J.K. SHAH TEST SERIES
Evaluate Learn Succeed

# SYJC –FEB 2016
## ECONOMICS

SET-B

Date : 23.01.2016
(80 Marks)
(3 hour)

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

1. when less is purchased at the constant prices, it is called ______ in demand.

**Ans.** decrease
(Increase / decrease / expansion / contraction )

2. Cross elasticity of demand is applicable to ______ goods.
(unrelated / substitute / inferior /natural)

**Ans.** substitute

3. An increase in supply means selling a _____ amount at the same price.
(large / smaller / constant / less )

**Ans.** large

4. In _____ market, seller creates product differentiation.
(competitive / perfect / pure / monopolistic )

**Ans.** monopolistic

5. ______ is the subject matter of macroeconomics.
(Growth theory / Factor pricing/ Market structures / Individual income)

**Ans.** Growth theory

**(B) Match the following Group 'A' with Group 'B'** **(5 Marks)**

| Group 'A' | Group 'B' |
|---|---|
| (1) Direct tax | a) Wealth tax |
| (2) Interest and dividend | b) Revenue receipts |
| (3) Balanced budget | c) Government Expenditure =Government Revenue |
| (4) Capital receipts | d) Borrowing |
| (5) Financial Year | e) 1st April to 31st march |

**(C) True or False.** **(6 Marks)**

1. Labours bear risks in business.

**Ans.** False

2. Macroeconomics is known as income analysis.

**Ans.** True

3. Total outlay is price multiplied by quantity.

**Ans.** True

4. If price falls, supply curve will shift to the left.

**Ans.** False

5. Fiscal policy is related with public revenue and public expenditure.

**Ans.** True

6. The difference between a country's exports and imports is termedas net earnings from foreign transactions.

**Ans.** True

**Q.2. (A) Define or explain the following concepts (any 3 ) (6 Marks)**

**1. Cross elasticity of demand.**

**Ans.** (1) Cross elasticity of demand can be defined as I percentage change in the quantity demanded of one commoJ (say 'x') in response to a given change in the price of another commodity (say 'y'). (2) Cross elasticity of demand is calculated with the help of the following formula :

$$E_c = \frac{\triangle Q_x}{\triangle P_x} \times \frac{P_y}{Q_x}$$

**2. Entrepreneur.**

**Ans.** (1) The factor which co-ordinates land, labour and capital is called entrepreneur. He not only combines all factors of production, but also organizes and supervises the production by undertaking all risks. (2) According to **F. H. Knight,** *"an entrepreneur is a who performs the dual function of risk taking and* control", According to Schumpeter, "Entrepreneur is associated with innovation".

**3. Aggregate demand.**

**Ans.** (1) Aggregate demand refers to the amount of sales proceeds which is actually expected from the sale of output produced at a given level of employment during a year. It is measured in terms of total expenditure on goods and services in an economy. (2) The determinants of aggregate demand are symbolically expressed as:

AD = C + I = G + (X-M).

**4. Fine and Penalty.**

**Ans.** (1) Fines and penalties are imposed on defaulters (law breakers) to maintain law and order. This generates revenue. For example, fine for jumping a signal. (2) Revenue collected in the form of fines and penalties is the non-tax revenue to the government.

**5. Macroeconomic variables**

**Ans. (1)** The economic variables of macro quantities *are* called macronomic/macro variables. National output, national income, aggregate demand, aggregate supply, total consumption, total investments, general price level, etc. are some macro variables.

(2) Macroeconomics studies the interrelation among the various macro variabies, their determination and causes of fluctuation in them. It also suggests policies to solve the problems related to macro variables.

**6. Limited legal tender.**

**Ans. (1)** Limited legal tender is that money which is accepted as a legal tender, only up to a certain limited amount. (2) It is obligatory to accept limited legal tender up to a certain limited amount.

**(B) Give reasons or explain (any 3) (6 Marks)**

**1. All desires are not demand.**

**Ans.** (1)Desire means an individual's wish to acquire a commodity. On the other hand, a desire which is backed by ability to pay as well as willingness to pay for a commodity is demand. Symbolically, Demand = Desire + Ability to pay + Willingness to pay.

**(2**) All desires may not be backed by ability to pay and willingness to pay. Therefore, all desires are not demand.

**2. The supply of agricultural commodity is relatively inelastic.**

**Ans.** 1. An agricultural commodity requires suitable weather conditions and sufficient time for the growth. 2) Therefore, in the short run, the supply of an agricultural commodity cannot be increased, though its price rises, Therefore, the supply of an agricultural commodity is relatively inelastic.

**3. Selling cost is incurred by a firm in monopolistic competition.**

**Ans.** (1) In monopolistic competition, every seller's product is a differentiated product. (2) In this type of market, though the product is differentiated, every seller's product is a close substitute for the product of the every other seller. (3) Therefore, in monopolistic competition, every seller tries to attract the consumers towards his product. (4) For this purpose, a heavy cost is incurred on the publicity of products by the use of media. The cost is also incurred on giving discounts, gifts, etc. to attract consumers. Therefore, selling cost is incurred by a firm in monopolistic competition.

**4. Labour cannot be stored.**

**Ans.** 1. Labourer and his labour (work) always go together. Hence labourer must be present himself where he is supposed to render his services. 2) If a labourer is absent for a day, his labour for that day goes wasted. Thus, the amount of labour lost is lost forever, it cannot be used for future. This labour cannot be stored.

**5. Autonomous investment is not directly linked with profit.**

**Ans.** (1) In a modern economy, government invests in public sector undertakings such as roadways, railways, irrigation projects, atomic energy projects, electricity generation plants, etc. irrespective of rate of interest and profit, *2.)* Thus, autonomous investment is generally made by the government in the public sector with a purpose of providing public utilities, promoting economic growth development as well as maximising social welfare.

Thus, autonomous investment is not directly linked with profit.

**6. Central Bank acts as a lender of the last resort of commercial banks.**

**Ans.** (1) The commercial banks operate on the basis of low cost reserve system. If there is a great demand for cash by depositors, even a well-managed commercial bank can run into difficulty. (2) In such a financial crisis, the Central Bank is the ultimate source of financial assistance to commercial banks. Commercial banks gets loans from the Central Bank to overcome their financial crises.

Thus, the Central Bank acts as a lender of the last resort.

**Q.3 (A) Distinguish between the following.(any 3) (6 Marks)**

**1. Individual demand and Market demand**

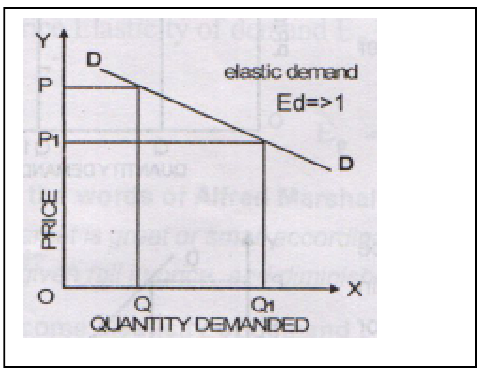
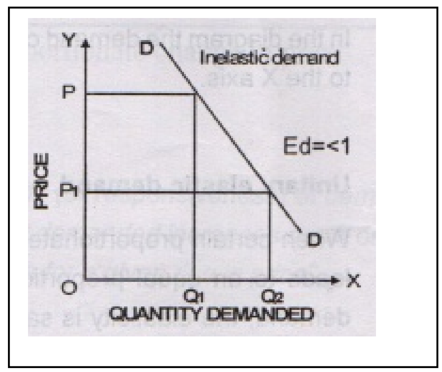
| **Individual demand** | **Market demand** |
|---|---|
| **1. Meaning** | |
| Individual demand refers to the demand by an individual at a given price during a given period of time. | A market demand is the aggregate demand of a commodity demanded by all consumers in the market at a given price during a given period of time |
| **Schedule.** | |
| **2. Narrow/wider concept** | |
| Individual demand is part of market demand. It is a narrow concept. | Market demand includes individual demand. It is a wider concept. |
| **3. Importance** | |
| Individual demand is not useful for framing business policy. It has no practical significance.sales targets | Market demand is useful for sellers to frame business policy and plan their sales targets |

Individual demand

| Price (₹) | Qty. demanded (Units) |
|---|---|
| 2 | 50 |
| 4 | 40 |
| 6 | 30 |
| 8 | 20 |
| 10 | 10 |

| Price of Mangoes per kg (₹) | Individual Demand Schedules | | | Market Schedule (A + B+C) |
|---|---|---|---|---|
| | Consumer A | Consumer B | Consumer C | |
| 50 | 1 | 2 | 3 | 5 |
| 40 | 2 | 4 | 6 | 12 |
| 30 | 3 | 6 | 10 | 19 |
| 20 | 4 | 8 | 15 | 27 |
| 10 | 5 | 10 | 20 | 35 |

## 2. Relatively Elastic Demand and Relatively Inelastic Demand

| **Elastic Demand (More elastic) (Relatively Elastic Demand)** | **Inelastic Demand (Less elastic) (Relatively inelastic demand)** |
|---|---|
| **1. Meaning :** | |
| Elastic demand refers to a situation When a lower proportionate change in price leads to a higher proportionate change in demand. Generally luxury goods like TV, Car etc. have elastic Demand | Inelastic demand refers to a situation when a higher proportionate change in price leads to lower proportionate change in demand. Generally necessary goods like food and medicine have inelastic demand |
| **2. Flatter/Steeper Curve** | |
|   |   |
| Elastic demand is indicated by demand curve DD which is flatter. | Inelastic demand is indicated by demand curve D D which is steeper. |
| **3. More than one/less than one** | |
| In case of elastic demand, elasticity is said to be more than one | In case of inelastic demand, the elasticity is said to be less than One. |

3. **Perfect Competition and Monopoly**

| Perfect Competition | Monopoly |
|---|---|
| **Meaning.** Perfect competition is a market where large number of sellers selling identical units of the same commodity at uniform price. | Monopoly is a market where there is only one seller controlling the entire supply. |
| **Entry and exit.** Under perfect competition there is free entry and exit of all the firms. | Under monopoly the entry of new firms is strictly prohibited. |
| **Price determination.** No individual seller can influence the price under perfect competition. He is a price taker. | Under monopoly, the seller can determine the price and he is a price maker. |

4. **Fixed Capital and Variable Capital**

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

5. **Partial Equilibrium and General Equilibrium**

| Partial equilibrium | General equilibrium |
|---|---|
| **Meaning.** | |
| An equilibrium which is related to a single variable or few variables may be called partial equilibrium or particular equilibrium. | An equilibrium which is related to numerous variables or the economy as a whole may be called as General equilibrium. |
| Prof. Alfred Marshall and Cambridge School of economists introduced equilibrium. | Walras and the Lay lanne school are associated with general partial equilibrium. |

| | |
|---|---|
| **Nature.** | |
| It is simple analysis which is more effective. It is easy to deal with such analysis. | It is complicated and difficult to deal with such analysis. |
| **Use.** | |
| It is useful to analyse a particular aspect of a problem at a particular time. It is suitable for analysis of variables which have no inter relationship. | It is useful to analyse the interrelationship of various sectors of the economy. |

**(B) Write Explanatory notes (any 2) (6 Marks)**

**1. Average propensity to consume**

**Ans.** The Average Propensity to Consume (A.P.C.)

The Average Propensity to Consume (APC) is defined as the ratio of aggregate consumption to aggregate income in a given period of time. The value of average propensity to consume, for any income level, may be calculated by dividing consumption by income. Symbolically,

A.P.C. = C/Y

Where, C=Aggregate Consumption Expenditure and

Y= Aggregate Income (National Income)

In the schedule of Propensity to Consume the A.P.C. is calculated at various income levels. It is obvious that the proportion of income spent on consumption decreases as income increases. The A.P.C. is 1.2, 1.0, 0.86, 0.82 and 0.80, respectively, as given in the schedule. It follows that A.P.C. decreases as income increases.

Given the Consumption Function C=f(Y)

APC = C/Y

If Y = 3000 and C = 2600

Then C/Y = 2600 / 3000

C/Y = 0.86

APC = 0.86

**2. Significance of Price Elasticity of Demand**

**Ans. 1. Monopoly and Elasticity of Demand:**

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

**2. Taxation Policy and Elasticity of Demand**

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

3. **Fixation of Wages and Elasticity of Demand:**

   The concept of Elasticity of Demand is useful to trade unions in collective bargaining, for wage determination. When trade union leaders know that demand for their product is inelastic, they will insist for more wages to workers.

4. **International Trade and Elasticity of Demand:**

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

5. **Public Utilities:**

   In case of public utilities like railways which have an inelastic demand, to avoid consumers exploitation government can either subsidise or nationalise them. Which shows need of government monopoly.

**3. Gross National Product (GNP)**

**Ans.** (1) Gross National Product is the total measure of the flow of goods and services at market value resulting from current reduction during a year in a country, including net income from abroad.

(2) The formula of Gross National Product is :

GNP = C + I + G + (X-M) + (R-P)

**4. Average propensity to save**

**Ans.** (1) Average Propensity to Save (APS) is the ratio of aggregate saving to aggregate income.

(2) It can be calculated as : APS = S/Y, where, APS = Average Propensity to Save, S = Aggregate Saving and Y = Aggregate Income.

(3) With a rise in income, the average propensity to save rises.

**5. Central Bank's measure of regulation of consumer credit**

**Ans.** This technique of selective (Qualitative) credit control is used to regulate the terms and conditions under which consumer instalment credit and hire purchase finance is provided by the banks. In developed and in developing countries, substantial part of the credit is used for consumer durable goods like cars, motorcycles, television sets, refrigerators, computers, microwave ovens, domestic furniture etc. when they are purchased on hire purchase or instalment credit system. Excess as well as insufficient demand for these items disturb the production. To avoid this problem, consumer credit is required to be regulated.

The method (technique) is implemented by determining the minimum down payment and maximum period of payment i.e. maximum equated monthly instalments (EMI). In order to check consume credit, the Central bank may increase the minimum down payment and reduce the maximum period of payment by reducing the number of equated monthly instalments (EMI). This will discourage the prospective buyers. On the other hand, a lower down payment and more number of instalments will encourage them.

**6. Secondary Functions of money**

**Ans. i) Standard of deferred payments –**

In the modern economy many transactions take place without instant payments. The debtors make a promise to make payments on some future date. Such future payments are possible because of money. Under Barter System taking loan was easy, but its repayment was difficult because loans were in the ' form of grains or cattle. Money facilitates lending and borrowings, because the borrowings are in the form of money and the repayment are also in the form of money. Due to general acceptability, stability of value compared to other goods, durability etc., money acts as a standard of deferred payments.

**ii) Store of value –**

Money works as a store of value. Along with satisfaction of present wants, provision for satisfaction of future wants is equally important. It requires savings from the current earnings. Money is a convenient means through which savings can be done easily. According to Lord J.M. Keynes, "money is a link between the present and the future." Money serves as a store of value because money has purchasing power. It can be used to purchase. real assets like land, house etc. and financial assets like shares, debentures, bonds, etc.

**iii) Transfer of Value –**

Today with the extension of trade among various countries and organizations it becomes necessary to transfer purchasing power from one place to another. This is easily done by money. Money helps to shift the purchasing power from one place to another e.g. real assets like building or agricultural land from one place can be sold and with the help of that money, building or land can be purchased at some other place.

**Q.4. Write answers to the following questions (Any 3) (12 Marks)**

**1. Explain the feature of micro economics**

**Ans. 1. Study of individual units**

Micro Economics is the study of behaviour of small individual economic units, like particular households, individual firms, individual prices etc.

**2. Price Theory**

Micro Economics is called price theory because it is primarily concerned with determination of prices of goods and factors of production.

**3. Slicing method**

Micro Economics splits the economy into small individual unit and then studies each unit separately in detail. Thus it is said that Micro Economics uses Slicing method.

**4. Partial equilibrium**

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

**5. Microscopic approach**

Micro Economics is the microscopic study of the economy. In the words of Prof. A.P. Lerner, "It is looking at the economy through microscope, as it were to see how the millions of cells in the body of economic - the individuals or households as consumers, and individuals or firms as producers play their part in me working of whole economic organism".

In Micro Economic theory, we discuss how the various cells of economic organism, such as thousands of consumers, thousands of producers or firms, thousands of workers and resource suppliers in the economy, do their economic activities and reach their equilibrium state. In other words in Micro Economics, we attempt only a microscopic study of the national economy. We do not study the national economy in its totality.

**6. Analysis of resource allocation and economic efficiency**

Micro Economics deals with the allocation of resources among competing groups. Micro Economics explains how relative prices of commodities and factors of production determine the allocation of resources in turn determines (a) What goods will be produced & in what quantities ? (b) How they will be distributed ?

It means Micro Economics also deals with the problem of income distribution.

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

**7. Use of marginalism principle**

Micro Economics uses marginalism principle as a tool of analysis. Marginal means change brought about in total by an additional unit i.e. marginal unit. All important micro economic decisions are taken at the margin. So this concept is of crucial importance in all areas of Micro Economics.

**8. Based on certain assumptions**

Micro Economics assumes laissez fair policy. pure, capitalism, full employment, perfect competition etc. which do not exist in reality. Also most of the theories are based on the 'ceteris paribus' assumption i.e. Other things being constant. The assumption makes the analysis simple, but at the same time, it neglects the interdependence between economic variables. The assumption makes the theories static and neglects changing economic world.

**9. Limited Scope**

Micro Economics studies individual economic its & not the whole economy. It does not deal with nation-wide problems like unemployment, inflation, deflation, poverty, balance of payment situation, economic growth etc. So its scope is limited.

**10. Analysis of market structures**

Micro Economics analyses different market structures i.e. perfect competition, monopoly oligopoly, monopolistic competition etc and tribes how prices & quantities are determined different markets.

**2. Explain the concept of total revenue, average revenue and marginal revenue**

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

**Revenue:** Revenue refers to the amount received by a firm from the sale of a given quantity of a commodity in the market at various prices.

**Revenue = Quantity x Price**

The concept of revenue can be analysed as Total Revenue, Average Revenue & Marginal Revenue

1. **Total Revenue (TR)**: Total Revenue refers to total receipts from the sale of given quantity of a commodity. It is the total income of a firm. Thus,

   Total Revenue=Total Quantity X Price

   For example, if a firm sells 15 tables at a price of ₹ 200 per table, then the total revenue will be

   Total Revenue = 15 Tables x ₹ 200

   = ₹ 3000

2. **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

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

3. **Marginal Revenue (MR):** Marginal Revenue is the net addition made to total revenue by selling an extra unit of the commodity. For example, if the total revenue from the sale of 20 tables is ₹ 4000 and that from sale of 21st tables is ₹4180, then MR or 21st table will be

   MRn = TRn-TR(n-l)

   = 4180 - 4000

   = 180 Where,

   MRn= Marginal Revenue of nth unit

   TRn = Total Revenue of n unit

   TR(n-l)=Total Revenue from (n-1) unit

   n = Number of units sold

**OR**

One more way to calculate MR is

MR = $\frac{\text{Change m Total Revenue}}{\text{Change in total number of units}}$

$$MR=\frac{\Delta TR}{\Delta TQ}=\frac{180}{1}=180$$

**3. Explain the features of perfect competition**

**Ans. 1) Large number of sellers/sellers are price takers**

There are many potential sellers selling their commodity in the market. Their number is so large that a single seller cannot influence the market price because each seller sells a small fraction of total market supply. The price of the product is determined on the basis of market demand and market supply of the commodity which is accepted by the firms, thus seller is a price taker and not a price maker.

**2) Large number of buyers:**

There are many buyers in the market. A single buyer cannot influence the price of the commodity because individual demand is a small fraction of total market demand.

**3) Free entry and exit:**

New firms can enter and exit the market without any restrictions.

**4) Homogeneous product:**

Firms produce and sell identical units of a given product, in perfectly competitive market, i.e., units of a commodity produced by each of them is uniform, in respect of size, shape, colour, quality, etc. Thus commodities have perfect substitute for each other.

**5) Perfect knowledge:**

The buyers as well as sellers in the perfectly

competitive market have perfect knowledge of the market conditions. Such knowledge will prevent the buyers from paying a higher price and a seller charging ^different price than what is prevailing in the market.

**6) Single price:**

In Perfect Competition all units of a commodity have uniform or a single price. It is determined by the forces of demand and supply.

**7) Perfect mobility of factors of production:**

Under Perfect Competition the factors of production that is land, labour, capital and organisation, enjoy complete freedom to move from one place to another and from one occupation to another. This implies optimum use of each factor input which can be available easily to the producers. Thus they will not face any problem in production of any commodity.

**8) No transport cost:**

There is no transport cost under perfect competition. It is assumed that in perfect competition all the firms are close to each other. There will not be any difference in transport cost and price will remain uniform.

**9) Non Government Intervention:**

Laissez faire policy prevails under perfect competition which means there is no government intervention in respect of production, transportation price determination of goods etc.

After analyzing all the features of perfect competition, it is clear that perfect competition is ideal form of market, but it is very difficult to realize the above conditions practically. Thus, perfect competition is an imaginary concept.

**4. Explain the budget expenditure of the government**

**Ans.** Budget expenditure refers to the estimated expenditure of the government during a given fiscal year.

**Budget expenditure includes**

i) **Plan expenditure**- that is expenditure incurred on various programmes in the plan. For example, expenditure on irrigation, transport, energy, agriculture allied activities, general economic social services, communication etc.

ii) **Non-Plan expenditure**: is expenditure that is incurred on other activities, which is out of the scope of government plans. For ex. Expenditure incurred for rescue of people affected by various calamities.

iii) **Development expenditure**- which is directly related to economic and social development of the country. For example, expenditure on health, education, industrial development, social welfare, scientific research etc.

iv) **Non-development expenditure** – is incurred on the essential services of the government. For example, expenditure on administrative services, defence, judiciary, police etc.

Budget expenditure may be further classified as : 1) Revenue Expenditure, 2) Capital Expenditure.

**5. Sources of Non tax revenue**

**Ans.** **Non-Tax revenue** : Non-tax revenue refers to receipts of the government from also sources other than those of tax receipts. The main sources of non – tax revenue are:

**a) Interest and Dividend on investments:**

Government receives interest on loans given to state governments union territories, private enterprise, which is an important source of non-tax revenue. Dividends are received by the government from its investment in other companies.

**b) Fees, License Fee:**

Fees refer to charges imposed by the government to cover the cost of recurring services provided by it. It is also a compulsory contribution. For example, registration fees, court fee etc.

**c) Gifts and grants:**

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

**d) Fines and penalties:**

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

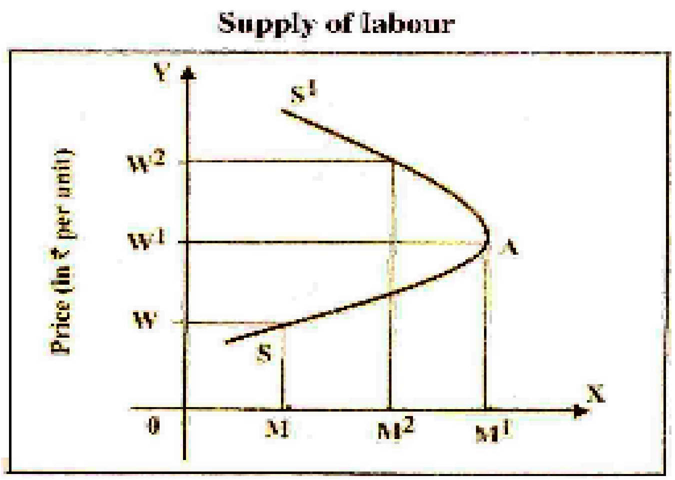
**e) Escheats:**

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

**6. Backward sloping supply curve of labour**

**Ans. Labour Supply:** In case of labour, as the wage rate rises, the supply of labour (number of hours of work) would rise. So the supply curve slopes upward, but the supply of labour decreases, with a further rise in the wage rate. Thereafter, supply curve of labour slopes backwards. This is because the worker would prefer leisure to work after receiving higher amount of wages.when wage rate rises the labour supply tends to fall.

It can be explained with help of backward bending supply curve as follows –




In the above diagram, supply of labour is shown on the X axis and wage rate on the Y axis. In the above diagram the curve $SAS^1$ represents a backward bending supply curve. The supply of labour rises with every rise in the wage rate up to $OW_1$. But thereafter, as the wage rate rises from $W_1$ to $W_2$ the supply of labour falls from $OM_1$ to $OM_2$. So supply curve slopes backward from A to $S^1$. The backward bending supply curve shows that as wage rate rises from $OW_1$, to $OW_2$,. The supply of labour falls, from $OM_1$ to OM thus there is a backward slope in the supply curve.

**Q.5Answer with reason whether you agree or disagree with the following statements. (any 3) (12 marks)**

**1. When MU is zero, TU diminishes.**

**Ans. No I do not agree**

**Statement of the law.**

"The additional benefit which a person derives from a given increase of his stock of a thing diminishes with every increase in the stock that he already has".

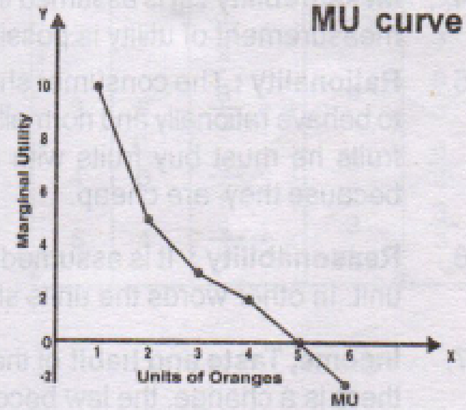
- Marshall

**Illustration of the law.**

The law explains that when a consumer consumes more and more of a commodity, the marginal utility derived from each additional unit diminishes. To explain the law, let us have a hypothetical utility schedule and diagram. Let us suppose a consumer consumes oranges. The following schedule indicates the total utility and marginal utility derived by the consumer.

**Utility Schedule**

| Units Consumed | TU | MU |
|---|---|---|
| 1 | 10 | 10 |
| 2 | 15 | 5 |
| 3 | 18 | 3 |
| 4 | 20 | 2 |
| 5 | 20 | 0 |
| 6 | 18 | -2 |




As the consumer increases consumption, the extra satisfaction (marginal utility) that he gains by the consumption of each successive unit goes on diminishing.
The total utility goes on increasing up to 4th unit. However it increases at a diminishing rate as MU of every additional unit declines.
The first unit of orange provides him the highest amount of satisfaction (10 units). At this point the marginal utility and the total utility are same. As long as total utility increases, the marginal utility diminishes upto 4th unit.
When the consumer reaches fifth unit, he enjoys maximum satisfaction (20 units). At this point, the total utility remains maximum and constant. The marginal utility is zero when the total utility is maximum i.e. there is complete satisfaction of a given want when the marginal utility is zero. This stage is called the point of satiety.
Any further consumption leads to negative marginal utility. When the consumer goes for the sixth unit, the marginal utility is - 2. This is called disutility. Consequently total utility starts declining and it is found to be 18 units.

The law is also diagrammatically represented.

In the diagram, the MU curve which is called the marginal utility curve, slopes downward from left to right. The 'downward slope' indicates the diminishing marginal utility when the consumer goes for more and more units.
The intersection between MU curve and X axis indicates the maximum satisfaction This is otherwise called the point of satiety.
After showing the point of satiety, the MU curve enters the negative quadrant indicating negative utility.

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

1. **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.

2. **Uniformity or Homogeneity :** All the units consumed should be identical, i.e. the size, shape, colour, quality of all units should be the same.

3. **Single use.** It is assumed that the consumer will consume only that commodity which satisfies a single want.

4. **Measurability:** It is assumed that the utility can be measured cardinally, (i.e.) Numerical measurement of utility is possible.

5. **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.

6. **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.

7. **Income, Taste and habit** of the consumer should remain the same throughout. When there is a change, the law becomes invalid.
8. **Constancy of marginal utility of money.** It assumed that marginal utility of each unit of money remains the same.

**2. There is difference between stock and supply**

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

**Reasons** :

(1) Stock refers to the entire quantity of commodity, which exists with the seller. It is the potential supply. Supply refers to the quantity of a commodity offered for sale at a given price and at a point of time
(2) Stock depends upon production, while supply depends on stock and price.
(3) Stock is a source whereas supply is a flow.
(4) Stock may exceed the supply. For perishable goods, the stock and supply can be same. However, supply can never exceed the stock

Therefore, there is a difference between stock and supply.

**3. Gross National Product and Gross Domestic Product are same Concept**.
**Ans. No, I do not agree with this statement**

**Reasons** :

(1) Gross National Product is the total measure of the flow of goods and services at market value resulting from current production during a year in a country, including net income from abroad.

(2) Gross Domestic Product is the gross market value of all final goods and services produced within the domestic territory of country during a period of one year. Net income from abroad excluded from Gross Domestic product.

(3) The formula of Gross National Product is follows :
GNP = C + I + G + (X - M) + (R - P)

(4) The formula of Gross Domestic Product is follows : GDP = C + I + G + (X-M)

Therefore, Gross National Product and Gross Domestic Pr are not the same concept, but are different concepts.

**4. Commercial banks cannot create credit money.**
**Ans. No, I do not agree** with this statement.

**Reasons** :

(1) Primary deposits refer to money deposited by the people in the form of cash with the banks. By keeping some part of primary deposits in the form of cash reserve, the rest of the primary deposit are used for lending loans.

(2) When a bank grants loan to a borrower, the bank opens deposit account in the name of the borrower and the mom transferred on the account of the borrower creates secondary deposits.

(3) When the borrower withdraws money from his loan account by a cheque, it is deposited by the payee in some other bank.

(4) Other banks again create credit on the basis of fresh deposit received after keeping the required reserves.

Thus, commercial banks can create credit money.

**5. When government expenditure is greater than government revenue it is called surplus budget.**
**Ans. No, I do not agree with this statement.**

**Reasons** :

(1) A budget in which anticipated government's expenditure is greater than estimated government's revenue is called deficit budget.

(2) On the other hand, a budget in which estimated government's revenue is greater than anticipated government's expenditure is called surplus budget.

(3) Thus, Deficit Budget = Government Expenditure > Government Revenue.

(4) On the other hand, Surplus Budget = Government Expenditure < Government Revenue.

Thus, when government expenditure is greater than government revenue it is not called surplus budget but it is called as deficit budget.

**6. Qualities of good money.**
**Ans. Yes, I agree with this statement**

There are qualities of good money

Any commodity cannot act as money. A thing which works as money must possess some qualities or characteristics. Following are the qualities of money.

1) **General acceptability**- The thing which acts as money must be easily accepted by all without hesitation for exchange.

2) **Divisibility** – It should be divisible into different denominations, e.g. 5 rupees, 10 rupees, 50 rupees, etc.

3) **Durability** – It should be durable. It should last for a longer period of time e.g. metallic coins are more durable than paper notes.

4) **Cognizibility** – It must be easily recognizable and distinguishable from other things.

5) **Portability** – It must be easy to carry from one place to another without any difficulty, expense and inconvenience e.g. paper notes are easily portable. They also possess high value in a small bulk e.g. notes of Rs.500, Rs.1000.

6) **Homogeneity** – The money of same denomination should be of the same size, quality etc.

7) **Stability of Value** – It must have general stability of value.

**Q.6 Answer in detail. (any 2) (16 marks)**

1. Explain the features or characteristics of utility.

**1. Relative concept -** Utility is related to time and place. It differs from time to time and place to place, e.g. Cotton clothes in summer and woollen clothes in winter have greater utility. Similarly, woollen clothes have more utility in Kashmirihan in Mumbai.

**2. Subjective concept -** Utility of a commodity . cannot .be same for all individuals. It differs from person to person, due to differences in taste, preference, choice, liking, etc., of the people, e.g. Utility of a book is greater for an educated person than an illiterate person.

**3. Ethically neutral -** The concept of utility has no ethical consideration. It is morally neutral.

A commodity which possesses utility may satisfy any want. It does not make any difference between good, bad, moral or immoral etc. e.g. Knife has utility for a housewife to cut vegetables and for a killer to harm somebody.

**4. Utility and usefulness are not same -** Utility is the want satisfying power of a commodity, whereas usefulness is the benefit derived by a consumer. Utility expresses Level of satisfaction of a consumer and usefulness indicates value in use of a commodity. A commodity which possesses utility may not be useful, e.g. A cigarette has utility for a smoker, but it does not have usefulness as it is injurious to health.

**5. Not same as pleasure -** Utility and pleasure are different. A commodity may have utility, but its consumption may not provide pleasure or happiness. e.g. An injection has utility for a patient but it is painful, so it does not give pleasure.

**6.Utility differs from satisfaction** - Utility and satisfaction are inter-related terms but there is a difference. Utility is the capacity of a commodity to satisfy human wants. Satisfaction is the feeling, of happiness realised by the consumer. Utility is related to the commodity, whereas satisfaction is experienced by a person. utility is anticipated satisfaction but satisfaction is the actual realisation.

Thus, utility is the starting point of consumption and satisfaction is the end result of consumption.

**7.Not easily measurable**- Utility is a psychologjcal concept. It is invisible and intangible. It cannot be measured cardinally i.e., in numbers. However, one can ordinally measure it. e.g. A thirsty person after drinking water, may derive higher or lower level of utility.

**8.Depends upon the intensity of wants-**

The utility of a commodity depends upon the intensity or urgency of want. The more urgent is the want, the greater is the utility and vice versa. As the urgency of want declines, utility diminishes. e.g. Utility of food is higher for a hungry person, and utility declines with the satisfaction of hunger,

**9.It is the basis of demand -**utility forms the basis of demand. If a commodity does not give any utility, a person may not demand it. He will demand a commodity only, if it gives him utility, e.g. Demand for pen is more from students because utility of pen is more for them.

**2. Explain various types of price elasticity of supply**

**Ans.** The concept price elasticity of supply explains the quantitative change in supply of a commodity, due to given change the price of commodity. Elasticity of supply may be defined as a ratio of the percentage change or the proportionate change in the quantity supplied to the percentage or proportionate change in the price. In Symbolic terms,

$$E(s)=\frac{\text{percentage change in quantity supplied}}{\text{percentage change in price}}$$

$$E(s)=\frac{\frac{\text{change in the quantity supplied}}{\text{original supply}}}{\frac{\text{change in price}}{\text{original price}}}$$

$$=\frac{\frac{\triangle Q}{Q}}{\frac{\triangle P}{P}}$$

$$=\frac{\triangle Q}{Q}\times\frac{P}{\triangle P}$$

In this equation $E(s)$ = Price elasticity of supply

$\triangle Q$ = change in quantity supply

Q = original quantity supplied

$\triangle P$ = change in price

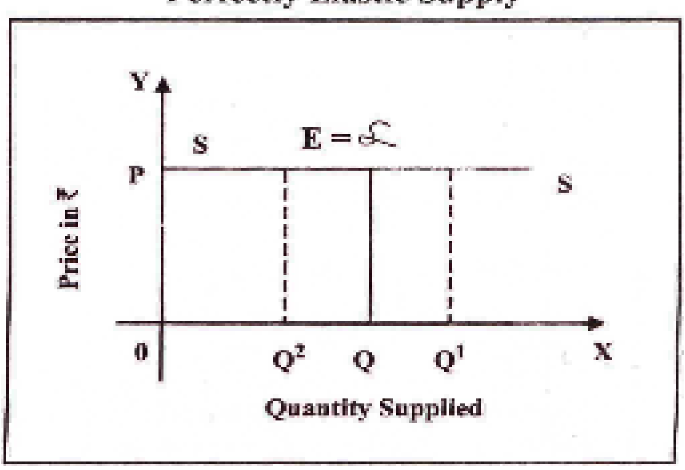
P = Original price

**Types of price Elasticity of supply :**

There are five types of Elasticity of supply.

i) **Perfectly Elastic Supply:** With a negligible change in price there is slight fall in price supply becomes zero. Then it is said to be perfectly Elastic Supply. It can be explained with the help of diagram.

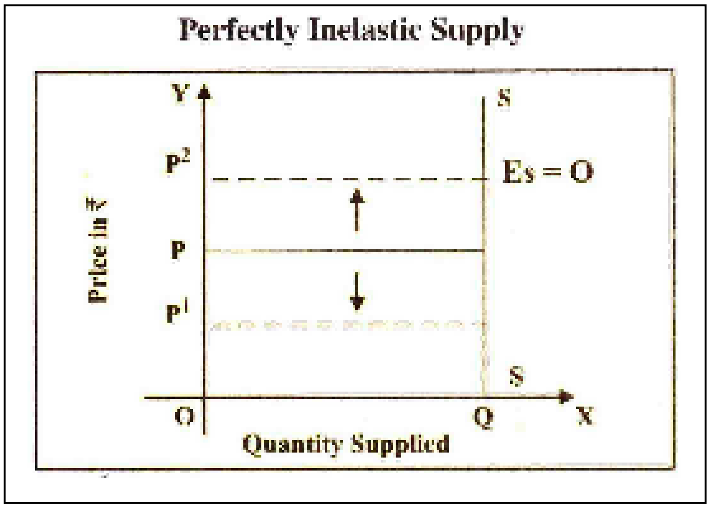
Perfectly Elastic Supply




In the above diagram, quantity supplied is shown on the X axis and price on the Y axis. Thus elasticity of supply is infinite. Es= (infinite). 'SS' is a supply curve is a horizontal straight line parallel to x axis.

(ii) Perfectly Inelastic Supply: When change in price does not bring about any change in quantity supplied, it is known as perfectly Inelastic Supply.

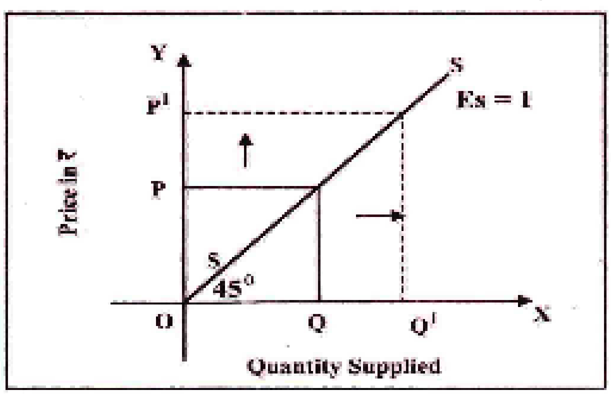
In this case elasticity of supply is zero. It can be shown with the help of following diagram.




In the above diagram, quantity supplied is shown on the X axis and price on the Y axis. Supply curves SS is a vertical straight line parallel to the Y axis. It shows quantity supplied remains the same even, if the price increases from P to $P^2$ or decrease from P to $P^1$ Thus elasticity of supply is zero Es = 0.

**iii) Unitary Elastic Supply :** When a change in price brings about a proportionate change in quantity supplied, then it is unitary elastic Supply. In this case Es = 1, it can be shown as follows –

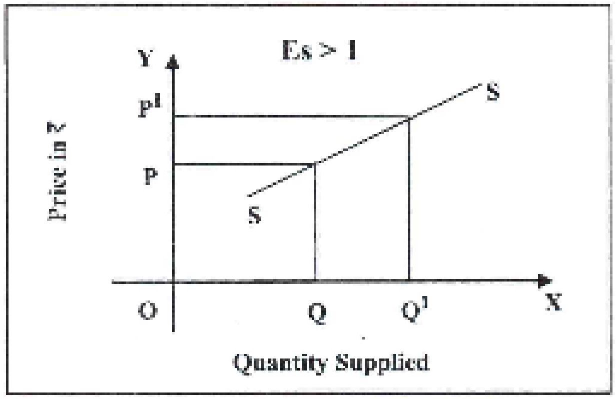
Unitary Elastic Supply




In the above diagram, quantity supplied is shown on the X axis and price on the Y axis. Quantity supplied rises from OQ to $OQ^1$ with a rise in price from OP to $OP^1$. Change in quantity supplied is proportionately equal to change in price. When the supply curve bisects the angle made by the X axis and Y axis. elasticity of supply is equal to one.

**(iv) More Elastic Supply/Relatively Elastic Supply:** When percentage change in quantity supplied is more than the percentage change in price, then it is more elastic supply. Here, the price elasticity of supply is more than one (Es > 1). So supply curve is flatter.

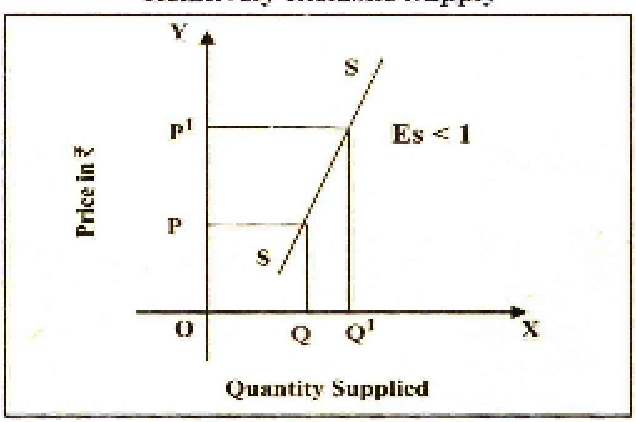
Relatively Elastic Supply




In the above diagram, quantity supplied is shown on the X axis and price on the Y axis. Due to a small change in price from OP to $OP^1$, there is a greater change in the quantity supplied from OQ to $OQ^1$. Here elasticity of supply is more than one.

**Less Elastic Supply/Relatively Inelastic Supply**: When percentage change in quantity supplied is less than the percentage change in price, then it is less elastic supply. In this case elasticity of supply is less than one. So supply curve is steeper.

Relatively Inelastic Supply




In the above diagram, quantity supplied is shown on the X axis and price on the Y axis. SS is the less elastic supply curve, which indicates that a greater change in price from OP to $OP^1$ bring about less than proportional change in the quantity supplied from OQ to $OQ^1$. Here the Price Elasticity of Supply is less than one.

**3. What are the primary functions of commercial banks?**

**Ans.**

**1. Accepting deposits**

Accepting deposits from the public is the primary or basic function of commercial bank. Banking business has its origin in this function. The bank acts as an intermediary by accepting deposits and paying interest on them and making loans and charging the borrowers interest at a higher rate. The difference between these two rates of interest minus the administrative charges, is the profit of the bank.

Commercial bank accepts following types of deposits.

a) Demand deposits

b) Time deposits

**i) Current account deposits**

It is usually opened by businessmen, corporations, industrial enterprise, public bodies, trustees etc. The account facilitates them to carry out their transactions with minimum cash at hand, as the deposits are withdrawable any time by the depositor by means of cheques.

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

**ii) Savings account deposits:**

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

**b) Time Deposits:**

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

They are in two forms:

i) Recurring Deposits

ii) Fixed Deposits.

**i) Recurring Deposits**

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

**ii) Fixed Deposits**

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

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

**2) Advancing of Loans:**

The deposits accepted by the banks from the depositors are not kept ‘as idle’ cash balance. After keeping certain cash reserves, the balance is used to lend to the needy borrowers in the form of loans and advances. Banks provide finance to institutions and individuals for various purposes.

The profit earning capacity of commercial banks depends upon this function. Commercial banks accept deposits at a lower rate of interest and give it as loans and advances at a higher rate of interest.

Generally, banks grant loans and advances to the borrowers in the following forms,.

1) Loans
2) Cash credit
3) Overdraft facility
4) Discounting of bills.

**1) Loans**

Loans can be classified into call loans, short- term loans, medium term loans and long-term loans.

**i) Call Loans/Money at Call Notice:**

Loans provided by commercial bank for a period of 7 to 15 days are known as call loans. These loans are taken by bill brokers or stock-brokers. The rate of interest is the lowest. These loans can be called back any time by the commercial banks from the borrowers.

**ii) Short term Loans:**

Short-term loans are provided by commercial banks for the period of not more than two years. The rate of interest is higher than call loans and lower than medium term loans. It is required by manufacturers and producers in order to fulfil their requirements of working capital.

**iii) Medium term Loans:**

Medium term loans are provided by commercial banks for the period from 2 years up to 5 years. The rate of interest charged by commercial banks is higher than the short term loans and lower than the long term loans. It is required by producers and manufacturers for making changes in the methods of production, purchase of equipments, tools etc.

**iv) Long term Loans:**

When commercial banks give loans for a period of more than 5 years they are referred as long term loans. The rate of interest charged by the commercial banks is highest as compared to other types of loans. It is required by producers for making permanent changes in the methods of production, technique of production etc.

**2) Cash Credit**

Cash credit facilities are allowed to any customer / borrower. The borrower is allowed to draw from that account upto a certain limit against eligible securities. Interest is charged on the amount actually drawn.

**3) Over Draft Facility:**

Overdraft facility is generally given to current accountholders. Commercial banks allow their customers to withdraw the amount from bank in excess of their balance. This arrangement is known as overdraft facility. The bank specifies the maximum limit of overdraft. Rate of interest charged by commercial banks is generally low.

4) **Discounting of 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.

**4. What is national income? Explain the theoretical difficulties involved in the measurement of national income?**

**Ans. i) Theoretical difficulties:**

This is also known as conceptual difficulties.

**1) Transfer payments:**

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

**2) Income of foreign firms:**

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

**3) Unpaid services:**

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

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

**4) Incomes from illegal activities:**

Income earned through illegal activities such as gambling, black marketing, theft, smuggling etc., is not included in national income. Such goods and services do have value and meet the needs of the consumers. Thus to that extent national income is underestimated.

**5) Treatment of government sector:**

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

**6) Production for self consumption:**

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

**7) Changing price levels**:

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