J. K. SHAH CLASSES
SYJC - ECONOMICS

PRELIMINARY TEST - 2

Branch - Andheri , Borivali & Vasai **Date: 23 /01/2017**
Total Marks : 80 **Total time: 3 hours**

SOLUTION

Ans.1. (A) Fill in the blanks with appropriate alternative given in the bracket. **[5]**

(1) Marginal
2) fall
3) vertical
4) single seller
5) Land

(B) Match the following: **[5]**

1) Complementary demand
2) Creation of utility
3) General Theory of Employment
4) Transfer payment
5) Government investment

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

Ans: True – 1, 3, 5. False – 2, 4, 6.

Ans.2. (A) Define or Explain the following concepts (Any Three) **[6]**

(1) Resource Allocation

(i) Micro Economics deals with the allocation of resources among competing groups.
(ii) Micro Economics explains how relative prices of commodities and factors of production determine the allocation of resources in turn determines what will be producted and in what quantities? How they will be distributed.

(2) Derived Demand

(i) It is also known as derived demand. When goods are demanded indirectly e.g. to produce consumers goods.
(ii) It is indirect demand for e.g. demand for factors of production like land, labour, capital, organisation etc. is derived demand.

(3) Income Elasticity of demand

(i) Income elasticity of demand is defined as "the degree of responsiveness of quantity demanded to change in income only, other factors including price remaing unchanged.
(ii) It is measured as follows.

Income elasticity of dd = $\dfrac{\%\ \Delta\, in\, Q\, Ded}{\%\ \text{of change in income}}$

(4) Monopolistic competition

(i) It is most realistic market structure. In this market there are some features of monopoly and some features of perfect competition.

(ii) According to Prof. E.H. Chamberlin "Monopolistic competition refers to competition refers to competition among a large number of sellers producing close but not perfect substitute."

(5) Personal Disposable Income

(i) It is the part of personal income which is left behind after paying personal direct taxes like me tax. personal property tax etc.

(ii) ∴ PDI =PI Direct taxes. Where PDI = Personal Disposable Income
PI = Personal Income

(6) Aggregate demand

(i) Aggregate demand refers to the sum total of demand for all goods and services in the economy by different entities such as consumers, businessmen, government and others at different prices during the year. It can be explained as follows.

(ii) AD = C + I + G + (x- m) i.e. Consumption expenditure + Investment expenditure + Government expenditure + Net foreign earnings.

(B) Give reasons or explain (Any Three) **[6]**

(1) Commercial Bank works for profit

(i) Commercial Banks Provides Primary and Secondary functions for earning Profits. e.g. Interest paid to depositors is paid out of the interest earned from borrowers. They indulge in to buying & Selling of Govt. Securities to earn profits.

(ii) Similarly in case of agency & general utility services, banks are not obliged to do so.

(iii) But whenever they perform such functions, they charge the beneficiary. E.g. Letter of credit, safe Deposit, lockers etc. are chargeable functions and not free.

(iv) Unless they earn profits, banks can't survive.

(2) Micro Economics studies single unit.

(i) It is because Micro Economic is the branch of economic.

(ii) Which concentrates on the study of single or individual economic unit.

(iii) Such as a consumer, a family, a business firm, determination price of a commodity etc.

(3) During the period of inflation surplus Budget is advisable.

(i) In the period of inflation supply of money in the economy is more.

(ii) If money supply is taken out from economy by way of tax revenue it will help to reduce aggregate demand and general price level, so this statement is correct.

(4) Saving bank A/c are usually opened by salaried class.

(i) It helps them to save small portion of their incomes such deposits are accepted by the commercial bank to encourage saving habits.

(ii) Account holders get interest, they can make periodical payment and also withdraw money with certain limitations.

(5) Any commodity cannot act as money.

(i) Money means anything which is generally accepted as a medium of exchanges.

(ii) All commodities cannot be accepted as a medium of exchange therefore this statement is correct.

(6) Saving may be used in future for unforeseen contigencies.

(i) The motive behind saving is to face unforseen contignecies in the life.

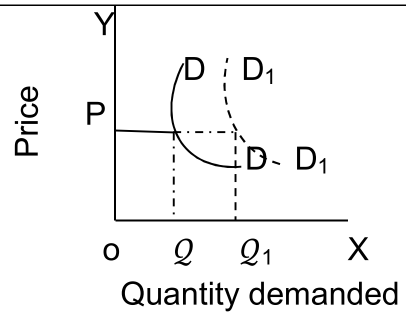
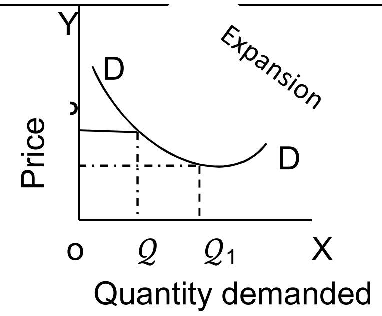
(ii) Such as accident, sickness, death of main earner etc. So this statement is correct.

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

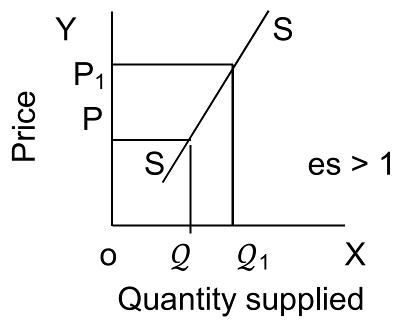
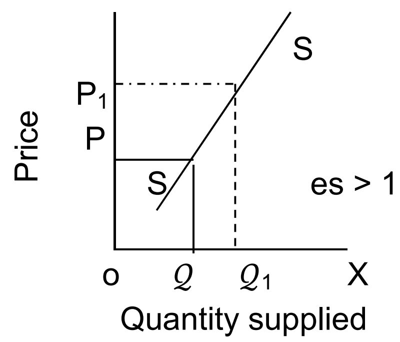
(1) Place Utility & Time Utility

Utility	Satisfaction
(1) When utility of a commodity changes due to change in the place of utilisation it is called place utility.	(1) When utility of a commodity increases with a change in the time of utilisation It is called time utility.
(2) e.g. utility of water increases when it is transferred from river to farm.	(2) e.g. umbrellas have greater utility during rainy season than in winter.
(3) It Increases with change in place.	(3) It increases with change in time.
(4) It is also created bv transferring place	(4) It is crated by keeping stock of commodity and making available it when needed.

(2) Increase in demand & Expansion in demand

	Increase in demand		Expansion in demand
1	When more quantity of a commodity is demanded at the same price, it is called increase in demand.	1	When more quantity of a commodity is demanded due to fall in the price it is called expansion in demand.
2	Price remain same while conditions of demand changes which have positive effect on demand	2	Price falls while conditions of demand remain same
3			
4	New demand curve is necessary to show increase in demand	4	It can be shown on the same demand curve.

(3) Relatively elastic supply & Relatively inelastic supply

	Relatively elastic supply		Relatively inelastic supply
1	When % of change in quantity supplied is more than % of change in price it is called relatively elastic supply.	1	When % of change in quantity supplied is less than % of change in price it is called relatively inelastic supply.
2	The price elasticity of supply is more than one	2	The price elasticity of supply is less than One.
3	 		
4	Numerical value of elasticity of supply is (e > 1)	4	Numerical value of elasticity of supply is e < 1

(4) Perfect competition & Monopolistic competition

	Perfect competition		Monopolistic competition
1	It is a market in which large number of seller sale homogeneous products.	1	It is a market when sellers are selling differentiated products.
2	Single price prevails in all part of market	2	Price discrimination is possible
3	Expenditure on advertisement and sales manship is not necessary	3	Expenditure on advertisement and salesman ship is necessary
4	Seller is price taker	4	Seller can fix price of his product.

(5) Insurable risk & Non insurable risk

	Insurable risk		Non Insurable risk
1	Risk which arises due to fire, floods, accident etc. can be insured.	1	Risk which rises due to change in the Market conditions it is called non-insureble Risk
2	Losses can be transferred to insurance company by taking insurance policy	2	Losses can not be transferred to insurance Company
3	It can be anticipated	3	It cannot be anticipated

4	It is not the cause of profit	4	If a avoided by entrepreneur, he can get Profit.

(6) Net National Product (NNP) & Net Domestic Product (NDP)

	Net National Product (NNP)		Net Domestic Product (NDP)
1	It is money value of all final goods and services produced in a country during a year including net income from abroad and excluding depreciation.	1	It is money value of all final goods and services produced in a country during a year excluding depreciation and net income from abroad.
2	NNP = NDP + Net income from abroad i.e. (X - M) + (R – P)	2	NDP = NNP - Net Income from international trade i.e. (X – M) + (R – P)
3	It is useful in the open economy having international transactions.	3	It is useful in closed economy having no international transactions.
4	It gives idea about net national income of a country.	4	It gives idea about net domestic income of a country.

Q.3 (B) Write short Notes (Any Two) **[6]**

(1) Market Demand Schedule

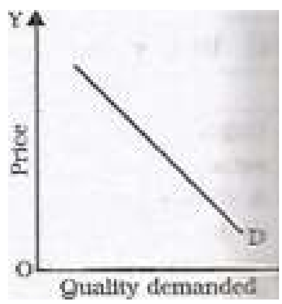
(i) Market demand refers to total quantity of a commodity demanded in the market at various alternative prices during a given period of time. Market demand is sum of the total of all individual demand.

(ii) Market demand schedule is a tabular representation of the various quantities of a commodity demanded in aggregate by all the buyers at different prices during a given period of time.

(iii) Following table indicate market demand.

Price	Quantity Demanded			Total market demand
	A	B	C	
5	5	10	15	30
4	10	15	20	45
3	15	20	25	60
2	20	25	30	75
1	25	30	35	90

(iv) In the above table price and quantity demanded by A, B & C consumers and total market demand is shown. The table shows that when price is ₹ 5/- market demand is 30 units when price falls to ₹ 4. 3, 2 & ₹ 1 market demand extended to 45. 60, 75 & 90 units respectively. Thus market demand schedule indicate functional relationship between price mid quantity demanded.



(v) Market demand curve: With the help of above market schedule we can draw market demand curve as follows.

In the diagram OX axis indicate market demand mid OY axis indicate price 'DD' is market demand curve which slopes downward and indicate that with fall in price market demand is extended

(2) Quantitative credit control instruments

Quantitative credit control instruments refers to those credit control instruments which used by the central bank to control credit creation by commercial Banks. They are as follows: -

(i) Bank rate : It refers to the rate of interest charged by the central bank to give loans to commercial Bank against discounted bills. If central Bank increases bank rate credit creation by commercial Bank will be less.

(ii) Open market operation: It refers to purchase and sell of govt. bonds and securities by the central bank. If central Bank sale govt. bonds credit creation will be less.

(iii) Variations in Cash Reserve Ratio (C.R.R.): Cash reserve ratio refers to the percentage of deposit be kept by commercial Bank as cash in hand and with Central Bank by commercial bank will be less.

(3) Determinants of supply

Supply refers to actual quantity of a commodity supplied by a seller in the market at various alternative prices during a given period of time supply depend up on following factors.

(i) Price of a commodity : There is a direct relationship between price and quantity supplied. - Higher the price more is the supply and vice versa.

(ii) Cost of production : Higher the cost of production lower is the supply and vice versa.

(iii) Availability of factors of production : If factors of productions are easily available supply will be more.

(iv) Technology of production : If modern technique of production is used supply will be more and traditional technique is used supply will be less.

(4) Features of Macro Economics

The word macro is derived from the Latin word 'makros' means large or aggregate Macro economics deals with aggregate behaviour of an economy.

Features of Macro economics

(i) Macro economic studies variables relating to the whole economy.

(ii) It studies problems related to income, employment, inflation, trade cycles, economic growth etc.

(iii) It deals with economic aggregates.

(iv) It uses lumpy method for it's study.

(v) It is based on realistic assumptions.

(vi) It gives idea about an entire economy as a whole.

(vii) It is useful to solve macro economic problems.

Q.4. Answer the following questions (Any Three) [12]

(1) Explain total outlay method of measuring price elasticity of demand.

Total outlay refers to total amount of money spend by a consumer on the purchase of a commodity, it can be obtained by price multiplied by quantity purchased. According to total outlay method elasticity of demand is measured by comparing change in total outlay expenditure on the commodity with given change lie price.

By comparing change in outlay we measure price elasticity of demand as following:

(A) Unit elasticity of demand : When the ratio of change in total outlay with given change in price is one or when total outlay remain same with change in price it is called unit elasticity of demand as own in following table.

Price	Quantity demanded	Total outlay Rs.	Elasticity of demand
5	4	20	
4	5	20	1

Above table shows that even when price changes total outlay is constant so elasticity of demand is

(B) Relatively more elastic demand: When with given change in the price of a commodity total expenditure on it increases it is called relatively more elastic demand as shown in the following table.

Price	Quantity demanded	Total outlay Rs.	Elasticity of demand
5	10	50	
4	15	60	>1

The above table show's that when price changes total outlay increases from ₹ 50/- to ₹ 60/- therefore demand is relatively more elastic.

(C) Relatively less elastic demand: When with given change in the price of a commodity total expenditure on the commodity fall it is called a relatively less elastic demand as shown in the following schedule.

Price	Quantity demanded	Total outlay Rs.	Elasticity of demand
5	4	20	
4	3	12	>1

The above table shows that when price fall from is The above table shows that when price fall from is ₹ 4/- to ₹ 3/- total outlay on the commodity declines from ₹ 20/- to ₹ 12/- therefore demand is relatively less elastic .

(2) Explain the relationship between Marginal utility and total utility with the help of diagrams.

(i) Margined utility refers to the addition made to total utility by the consumption of one more unit of a commodity while total utility refers to the sum of the utilities derived by a person from the consumption of all units at a particular point of time.

(ii) With increase in the consumption marginal utility diminishes while total utility increases at diminishing rate with further increase in consumption marginal utility becomes zero when marginal utility is zero total utility is highest this can be explained with help of following schedule and diagram.

Units of mangoes	Marginal utility	Total utility
1	12	12
2	08	20
3	04	24
4	00	24

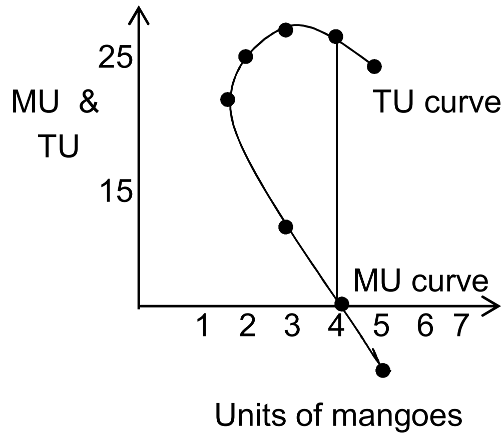
(iii) The table shows that with increase in the consumption marginal utility dimishes while total utility increases at diminishing rate at 4th unit when marginal utility is zero, total utility is highest that is 24 thereafter from 5th unit total utility start declining. This can be explained with the help of besides diagram.

(iv) With the help of diagram relationship between total utility and marginal utility can be explained in brief as follows:

(a) With increase in consumption marginal utility diminishes while total utility increases at diminishing rate.

(b) With further increase in consumption marginal utility becomes zero when marginal utility total utility is highest.

(c) With further increase in consumption marginal utility becomes negative, when marginal utility is negative total utility .starts diminishing.



(3) Central Bank of the country has the monopoly of note issue "Explain".

Central bank is apex monetary institution of the country which controls and regulates s of money and banking business in the country.

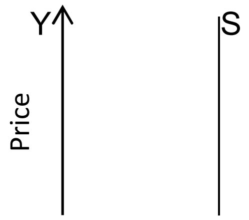
(i) Central Bank enjoy monopoly right of issuing currency notes. In India Reserve Bank of In our Central Bank. It was established on 1st April 1935 and nationalized on 1st Jan 1949.

(ii) It has given monopoly right of issuing currency notes. Currency notes of ₹ 2, 5, 10, 50, 100, 500 and 1000 are issued by Reserve Bank of India and coins of small denominations are issued by ministry of finance government of India but circulated through RBI.

(iii) To have control oil issuing money and maintain uniformity in issuing currency notes. RBI is given monopoly power of issuing currency notes.

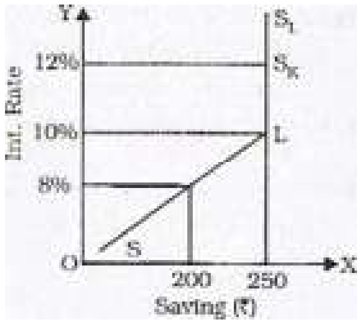
(4) What are the exceptions to the law of supply?

i) Rare collections : In the ease of rare collections like old stamps, old coins, old photographs, old currency notes etc. even if price rise or fall supply wall remain unchanged as shown below. In the diagram supply curve 'SS' which is vertical straight line parallel to OY axis indicates that even if price rise or fall supply will remain unchanged.



S

O Q X Quantity Supplied

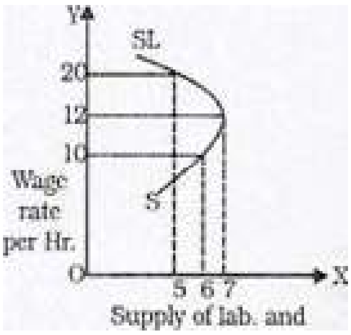


(ii) Saving : In the case of saving with rise in the interest rate supply of saving will rise up to some extent but there after it will remain constant as shown in the diagram because after certain limit person may not be able to save as shown in the diagram.

In the diagram SL is the supply curve of saving which slopes upward upto L point with increase in interest rate but there alter with increase in interest it becomes vertical line from L to SL point and it indicates that supply of saving is exception to this law.

(iii) Labour : In the case of labour with increase in wage rate supply of labour will increase up to some extent but thereafter even at highter wage rate labour prefer rest to work therefore supply of labour will be backward ending as shown in the diagram.

In the diagram 'SSL' is the supply curve of labour which is backward ending it slopes upward up to some extent i.e. when wage rate rises from S. 10/ to Rs. 12/ per hour, but when wage rate rises to Rs. 20/ per our. labour prefer rest to work therefore supply of labour is backward ending because with less hours of work labour earns more.



(iv) Sellers need for cash : When seller is in urgent need for cash even at lower price seller will supply more quantity and when seller is not in the need of cash even at higher rice he will supply less quantity.

(v) Agriculture product : In the case of agriculture product supply depend upon natural factors, therefore in the year of bumper crop even at lower price supply will be more and vice versa.

(vi) Self consumption : When seller require more quantity for self consumption even at higher price he will not supply more quantity and vice versa.

(vii) Fashion : When a commodity goes out of fashion to clear the stock of a commodity even at lower price supply will be more and vice versa.

(5) What are the features of perfect competition?

Perfect competition is a market in which there are large number of buyers large number of filers selling homogeneous product and same price prevails in all parts of the market.

Features of perfect competition:

(i) Large Number of sellers: Under perfect competition there arc very large number of sellers in the market, each one of them sell very small portion of total market demand, seller under perfect competition is price taker he has to decide how much to sale at given market price either by selling more/less he cannot influence market price. His position is like a drop of water in the sea.

(ii) Large Number of Buyers: Like sellers there are very large number of buyers in the market. Like seller buyer is also price taker, either by demanding more / less buyers also cannot influence market rice his position is also like a drop of water in the sea.

(iii) Homogeneous Product: All units of a commodity sold under perfect competition are perfectly homogenous to each other in respect of size. Weight, colour taste, price, shape etc. So that a consumer m buy from any seller and same price prevails in all parts of the market.

(iv) Free entry and exit: There is freedom of entry mid exit to both buyers and sellers of a commodity any buyer or seller can enter or exit from market at any time, there is no any restriction.

(v) Perfect Knowledge: It is assumed that both buyers as well as sellers have perfect knowledge bout market so that no one can able to buy or sell at lower or higher price.

(vi) Perfect Mobility of factors of production: Under perfect competition It is assumed that factors of production i.e. land, labour capital and organization are perfectly mobile from one place to another place and one occupation to another occupation as per their ability.

(vii) Absence of transport cost : It is assumed that there is no transport cost so that goods can be sold at uniform price all over the market.

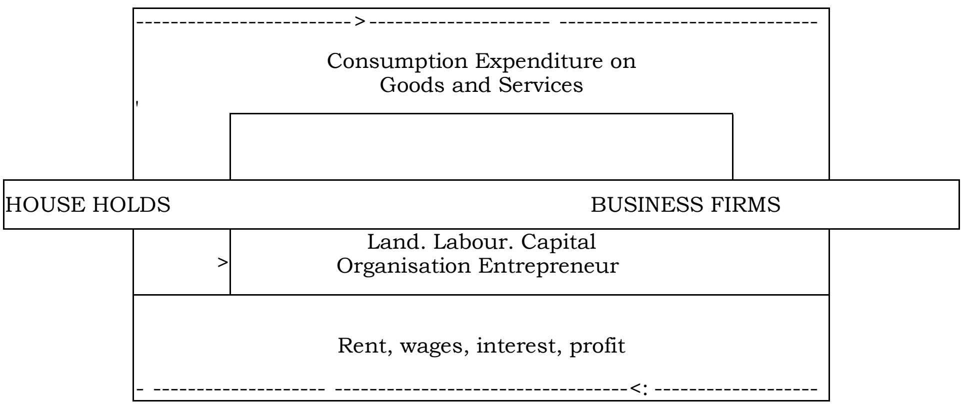
(viii) Non intervention by the government: It is assumed that government follows the policy of on intervention or laissez faire policy and provide complete freedom to both buyers as well as sellers to take their own decisions

(6) Circular flow of National Income.

(i) Circular flow of national income refers to the flow of real goods and services and money business firms to households and household to business firms

(ii) In any economy economic activities are undertaken by two basic units that is business firm households. Business firm is the basic production unit while household is the basic consumption

(iii) The nature of economic activity in any economy can be explained with the help of following diagram.



(iv) In the above diagram two units of the economy i.e. Business firms and households are shown. To produce goods and services business firm hire factors of production that is land, labour, capita organisation. Business firm uses these factors and pay rent, wages, interest and profit to house and flow of money starts, when household purchases goods and services from business firm by spending money in the form of consumption expenditure again flow of money flows to business firms an circle is completed. Thus, circular flow of national income refers to the flow of real goods and services mid money from business firms to households and households to business firms.

Q.5. State with reasons whether you agree or disagree (Any Three) [12]

(1) There are no real exceptions to the law of Diminishing marginal utility.

Ans: I agree with the statement that there are no real exceptions to the law of diminishing marginal i'ility even though following are exceptions to the law of diminishing marginal utility.

Reasons:

Exceptions to the Law: Following are the exceptions to this law:

(1) Hobbies : This law is not applicable to hobbies like, stamp collection, coin collection, etc. where the person derives more and more utility from every additional stamp or coin. But this is not a genuine exception because the homogeneity condition of the law is violated. Each time a new variety of stamp is collected, therefore satisfaction increases, but if the stamps are of the same type, marginal utility diminishes.

(ii) Drunkards : This law is said to be not applicable to a drunkard because his satisfaction increases with every glass of liquor. This is true, but here the condition of rationality of the law is not fulfilled. A drunkard's behaviour is quite irrational.

(iii) Misers: It is said that the law cannot be applied to miser who derive more and more utility from more and more money but even here it can be argued that the miser is an abnormal person and the condition of rationality is not fulfilled.

(iv) Music and poetry : In the case of music and poetry it is commonly experienced that a repeated rearing gives a better satisfaction than the first one and so the law is inapplicable, but it may be said that the repeated hearing of the same song will surely prove to be monotonous and give less satisfaction.

(v) Money : It is said that the law is not applicable to money. But this is not true. Money is only a medium of exchange. Since wants are multiple, every additional rupees fufills a new want. Thus, homogenity condition is not fulfilled.

(2) There are no exceptions to the law of demand.

Ans: No. **I do not agree** with the statement, that there are no exceptions to the law of demand because following are the exceptions to the law of demand.

Reasons:

(i) Inferior goods : Inferior goods refers to those goods which are used by poor people they are low quality and low price commodities. If prices of such commodities fall demand for them also falls.

(ii) Prestige goods : It refers to those goods which arc used by rich people to show their richness in the society when prices of costly goods are higher demand for such goods from rich people will be higher.

(iii) Giffen goods : It refers to those goods in case of which if price is higher demand is more and if price is lower demand is less. Sir Robert Giften in 19th century studies, demand for bread and meat in Britain in the case of bread i.e. low quality and low price commodity he found that when price of bread was lower demand for bread was less and when price of bread was higher demand for bread was higher Ills is called Gif fen's paradox.

(iv) Necessaries : In the case of necessary goods even if price rises or fall demand for them wall remain same.

(v) Quality : If the price of a commodity is higher due to improvement in the quality and if a consumer is aware of it then even at higher price demand will not fall.

(vi) Fashion : When a commodity goes out of fashion even at lower price demand for it will be less.

(vii) Demonstration effect : There is a tendency on part of low income group people to follow standard of living of high income group people. In such cases even at higher price demand will be more and vice versa.

(viii) Price illusion : When a consumer is governed by wrong belief that higher the price higher is the quality and lower the price lower is the quality then even at higher price demand for a commodity will be more.

Thus there are many exceptions to the law of demand therefore I do not agree with this statement.

(3) Single seller is the only feature of monopoly.

Ans: I **do not agree** with the statement that single seller is the only feature of monopoly because following are feature of monopoly.

Reasons:

(i) Single seller : In monopoly there is a single seller of a commodity who controls and regulate market supply of a commodity.

(ii) Large Number of Buyers : Under monopoly there are very large number of buyers in the market, who have to borrow goods supplied by monopolist.

(iii) No freedom of entry to seller : There is no freedom of entry to new seller in the market En of new firm is restricted either by natural, legal, technological or any other barrier.

(iv) Price discrimination : Since there is single seller of a commodity he can follow pr, discrimination that is to charge different price to different buyers.

(v) Abnormal profit : Since there is a single seller of a commodity and he can fix the price, he charge higher price for the product and earn abnormal profit.

(**vi) A seller can fix price or output:** A seller can fix either higher price or higher sell or output a not both because seller has control only on supply and not on demand because demand side is controlled by the consumer if seller charges higher price a consumer will demand less therefore seller cannot fix higher price and sell more quantity.

(vii) Product differentiation : A seller can also follow product differentiation by making differed in the taste, size, quality of product etc.

(viii) Downward slopping demand curve : In a monopoly market seller faces downward slopping demand curve which indicate that a seller can sell more quantity only at lower price if he charges higher price he cannot sell more quantity.

Thus there are many features of monopoly so single seller is the only feature of monopoly this statement is not correct and so I am not agree with it.

(4) Natural Resource is the only determinant of aggregate supply.

Ans: No. **I do not agree** with the statement that natural resources is the only determinant of aggregate demand because aggregate demand depend up on (1) Natural resources (2) Labour (3) Capital (4) Technology

Aggregate supply function can be explained as follows.

Asf = f (N. L. K. T)

Where : Asf = Aggregate supply N = Natural Resources L = Labour, K = capital

T = Technology given and (remain constant)

Let us discuss these determinants in detail :

Reasons:

(i) Natural Resources (N) : Natural resources include all free gifts of nature available in their natural form on the earth above the earth and below the surface of earth, it includes Land, fertility of Land, rivers, mountains seashore, forest, mineral deposits like iron, bronze, copper, gold, silver reservoirs like petrol, disel, etc. If natural resources in the country are more aggregate supply will be more.

(ii) Labour (L) : In economics labour refers to "any exertion of mind or body undergone partly or wholly to get some reward rather than the pleasure derived from the work" If supply of labour is ma they are skilled mid efficient aggregate supply will lie more.

(iii) Capital (K) : In Economics Capital is defined as "man made means of production which is used for further production of goods and services" capital include Machinery, plant factory building equipment raw material etc. If the stock of capital in the country is more aggregate supply will be more.

(iv) Technology (T) : There are two techniques of production i.e. Labour intensive and capital intensive. If labour intensive technique is used aggregate supply will be less and if capital intensive technique is used aggregate supply will be more.

Thus aggregate supply is determined by Natural resources, labour, capital and technology therefore I am **not agree** with the statement.

(5) Money performs some secondary functions also.

Ans: I **do agree** with the statement that money performs some secondary functions.

Money means anything which is generally accepted as a medium of exchange, measure of value, standard of deferred payment & store of value. First two functions are primary functions & last functions are secondary functions.

Let us discuss secondary functions of Money.

Reasons:

(a) Standard of deferred payment : Money performs this function because the value of money remains more or less stable. Therefore, credit transactions which me necessary for the development of business becomes possible due to use of money. In such transactions goods or services are pure! and used in the current period while payment is made infuture.

(b) Store of value: Money also used as store of value. Saving which is the life blood of modern economic system is possible only due to use of money. Saving in terms of money is possible because value of money remains more or less stable & changes in value are compensated with payment of interest, Thus, standard of deferred payment & store of value are two secondary functions of money.

(6) Macro Economics deals with the whole economy.

Ans: Yes**, I do agree** with this statement. The word macro is derived from the Greek word 'Makros' which means large or aggregate. Macro economics is a branch of Economics which deals with aggregate behavior of an economy as a whole. Macro Economics deals with aggregates and their determination.

Reasons:

The subject matter of macro economics

(i) The theory of income: It discuss about determination, measurement and analysis of national income.

(ii) Theory of employment: It is related to determination of the level of unemployment different types of unemployment that is open, disguised, technical, frictional, cyclical, seasonal unemployment and policies to solve unemployment problems.

(iii) Price stability: It discuss about the trade cycles, inflation, deflation and macro economic policies to have price stability.

(iv) Existence of full employment: Macro economic theory also deals with measures to be taken to achieve full employment and monetary and budgetary policies for achieving full employment.

(v) Economic growth: Macro economics also deals about different theories and policies for economic growth.

(vi) Economic justice: Macro economics also deals with policy measures to have economic justice and formulation of taxation policy budgetary policies to achieve economic justice.

(vii) Improvement in common standard of living: Macro economics deals with distribution of national income and improve common standard of living of all people so as to provide benefits of economics development to all sections of the society. In short the subject matter of macro economics is related to monetary policy, fiscal policy, income policy, trade policy, industrial policy, import and export policy, monetary policy, economic planning etc.

Thus macro economics deals with aggregate economic behavior of an economy. So. macro economics deals with whole economy.

Q.6. Answer in detail (Any Two) **[16]**

(1) Explain the equilibrium between aggregate demand and aggregate supply.

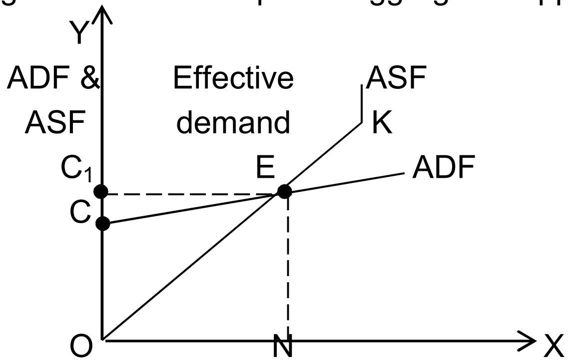
(i) The concept of effective demand is given by J.M. Keynes in his book 'The General Theory of Employment Interest and Money.

(ii) According to Keynes effective demand refers to the level of demand at which aggregate demand is equal to aggregate supply. Thus effective demand is the equilibrium between total demand and total supply, so that entrepreneurs have no intention to expand or contract output.

The diagram indicate determination of effective demand.

(iii) In the diagram OX axis indicate level of employment OY axis indicates aggregate demand and supply. ASF is aggregate supply function curve mid ADF aggregate demand function curve, ADF intersect ASF curve at E point where effective demand is determined ON is the level of employment and OC_1 is the level of ASF and ADF.

(iv) Thus according to J.M. Keynes effective demand is determined at the point where aggregate demand is equal to aggregate supply.



Level of employment

(2) Explain types of price elasticity of supply.

Ans: When price of a commodity changes demand for it will either extend, contract or remain same This response of change in quantity demanded to given change in the price Is measured by price elasticity demand

Definition : "Price elasticity of demand refers to the degree of responsiveness of quantity demanded with given change in the price of a commodity assuming that except price all other conditions of demand remain same

Price elasticity of demand = $\frac{\%\, of\ change\ in\ Quantity\ Demanded}{\%\ of\ change\ in\ the\ price}$ or

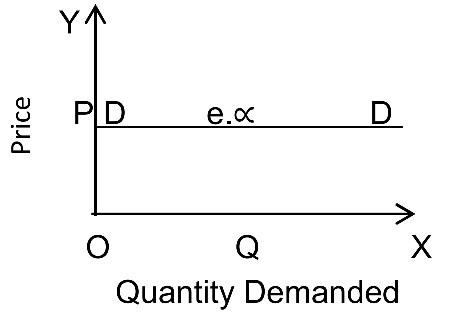
AQ $\frac{\Delta\, Q/Q}{\Delta P/P}$

where : AQ = Change in quantity demanded
Q = Original demand
ΔP = Change in price
P = Original price

Type of price elasticity of demand :

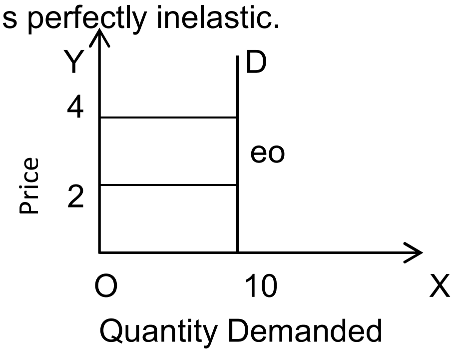
(i) Perfectly elastic demand ($e\alpha$): When responsiveness of change in quantity demanded to given change in price is infinite it is called perfectly elastic demand as shown in the diagram.

In the above diagram curve DD which is horizontal straight line parallel to OX axis indicate that demand is perfectly elastic.



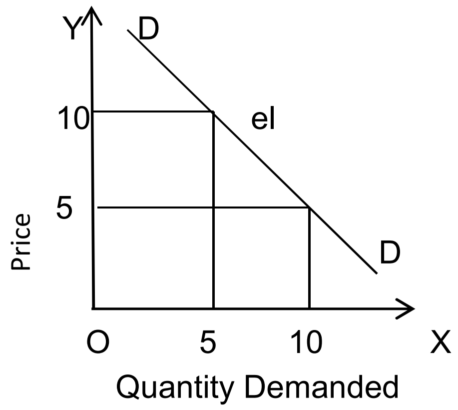
(ii) Perfectly inelastic demand (eo) : When responsiveness of change in quantity demanded to given change in price is zero, it is called perfectly inelastic demand as shown in the diagram.

In the diagram demand curve DD which is vertical straight line parallel to OX axis indicate that demand is perfectly inelastic.



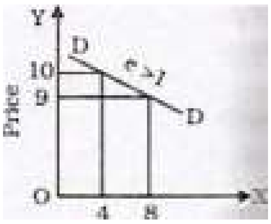
(iii) Unit elasticity of demand: When responsiveness of change in quantity demanded to given change in the price is exactly proportionate it is called unit elasticity of demand as shown in the diagram.

In the diagram demand curve DD which is downward slopping and haring proportionate distance towards ox and OY axis indicate that demand is unit elastic.



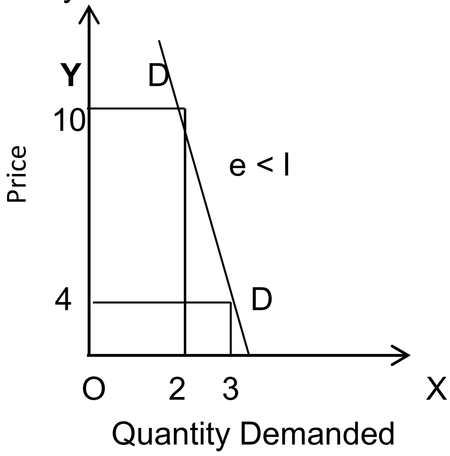
(iv) Relatively more elastic demand (e > 1): When the responsiveness of change in quantity demanded to given change in price is more than proportionate it is called relatively more elastic demand as shown in the diagram.

In the diagram demand curve DD which is flatter and downward slopping indicates that demand is relatively more elastic.



(v) Relatively less elastic demand (e < 1): When the responsiveness of change in quantity demanded to given change in price is less than proportionate it is called relatively less elastic demand as shown in the diagram.

In the diagram demand curve DD which is Steper and downward slopping indicates that demand is relatively less elastic.



(3) Explain the law of demand and state its assumptions.

Introduction : Law of demand is one of the most important basic laws of consumption in Economics Ir is given by Alfred Marshall in his book 'Principles of economies'. It is based on utility analysis.

Statement of law : The law of demand states that "Other things being equal demand varies, inversely with the price".

Explanation of the statement : The law of demand is the general experience of all of us. Demand rises with a fall in price & contracts with rise in price. Thus we say that demand is a function of price i.e. demand depends upon price 6c demand is inversely realted to price. However the law becomes applicable when other things remaining same i.e. ceteris paribus.

Assumption :

(i) No change in population, (ii) No change in prices of related goods, (iii) No change in fashion or taste, (iv) No change in weather, (v) No change in quantity of money in circulation, (vi) No change in age- composition. (vii) No change in sex ratio, (viii) No change in prices of substitutes, (Ix) No introduction of ('heap & improved substitutes (x) No change in habits Si customs, (xi) No change in wealth distribution, (xii) No change in technical knowledge, (xiii) No advertisements 6c high pressure salesmanship, (xiv) No expectations about changes in price.

Schedule : As per the law of demand at any give time the demand for a commodity or service at prevailing price is greater than what it would be at higher price and lesser than what it would be at a lower price.

Demand Schedule

Explanation of the schedule:

Like other laws in economics the law of demand is also better explained with the help of demand Schedule. The demand schedule is a tabular representation of the various

Price per kg in ?	Quantity of sugar demanded in kgs				Total
	A	B	C	D	
8	-	1	2	3	6
7	1	2	3	4	10
6	2	3	4	**5**	14
5	3	4	5	6	18
4	4	5	6	7	22

quantities of commodity demanded at different prices during a given period of time.

The above schedule explains the various quantities of sugar demanded by different consume A, B, C, & D at different prices. It also shows the market demand at various prices. The market demand is the sum total of all individuals purchases of sugar. Thus the market demand rises at lower price 6c vice versa. Which clearly indicates the inverse relationship between demand & price.

Explanation of diagram :

In the above diagram the quantity of sugar demanded is shown along X-axis & the price per kg is shown along Y-axis. By plotting the points of total demand & joining these points of total demand we get a continuous line, we get the demand curve (DD).

It is observed that the demand curve slopes downwards from left to right. It shows inverse relationship between the price of a commodity and it's demand i.e. when price is high demand is low and when price is low demand is high. At original price of ₹`8. Demand is 06 kg. When price falls from ₹ 8 to ₹ 4 demand rises from 6 to 22 kg. respectively.

The various point on the demand curve are alternative & not successive. All the points in the demand curve are imaginary and hypothetical in nature.

Conclusion : From the above discussion it is clear that D = f(P) i.e. demand is the function of price & demand is inversely related to price.

(4) Explain the process of multiple expansion of credit by Commercial Bank.

Ans : Commercial bank is not only custodian of money but in an important sense commercial bank is also manufacture of money, on the basis of primary deposit commercial bank create it's own money which is known as credit money, the process of credit creation can be explained as follows.

On the basis of primary deposits received from depositors commercial bank create it's own credit money, while granting credit, bank ask borrower to open an account in the bank arid issue cheques to his creditors. While cheques ;ire issued credit money is created.

The process of multiple expansion of credit can be explained as follows.

Assumptions:

(1) There are different banks in an economy that is A.B.C.... etc

(2) Primary deposit received by bank A is Rs. 1000/

(3) Cash reserve ratio is 10%

When bank A receive deposit of Rs. 1000/- and maintain 10% cash reserve ratio it's balance sheet will be as follows.

Balance sheet of Bank A

Liabilities	Rs.	Assets	Rs.
Deposit	1000	Cash	100
		Loan to Mr. x	900
	1000		1000

When loan is received by Mr. X he issue cheque to his creditor worth ` 900/- having a/c in the Bank 'B' when he deposit his cheque in Bank 'B' the balance sheet of bank 'B' will be as follows.

Balance sheet of Bank B

Liabilities	Amt. Rs.	Assets	Amt. Rs.
Deposit	900	Cash	90
		Loan to Mr. Y	810
	900		900

Balance sheet of Bank C

Liabilities	Amt. Rs.	Assets	Amt. Rs.
Deposit	810	Cash	81
		Loan to Mr.K	729
	810		810

When Mr. K get loan of Rs. 729, again he deposit the cheque in his bank thus deposit becoming loan and loan becoming deposit will continue till the primary deposit is used as cash reserve. How much credit money can be created by commercial bank can be explained with help of following formula

$K \frac{1}{r}$ Where K = Deposit multiplier

1 = Primary deposit

r = cash reserve ratio.

Primary deposit Rs. 1000/- Cash reserve ratio 10%

$K \frac{1}{r}$ $K = \frac{1000/10}{100}$

₹ 10,000 = $\frac{1000}{1} \times \frac{100}{10}$ Credit money ₹ 10,000/-

Thus commercial bank is not only custodian of money but in an important sense commercial bank also create credit money.

x---x----x----x----x---x