of product pricing and factor pricing.

**3. Slicing method:** Micro approach is known as the slicing method since it splits the whole economy into small units for the purpose of intensive study. **The words of Prof. Mc connell, In micro economics we examine the trees, not the forest.**

**4. Partial equilibrium:** Micro economics analyses the equilibrium of a single variable through partial equilibrium. For e.g. equilibrium of a consumer, equilibrium of an individual firm etc.

Thus Micro economics is a study of individual units.

**2. There are no exceptions to the law of demand**

**Ans. No. I disagree with this statement.**

Following are the exceptions to law of demand.

**(i) Giffen goods or Giffen Paradox.**

According to Sir. Robert Giffen, there is direct relationship between price of inferior good and demand. Such inferior good is called Giffen good. Law of demand is invalid in case of giffen goods.

He noticed that when the price of bread goes up, the low paid British workers cut their expenditure on meat and buy more bread.

It is also found in case of inferior goods like bajra When the price of inferior good rises,

The real income (purchasing power) declines.

Therefore the poor people are compelled

to reduce consumption of superior goods and buy more of inferior good. When price falls, the real income rises. They buy more of superior commodities and less of inferior goods.

The demand curve for giffen goods slopes upward to the right. It indicates the direct relationship between price and quantity demanded.

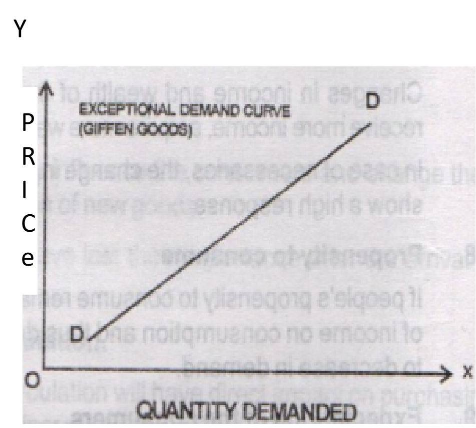
**(ii) Prestige goods (Veblen Effect).**

According to Thorstein Veblen, rich people consume prestige goods like diamond, costly cars etc. to enjoy snob appeal. They get great pleasure out of it as they act as the status symbol, (i.e.) greater the price of diamond, higher the consumption. If the price of diamond falls, they will buy less of diamond. Thus the desirability of such goods depends upon price and prestige and not on merits. Higher the price, higher the demand.

**(iii) Necessities.**

In case of necessary goods like food and medicine, law of demand fails to work. People will continue to demand irrespective of rise or fall in price. Therefore the law of demand is invalid.

**(iv) Habitual goods.**




When people are habituated to the use of certain goods, they are ready to demand them irrespective of high prices. Due to habitual use, they are addicted to the consumption of goods like pan masala, cigarettes, drugs, liquor etc. They will not stop demanding even if prices rise.

**(v) Price Illusion.**

A section of the people are under the impression that highly priced products possess high quality and are capable of providing higher satisfaction. They continue to demand more of such items despite the fact that the prices are rising.

**(vi) Ignorance effect.**

Sometimes, due to ignorance, people buy more of a commodity at a higher price. This may happen when the consumer is unaware of the price of that commodity in other places. This is called ignorance effect. It also happens when people buy commodities because of mistaken identity when it looks like original product due to deceptive packing, label etc.

**(vii) Demonstration effect.**

When Indians try to imitate life style of foreign countries, they demand foreign goods even if the prices rise. This may also happen when a poor person imitates the life style of a rich person.

**(viii) Emergencies.**

The law is not applicable during emergencies like war, famine etc. The panic striken households create further scarcity by consuming more even at higher prices during such times. Under such situations, the law of demand does not work.

**3. A seller is price maker in monopoly.**

**Ans. Yes. I agree.**

**(1) One man show.**

Monopoly is the market where a single seller enjoys complete control over supply of the commodity. As there is no rivalry, the monopolist need not bather about the actions of other sellers. Being the only seller in the market, to enjoys domination and fixes the price as per his own calculation.

**(2) Absence of substitutes.**

Monopolist faces no competition and there are no substitutes for his product. In the absence of substitutes, he is the only producer to supply the product to the consumers. All consumers have no option but to approach the monopolist for consumption of that particular product. This makes the position of monopolist more comfortable to decide the market price.

**(3) Infrastructure.**

The monopolist enjoys a strong net work of infrastructure including transport, communication and storage. He can invest generously to bring new technology. Thus he is in a better position to expand or contract his capacity to produce and supply. Therefore he will be able to fix the price in a manner he likes.

**(4) Discrimíniting monopoly.**

It is a type of monopoly in which the monopolist is in a position to charge different prices for same product. He will be able to charge the higher price from those who are economically stronger and a lower price from poor section.

**(5) Changes in elasticity of demand.**

A monopolist will be in a position to exploit a elasticity of demand at different market. He charges higher prices in markets where the demand is inelastic. At the same time he will charge lower prices in those markets where the demand is elastic.

**(6) Control on supply.**

Monopolist enjoys complete control on supply of the product. Due to strong financial background, he will be able to mobilise sufficient resources at short notice and expand supply. By controlling supply, he will be able to control price.

**4. The scope of Macro Economics is wide**

**Ans. Yes, I agree.**

**1. Macro economics studies macro variables.**

The term macro is derived from Greek word 'makro' meaning large.

Macro economics is concerned with the study of macro variables like aggregate demand, aggregate supply, total savings, total investment, national income etc. Such variables represent the whole economy.

Therefore it is a study of aggregates covering whole economy.

**2. Objectives of macro economics are broad based.**

The main objectives of macro economics are achievement of price stability, full employment, economic growth etc.

There are broad based issues dealing with the economy as a whole.

**3. Macro Economics presents over all picture of the economy.**

Macro economy presents the overall picture of the economy. It takes into account the entire economy into consideration. In otherwords it studies the forest and not the trees. Thus it gives a birds eye view of the economy.

**4. Macro economics provides remedies for solving national problems.**

Macro economic theory provides solution to macro issues at the national level. It provides remedial policies for facing problems such as unemployment, fluctuation in national income, depression etc. Thus it is an analysis of aggregates.

**5. The money value of intermediate goods is not included in NI**

**Ans. Yes, I agree** with this statement.

**Reasons** :

(1) National income includes the money value of only final goods and services. The money value of intermediate goods already get included in the money value of final goods and services.

(2) For example, in the value of the final product i.e. bread, the values of intermediate goods are already included.

(3) A separate accounting of the values intermediate goods (wheat, flour, etc.) along with the accounting of the value of final product (bread) would lead to double counting.

(4) Due to double counting, the national income gets overestimated.

Therefore to avoid the error of double counting, the money value of intermediate goods is not included in the estimation of national income.

**6. Credit control is the function of central bank of the country.**

**Ans. Yes, I agree** with this statement.

**Reasons** :

(1) The chief objective of the Central Bank is to maintain price and economic stability. Price instability, i.e. both inflation an deflation, has harmful effects on economic development of a count Therefore, it is necessary to regulate the total supply and the use o credit.

(2) The expansion of credit tends to create inflationary pressure. Therefore, to overcome inflation, the Central Bank has to restrict the supply of credit. I

(3) The contraction of credit tends to create deflationary pressure. Therefore, to prevent depression, the Central Bank has to expand credit.

(4) The Central Bank as an executor of the government's monetary policy, controls the volume and direction of credit by using qualitative and quantitative techniques.

Thus, credit control is the function of Central Bank of a country.

**Q.6 Answer in detail [Any 2] [16 Marks]**

**1. Explain the exceptions to the Law of DMU**

**Ans.**

Certain cases are considered as an exceptions to the law, for which the law is not applicable. They are follows:-

**1. Hobbies** - In certain hobbies like collection of stamps, rare coins, precious paintings, etc., the law is not applicable because every additional increase in stock gives more pleasure, which increases MU But it violates homogeneity condition.

**2. Misers -** In case of miser, every additional rupee gives him more and more satisfaction, because he is a irrational person. So his MU tends to increase with an increase in the stock of money. However, it ignores rationality assumption.

**3. Drunkards -** It is. said that, in case of drunkards the level of intoxication increases. every additional unit of ljquor consumed.

So, MU received by drunkards may increase. This condition is similar to all addicts.. But here, condition is violated.

**4. Music-** Some people are fond of music. It is experienced that, a repeated of hearing of i.e. gives more and more satisfaction. It increases MU of music. So the law is not applicable. However, is does not fulfil the assumption like homogeneity and continuity.

**5. Power -**It is an exception to the law because when person acquires power, his lust for power increases. He would want to have more, and more of it. However, it violates rationality assumption.

**6. Reading -** Since, more reading gives deeper knowledge, a scholar may receive more and more satisfaction. when he reads various books-again and again, and therefore Marginal Utility tends to increase. But, here homogeneity and continuity conditions are not satisfied.

**7. Money** - It is observed that MU of money never becomes zero. It increases when the stock of money increases. It is because money is a medium of exchange is used to purchase various goods, and services to satisfy various wants. Therefore the law is not .applicable in case of money. According to some economists , however the law is applicable to money.

All these cases are said to be exceptions of the law. But they are not real exceptions as they violate some of the assumptions. So the law of DMU has universal applicability.

**2. Explain the assumptions of the Law of Supply**

**Ans. 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:

**1) 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.

**2) 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.

**3) Government's Policies remain unchanged**: It is also assumed that Government policies like taxation policy, trade policy, etc., remain unchanged.

**4) 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.

**5) No Future Expectations:** The law also assumes that the sellers do not expect future changes in the price of the product.

**6) 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.

**7) 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.

**8) Constant scale of production:** It is assumed that the scale of production remains constant during the given period of time.

**3. Explain the types of Monopoly**

**Ans. 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.

**4. What are the objective factors influencing consumption function.**

**Ans.** 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) **Changes in Wage Rate**: If income in terms of wage rate increases, consumption expenditure increases. A change in income distribution will cause change in expenditure on consumption.

2) **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.

3) **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.

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) **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.

6) **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.

7) **Changes in Depreciation Allowances**: Increase in depreciation allowance would reduce income of shareholders and consequently, their consumption may decrease.

8) **Demographic Factor**: 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.