J. K. SHAH CLASSES

SYJC - ECONOMICS

PRELIMINARY TEST - 1

Branch - Andheri , Borivli & Vasai **Date: 23 /12/2016**

Total Marks : 80 **Total time: 3 hours**

A.1. Select the paper option from the brackets given & rewrite the same. (5 marks)

1. (c) slicing
2 (b) fall
3. (c) J.M. Keynes
4. (c)1935
5. (d) An Organization

A (B) Match the following. (5Marks)

A	B
1. Fees, License fee	a. Transfer Income
2. Near money	b. Creating Utility
3. Unemployment allowance	c. Rightward shift in supply curve
4. Production	d. Leftward shift in supply curve
5. Increase in Supply	e. Fiat Money
	f. Tax Revenue
	g. Bins of exchange
	h. Non- tax revenue

C. State True or false (6 marks)

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

A.2. Define/ Explain the concepts [Any-3] (6 Marks)

1. **Micro Economics.**

Ans. Meaning and Definitions of Micro Economics.

Micro means a small part of a thing. Mi Economics thus deals with a small part of national economy. It studies the economic actions and behavior of individual units such as individual consumer, individual producer or firm, the price a particular commodity or factor etc.

Let us discuss some important definitions Micro Economics to understand it's meaning, nature & subject matter.

(1) According to Kenneth Boulding "Micro Economics is the study of particular firms

particular households, individual prices, wags, incomes, individual industries, particular commodities."

It means Micro Economics is a study economic activity of households as consumption unit, individual firms & industries as production unit and individual prices, wag incomes and their determination.

(2) In the words of Maurice Dobb, "Micro Economics is in fact a microscopic study

the economy".

It means in Micro Economic analysis each individual unit is examined separately detail.

2. Labour.

Labour: Meaning and Features

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

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

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

1) Inseparable from the body of the worker -

Labourer and his work always goes together. Hence, labourer must be present himself where he suppose to render his services.

2) Human and active factor of production -

Labour being a human factor has feelings, likes and dislikes. Therefore, he cannot be treated as a machine. Other factors become productive only after the application of labour. So labour is the most active factor of production.

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

4) Restricted mobility: According to Adam Smith, "Of all the luggages, the labour is the most difficult to be transported." Labour can move from one country to another country in the same way. Labour can change his business easily, but due to the family attachment, housing problems, climate etc., restricts geographic mobility of labour.

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

6) **Efficiency of labour -**Efficiency of labour differs from worker to worker. These differences are on account of a number of factors such as training, education, surrounding, culture, physical strength etc. Thus, labour is a heterogeneous factor of production, that's why labour is categorized under different classes such as skilled labour, semi-skilled labour and unskilled labour.

7) **Less bargaining power -** Individual worker has weak bargaining power. They are helpless to accept the low wages offered to them, rather than remaining unemployed. However, in modern days trade unions fights for the rights of the labour. Labour can form a trade union, and through trade union they can put forward their demands for better working conditions, higher wages etc.

8) **Inelastic Supply of labour** -Supply of labour is relatively inelastic during the short period of time this is because working population is between the age group i.e. 15-59. Supply of labour cannot be quickly increased or decreased to meet the changes in the demand for it.

3. Cash reserve Ratio.

Variable Cash Reserve Ratio

Lord J.M. Keynes has popularized this as a method of credit control by the Central Banks.

a) **Cash Reserve Ratio (C.R.R.)**

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

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

An increase in Cash Reserve Ratio leads to a contraction of credit, increase in lending interest rates and a reduction in money supply in the economy. This can reduce inflationary pressures.

A decrease in Cash Reserve Ratio leads to an expansion of credit, a decrease in lending interest rates and an increase in money supply in the economy.

When Central Bank wants to reduce money a supply, the C.R.R. will be raised, and it will be reduced to expand the quantity of money. It is a very effective instrument as it affects the base of credit creation.

4. Monopoly.

Ans - Monopoly

Meaning and its Features

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

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

According to Chemberlin, "A monopoly refers to a single firm, which has control over the supply of a product, which has no close substitute.

Features of Monopoly

1) **Single seller**

In a monopoly market there is a single seller or a single producer. Under monopoly he has no rivals and he faces no competition.

2) **No close substitute**

There are no close substitutes for the commodity sold in the market. Likewise other firms may not produce the same product. Hence, monopolists do not face any competition.

3) **Barriers to entry**

Under monopoly the entry of other firm is strictly restricted. The seller has complete hold over the supply in the market. Such provision protects the monopoly powers.

4) **No distinction between firm and the industry**

Under monopoly there is only one seller, there is no distinction between the firm and the industry. Thus, under monopoly the firm is an industry.

5) **Control over the market supply**

The monopolist has complete hold over the market supply. He is a sole producer of the commodity. Therefore entry barriers such as natural, economic, technological or legal do not allow competitors to enter the market.

6) **Price maker**

The firm under monopoly is price maker and not the price taker. He can charge any price for the commodity as he has complete control over the supply of the product.

7) **Super normal profit**

The monopolist always wants to earn supernormal profit. His decision regarding the price and the level of output are guided by the profit maximization motive. Thus, sometimes at high price, he supplies the product as per the demand and sometimes he controls the supply of the product and sells the product at high prices.

8) **Price discrimination**

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

5. **Deficit Budget.**

Ans - Deficit Budget:

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

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

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

6. **Lumping Method.**

Ans. Lumping method

Macro analysis deals with the behaviour of aggregates i.e. total values of economic variables related to whole economy. It uses method of lumping to deal with macro variables, such as aggregate demand, aggregate supply, national output etc.

Q.2 (b) Give Reasons [Any-3] (6 Marks)

1 - The CRR affects the lending capacity of the banks.

Ans. i. Direct effect.

CRR acts as a quick and direct method of controlling credit. Changes in the cash reserve ratio affects the size of excess cash reserves with commercial bank. It will have direct impact on their capacity to create credit.

ii. Contraction of credit.

Whenever the bank raises the cash reserve ratio, it reduces the excess cash reserves and restricts credit. It reduces money circulation and controls inflation.

iii. Expansion of credit.

Similarly, a fall in cash reserve ratio leaves large excess reserve with the commercial banks and expands credit. This would expand money circulation and controls deflation.

iv. More effective than other methods.

The method of varying cash reserve ratio will have more effect than other measures. Central bank need not depend upon or persuade commercial banks to bring effect. Expansion or contraction of credit can be done simply by a stroke of pen.

2. Saving account deposits are usually operated by salaried class.

Ans. i) Safety, security and transaction.

Generally salaried class open saving account for purpose of transaction. It also assures them safety and security.

ii) Helps to avoid risk.

Salaried people from middle class are not risk takers. They are not interested in investing their money in risky fields. They prefer riskless saving account with nominal interest.

iii) Suits salaried people.

Many organisations especially government organisation pay salaries to their employees through banks. Thus it becomes customers for salaried people to start saving accounts.

iv) Middle class and lower middle class prefer saving account to other accounts.

Saving accounts suit the requirements of middle class and lower idle class who are salaried people. Such accounts make them convenient and comfortable.

3. National Income estimates are accurate in India.

Ans. In countries like India, it is not possible to have complete accuracy in the calculation of national income due to the following difficulties.

(i) Non-monetized Sector:

National income means money value of all the goods and services. In India, a significant preparation of transactions is carried out under barter system. For e.g. Agricultural sector still practise barter system. Such exchanges carry no money value and can not be included.

(ii) Statistical Data :

It is difficult to collect exact information of incomes of all people in a country like India. The data of output and incomes may be shown less for income tax purpose.

(iii) Illiteracy and ignorance :

In underdeveloped countries like India, people who are illiterates do not keep accounts of income and output. They are so ignorant that they even do not know their exact income and expenditure.

(iv) Illegal Activities and Black money:

Incomes of illegal activities like smuggling cannot be included in national income. Many a times, people show only a fraction of their and rest is kept as black money.

4. Labour cannot be stored.

Ans. i) Labour and labourercan not be separated. Capital can be separated from capitalist and stored. But labourcan not be separated from labourer. The labourer must be present when labour is being used.

ii. Labour lost once is lost forever.

If a worker is absent today, today's labour is lost. He can't recover the lost labour. Labour once lost is lost forever. Therefore it is not possible to store it at present and use in future.

iii. Labour is invisible talent.

Labour is a kind of talent or skill which is invisible. Whether it is physical or mental work, it has no shape or structure. Labour is not the person but the personal talent of that person. Therefore it can not be stored.

iv. Labour is a qualitative aspect.

Labour is a quality. Qualities like intelligence, beauty can not be separated and stored in a place. Similarly labour is a human quality which cannot be separated.

5. Price discrimination is possible under monopoly.

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

1. Complete control.

Price discrimination refers to the policy of charging different prices from different customers for the same product or service. Monopoly being a single firm controlling the entire market, it is in a position to adopt the policy of discrimination.

2. Price discriminating monopoly.

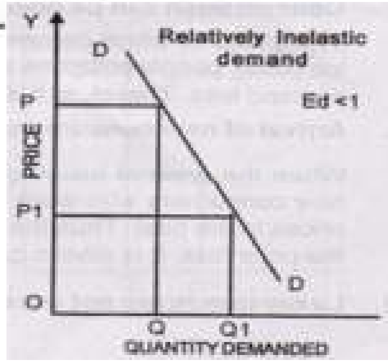
Monopoly that practises price discrimination is called discriminating monopoly. As the monopolist enjoys controll over two or more than two markets for the same product it is possbile for him to go for price discrimination.

3. Difference in elasticity of demand.

When the monopolist finds difference in elasticity of demand in different areas he can adopt price discrimination. He can charge less price for the market having elastic demand and higher price for market having inelastic demand.

4. Resale not possible.

Price discrimination is possible when the resale of a product or a service is not possible. For example a lone doctor in a particular region can charge higher fees from rich people and lower fees from the poor. This is because the poor person can not go for resale of doctor's service at a higher price to another person.



6. Demand for necessaries is inelastic.

Ans. i. Necessary goods have inelastic demand.

Generally, all necessary goods have inelastic demand. Medicine, salt and agricultural goods are necessary goods. So their demand is inelastic, i.e. whatever may be the price, the consumer will continue to demand more or less the same quantity of the commodity.

ii. Commodities which have a specific use will have inelastic demand.

Salt, food and medicine and agricultural goods can be used only for a specific use and therefore their demand is inelastic.

iii. Consumption cannot be postponed.

Necessary goods are important for survival. People cannot postpone consumption of such goods. Therefore the demand for such goods is inelastic.

iv. A lower percentage of change in price leads to higher percentage of change.

In case of necessary goods like medicine, salt and agricultural goods (food), a higher proportionate change in price leads to a lower proportionate change in demand, (i.e.) change in demand is smaller than change in price. Thus they have inelastic demand.

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

1. Micro Economics and Macro Economics

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

2. Output method of measuring national income and Income method of measuring national income.

Ans.

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

and services act as the main determinants of national income	determinant of national income.

3. Exports and Imports

	Exports	Imports
1. Meaning	Exports refers to those goods which are sold in the foreign market via foreign trade.	Imports refers to those goods which are bought in the foreign market via foreign trade.
2. Balance of payment position	If exports exceed imports, it results in favourable balance of payment position.	If imports exceed exports, the country faces unfavourable balance of payment position.
3. Aggregate demand & supply	Exports are added to aggregate demand.	Imports are added to aggregate supply.

4. Direct Tax and Indirect Tax

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

5. Fixed capital and variable capital

Ans.

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	Variable capital changes with

the short run irrespective of changes in the output. However, in the long run, fixed capital is variable.	change in the output.
When.	
Fixed capital arises even when there is no production.	Variable capital is required only when the production is on.

6 **Stock and Supply**

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

Q.3.(B) Write Short Notes [Any Two] (6 Marks)

1. Types of monopoly.

2. Types of budget.

1. Types of Monopoly

1) Natural monopoly

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

2) Public monopoly

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

3) Private monopoly

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

4) Legal monopoly

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

5) Simple monopoly

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

6) Discriminating monopoly

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

7) Voluntary monopoly

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

2. Types of Government Budget

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

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

1. Balanced Budget
2. Surplus
3. Deficit Budget

3. Concepts of Cost:

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

1. **Total Cost:** Total Cost (TC) is the total expenditure incurred by a firm on the factors of production required for the production of goods and services. Total cost is the sum of total fixed cost (TFC) and Total Variable cost (TVC) at various levels of output. Thus,

   TC = TFC + TVC

   TFC = Cost which is incurred on fixed factor of production like land.

   TVC = Cost which is incurred on variable factors like labour, raw material, etc.

4. Determinants of demand. **Pending**

Ans.4. Write short answers [Any-3] (12 marks)

1. TYPES OF MONEY-

1. COMMODITY MONEY

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

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

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

2. Metallic Money

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

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

a) Standard or full-bodied coins

b) Token coins.

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

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

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

Following factors gave rise to the introduction of paper money.

1) Difficulty in transferring large sums of metallic money.

2) Supply of gold and silver lagging far behind the demand for money.

3) Loss of weight and value of coins due to wear and tear, etc.

2. Determinants of Market Supply

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

1) **Price of a commodity:** Price is an important factor influencing the supply of a commodity. More is supplied at a higher price and less is supplied at a lower price.

2) **Cost of Production:** If the factor price increases the cost of production also increases. Thus, supply decreases.

3) **State of Technology:** Technological improvements reduce the cost of production, which leads to an increase in production and supply.

4) **Government Policy:** Government Policies like taxation, subsidies, industrial policies, etc., may encourage or discourage production and supply, depending upon government policy measures.

5) **Nature of Market:** In a competitive market, the supply of goods would be more due to large number of sellers. But in monopoly, i.e., single seller market, supply would be less.

6) **Prices of other Goods:** An increase in the prices of other goods makes them more profitable in comparison to a given commodity. As a result, the firm shifts its limited resources from production of a given commodity to the production of other goods. For example, an increase in the price of wheat will induce the farmer to use his land for the cultivation of wheat instead of rice. So supply of rice decreases.'

7) **Infrastructure Facility:** Infrastructure in the form of transport, communication, power, etc., influences the production process as well as supply. Shortage of these facilities decreases the supply.

8) **Exports and Imports:** Exports reduce the supply of goods within the country. Whereas imports increase the supply of goods.

9) **Future Expectations:** If the prices are expected to rise in the near future, the producer may with hold the stock. This will reduce the supply.

10) **Natural Conditions:** The supply of agricultural products depends on the natural conditions. For example, a good monsoon and favourable climatic condition will produce a good harvest, so the supply of agricultural products will increase.

3. Explain features of Labour.

Labour: Meaning and Features

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4. Explain historical review of Macro Economics.

Ans. Historical Review of Macro Economies

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

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

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

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

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

5. Explain Giffens Paradox.

Ans. Following are the exceptions to law of demand.

(i) Giffen goods or Giffen Paradox.

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

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

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

The real income (purchasing power) declines.

Therefore the poor people are compelled

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

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

(ii) Prestige goods (Veblen Effect).

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

(iii) Necessities.

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

(iv) Habitual goods.

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

(v) **Price Illusion.**

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

(vi) **Ignorance effect.**

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

(vii) **Demonstration effect.**

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

(viii) **Emergencies.**

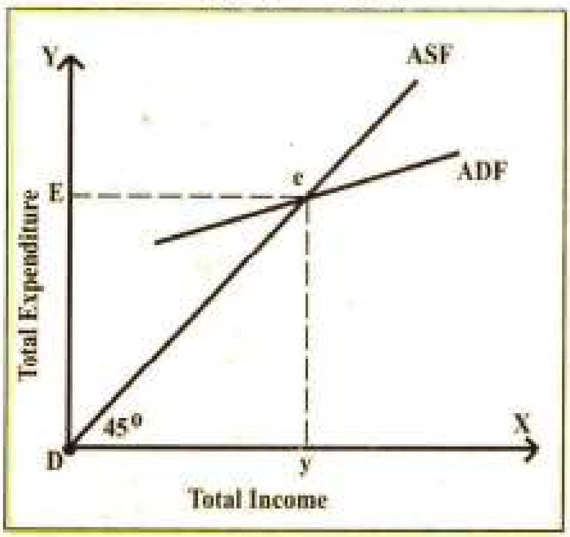
The law is not applicable during emergencies like war, famine etc. The panic striken households create further scarcity by consuming more even at higher prices during such times. Under such situations, the law of demand does not work.

6. Explain Effective demand.

Ans. EFFECTIVE DEMAND

Effective Demand is also called macro-economic equilibrium.
According to Keynes effective demand is determined with the intersection of aggregate demand and aggregate supply in the economy.
The aggregate demand consists of consumption demand, investments demand, government demand, and foreign demand. Similarly aggregate supply depends on natural resources, labour, capital and technology.
The equilibrium point of effective demand is that point, where aggregate demand function equals to aggregate supply function.
Effective Demand can be shown in the following diagram.

Equilibrium between Aggregate Demand & Aggregate Supply.



The diagram indicates.

ASF = Aggregate Supply Function Curve

ADF =Aggregate Demand Function Curve

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

Q.5 Explain do you agree/ disagree [Any 3] (12 marks)

Ans.1. Micro Economics is known as income theory.

Ans. No. I disagree

Micro Economic Theory

- Product pricing
  - Theory of demand
  - Theory of Production cost
- Factor of pricing (Theory of Distribution)
  - Wages
  - Rent
  - Interest
  - Profit

1. **Micro economics is mainly concerned with price determination.**

   Micro economics assumes full employment as given. Therefore its main concern is to study the allocation of resources and price determination. It explains how the resources are allocated and how the prices of millions of goods and services are determined. Since micro economics is concerned with product pricing and factor pricing, it is also known as price theory.

   Macro economics is concerned with study of national income, fluctuations in national income and factors determining national income. Therefore macro economics is known as income theory.

2. **Product pricing.**

   The theory of product pricing is part of micro analysis. Product pricing explains how the relative prices of various goods such as cotton, sugar, car, vegetables, rice, wheat etc are determined.

3. **Factor pricing.**

   Factor pricing which is otherwise known as theory of distribution explains how the prices of various factors are determined. It includes economic theories explaining determination of rewards for factors like land, labour, capital and organisation in the form of rent, wages, interest and profit.

4. **Role of market forces.**

   Micro economics explains that interaction of market forces like demand and supply results in the determination of equilibrium price. It tells us how equilibrium price is determined in product market as well as factor market.

5. **Prices under competition.**

   Micro economics also deals with different competitive market and price determination in such markets.

Micro economics

- Perfect competition
- Monopoly
- Imperfect competition
  - (a) Monopolistic competition
  - (b) Duopoly
  - (c) Oligopoly

It explains the types of market on the basis of degree of competition prevailing in such market. It explains the price determination of firms and industries under different market conditions.

Ans 2.Perfect competition means Monopolistic Competition.

Ans. No I disagree with this statement.

Perfect competition and monopolistic competition are not one and the same. They are different from each other.

1. **Meaning :**

   Perfect competition is a market where large number of sellers selling identical units of the same commodity. The number of sellers and buyers are so large that no single firm or buyer can influence the price. The demand and supply forces operate freely without interference of any external forces. Monopolistic competition is the market where there are many sellers selling same but differentiated products to a large number of buyers. It is the mixture of the features of monopoly and perfect competition.

2. **Homogeneous &heterogeneous products.**

   In a perfectly competitive market, the product is homogeneous in character. There is no product differentiation by the sellers. All the units sold are identical.

   Product differentiation is the vital feature of monopolistic competition. Products are differentiated on the basis of brand name, shape, color, design, quantity and quality.

3. **Price takers and price makers.**

   Under perfect competition, sellers are price takers and not price makers. All buyers follow uniform price.

   Sellers are price makers under monopolistic competition. Different buyers pay different prices for the same product.

4. **Idealistic and realistic markets.**

   Perfect competition is an ideal market which hardly exists.

   Monopolistic competition is the real market which exists practically.

   e.g. Firms manufacturing Tooth Pastes.TV. Sets, Shoes, represent monopolistic competition.

5. **Relationship with monopoly.**

   Perfect competition and monopoly are contradictory to each other. Monopolistic competition is the blending of perfect competition and monopoly.

6. **Average revenue and marginal revenue :**

   Average Revenue and Marginal Revenue curves are one and the same and parallel under perfect competition, i.e. AR = MR.

   AR and MR are different and downward sloping under monopolistic competition. MR remains below AR. MR<AR.

7. **Demand curve.**

   In case of perfect competition demand curve remains a horizontal straight line parallel to x axis. In case of monopolistic competion, the demand curve is downward sloping.

8. **Selling cost**. Selling cost is inevitable under monopolistic competition. In the face of tough competion, the sellers of monopolistic competition spend a significant portion of their revenue towards advertisement, publicity, salesmanship etc.

   There is no selling cost under perfect competition.

9. **Perfect knowledge of market.**

In perfect competition market both buyers and sellers have perfect knowledge regarding price structure and availability of substitute.

In monopolistic competition there are various products possessing same features. There are different brands of the same product which are sold in different prices. It is difficult to have perfect knowledge. In fact sellers adopt campaigns and advertisements to spread knowledge of price structure.

3. Aggregate supply is influenced by the state of technology only.

Ans - Pending

4. The calculation of national income exclude the value of intermediate goods.

Ans. Yes. I agree with the following statement.

1. Only final goods and services are included.

National product is defined as the money value of all final goods and services produced in the economy annually. Therefore there is no possibility of intermediate goods being included in the calculation of national income.

2. Intermediate goods are part of final goods.

Final goods are those goods which are ready for consumption. There is no need to include the value of intermediate goods since they are already a part of final goods. The reason being that no final good can be produced without the use of intermediate goods. Cotton is the intermediate goods for the final good cotton shirt. As cotton is already a part of final good, there is no need for including is separately

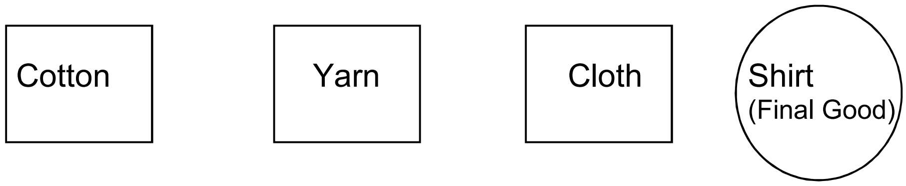
3. Inclusion of intermediate goods leads to double counting

Since the intermediate good sugarcane is part of sugar, inclusion of the value of sugarcane separately amounts to double counting. It results in over estimation of national income.

4. Goods which crosses the production boundary becomes final goods.

The intermediate goods do not cross the production boundary. The production process of intermediate goods is still on. They are not treated as final goods and therefore their value is not included in the calculation of national income.

Final goods are those goods which crosses the production boundary and reaches the consumer. In case of final goods the process is completed. Following example would make the point more clear.



5. Intermediate goods need no be included separately.

in the above example cotton, yarn and cloth are not final goods. Shirt is the final good which includes the value of all intermediate goods. Therefore there is no need to include the value of intermediate goods separately.

6. Final goods may be consumer goods or capital goods.

Cotton is transformed into cotton shirt which is a consumer good. Iron ore is transformed into a machine which is a capita! good. The consumer goods and capital goods are final goods which are included in the estimation of national income.

Ans. 5. Central Bank having monopoly of note issue is most appropriate institute of the government

Yes agree with the following statement.

i. Central bank is the only authority to issue notes.

Central bank is entrusted with the job of printing and issuing currency notes. It is the only bank in country which is authorised to issue currency notes. No commercial bank in India enjoys the power to issue notes.

In India RBI prints and issues ail currency notes except 1 rupee note and coins The central bank has its issue department which issues notes to commercial banks. Though coins are manufactured by government mint, they are circulated by central bank.

ii. Central bank is a legal monopoly to issue notes.

In India Reserve Bank of India acts as the central bank which enjoys the monopoly of note issue. The R.B.I, keeps a minimum reserve to issue currency notes since 1957. Under this system the Reserve banks of India its a minimum reserve of Rs. 200 crores out of which 115 crores must be in gold and the remaining 85 crores in foreign securities. There is no limit for the issue of currency notes.

iii. Notes enjoy distinct prestige.

Notes issued by RBI enjoy distinctive prestige as RBI enjoys the monopoly. Such a distinct prestige make the notes of RB! popular, it enjoys wider recognition. Since the notes are guaranteed by government security, it adds further strength to the dignity of RBI notes. Such prestige and dignity will be lost if commercial banks and co-operative banks are allowed to print notes.

iv. Controlling money supply.

At present size of deposit money and volume of credit creation by commercial banks have been ever expanding. This has created a need for a powerful controlling authority to avoid excess credit creation. The power of monopoly of note issue provides central bank to have absolute control on money circulation.

Ans . 6 Commercial banks perform many general utility services.

Yes. I agree with following statement.

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

1) Safe Deposit Vault:

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

2) Remittance of funds/Transfer of money:

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

3) **Letters of credit:**

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

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

4) **Reference/Status Report:**

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

5) **Underwriter/Underwriting**

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

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

6) **Dealings in foreign exchange:**

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

7) **ATM facility, credit card, debit card:**

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

Q.6 Explain in detail. [Any 2] (16 marks)
1. Explain the law of demand and its expectations.
Ans. Law of Demand

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

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

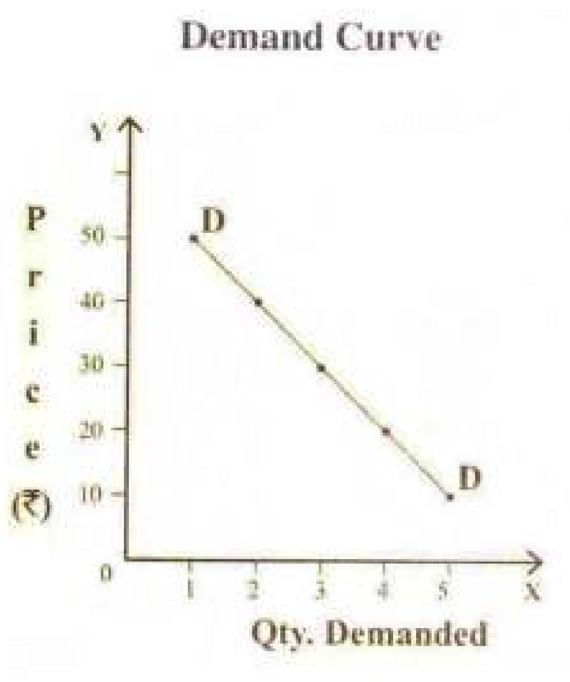
The law of demand explains change in the behaviour of consumer demand due to various changes in price. Marshall's Law of demand describes functional relation between demand and price. It can be expressed as D = f (P) that is demand- function of price. The relation between price and demand is inverse,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

Demand Schedule

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

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

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



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

Why demand curve slopes downwards from left to rignt?

The reasons for downward slopping demand curve are as follows:

1. **The law of diminishing marginal utility:** We have seen that marginal utility goes on diminishing with increasing stock of a commodity. Therefore, a consumer tends to buy more when price falls.
2. **Income effect:** When price falls. purchasing power of a consumer rises, which enables him to buy more of that commodity whose price falls. This is income effect.
3. **Substitution effect:** In case of substitute goods, when price, of a commodity rises. its substitutes become relatively cheaper. , Therefore, a consumer will purchase more of that commodity.
4. **Multipurpose uses:** When a commodity can be used for satisfying several needs, its demand will rise with a fall in its price, and fall with a rise in its price.

Assumptions of the Law of Demand

The law of demand is based on following assumptions.

1. **Size and composition of population remains constant:**

   There should not be any change in the size and composition of population. Because a change in population will bring about a change in demand even if price remains the same.

2. **Income of the consumer remains constant**:

   Income of consumer should remain constant. If there is any change in income, demand tends to change even though price is constant. For . example, if income increases people will demand more quantity of a commodity even at a higher price.

3. **Tastes and habits remain constant:** Taste, habit, custom, tradition and fashion etc. should remain unchanged. Due to changes in taste and preference, people's demand for go undergoes a change.

4. **No change in expectations about future price changes:** There should not be any change in the expectations about the prices of .goods in future. If consumers expect that price will rise or fall in future, they will change their present demand though price is constant**.**

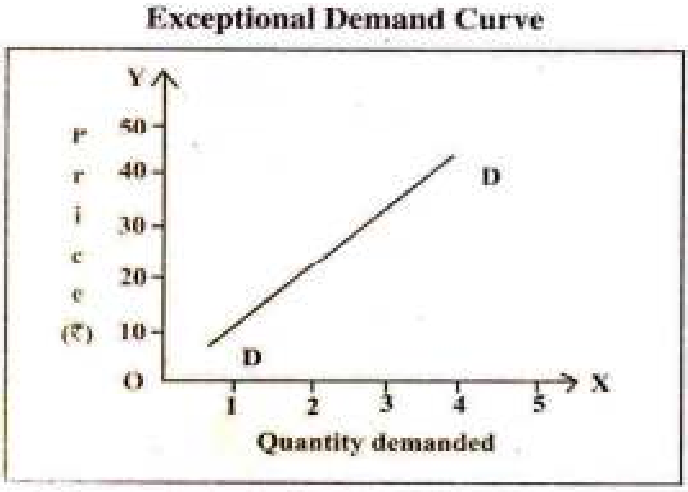
5. **Prices of substitutes and complementary goods remain constant:** The prices of substitute and complementary goods should remain constant. For instance, if price of tea rises its demand will fall. but demand for coffee will increase.

6. **Government Policy .remains constant:** Taxation and fiscal policy of government should not change. A change in income tax. for instance, may cause changes in consumer's disposable income and hence demand.

Exception of Law of Demand

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

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



Following are the exceptions to the Law of Demand.

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

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

2. **Prestige goods**: Diamonds, high priced motor cars, luxurious bungalows are prestige goods. Such goods have a snob appeal". Rich people consume such goods as status symbol. Therefore, when the price of such goods rises I their demand also rises.

3. **Price illusions or Consumers Psychological bias:** Consumers have illusion that high priced goods are of a better quality. Therefore the demand for such goods tends to increase with a rise in their price. e.g. Branded products which are expensive are demanded at high price.
4. **Demonstration effect:** The tendency of low income group to imitate the consumption pattern of high income groups is known as Demonstration effect. For example demand for I consumer durables such as washing machine, latest mobile etc.
5. **Ignorance:** Sometimes people do not have proper market knowledge. They may not be aware of the fall in price, of a commodity and thus they tend to purchase more at a higher.

6. **Speculation:** When people speculate a change in price of a commodity in the future, they may not act according to the Law of demand. People I may tend to buy more at rising price, when they anticipate further price rise. For example, in the stock market people tend to buy more shares at rising prices. Even if prices of some goods like sugar, oil etc. are rising before Diwali, people go on purchasing more of these things at rising prices because they think that prices of these goods may increase, further during Diwali. "

7. **Habitual Goods:** Due to habit of consumption certain goods like tobacco, cigarettes etc. are purchased even if prices are rising. Thus it is an exception.

2. Explain the subjective and objective factors of consumption functions.

Ans. DETERMINANTS OF CONSUMPTION FUNCTION:

The consumption function depends upon the income level. According to Keynes, consumption function is affected by certain subjective (psychological) factors and objective (institutional) factors. These factors can be briefly described as follows:

A) Subjective or Psychological Factors

These factors are internal factors. They are dependent on the psychological characteristics of human nature, institutional pattern and social practices. Basically, they are human behavioural factors, which have an influence on individual's consumption decisions and are fairly stable during the short period.

According to Keynes, individual's nature compels them not to spend their entire income. Hence, they save part of their income. Following are the motives which induce people to save and hence influence consumption levels.

1. **Motive of Precaution**: Generally, people save a large part of their income as a precaution against future unforeseen contingencies and thus, to that extent, the current consumption is reduced.

2. **Motive of Foresight**: Individual has to provide for the future needs like higher education of children, maintenance of dependants, maintenance during old age etc. Hence, individual is likely to reduce his or her present consumption in order to save more.

3. **Motive of Calculation**: In order to earn income, people invest in shares, debentures or other income earning assets. This is likely to reduce their present consumption. Investment decisions depend on future expected trends in the prices of income-earning assets.

4. **Motive of Improvement**: Generally, people have the desire to enjoy improved standard of living and also higher status in the future. Such a motive for improvement reduces current consumption.

5. **Motive of Independence**: In order to attain some measure of independence and power in man's life, man intends to save more. This motive is likely to dampen present consumption.

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

7. **Motive of Pride:** Individual takes pride in leaving substantial wealth to his or her children. Also, a person may like to give donations. Such a motive of pride may dampen present consumption.

8. **Motive of Avarice**: The desire to satisfy pure miserliness i.e. unreasonable but insistant abstinence from expenditure.

(B) OBJECTIVE OR INSTITUTIONAL FACTORS:

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

These are:

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

2) **Change in Disposable Income**: Consumption expenditure depends upon disposable income. If there is a change in disposable income there will be a change in expenditure on consumption.

3) **Change in the Rate of Interest**: Change in the rate of interests is likely to affect consumption function. An increase in the rate of interest may have a dampening impact on consumption. On the others hand, a fall in the rate of interest may encourage people to consume more.

4) **Change in Capital Value (Windfall Gains or Unexpected Gains):** Capital gains are due to sudden change in money value of wealth. The consumption expenditure of wealthy classes is likely to be extremely susceptible to unforeseen change in the value of their wealth. During the period of prosperity, huge unexpected gains or windfall gains may accrue to the capitalist class, and as a results their consumption may increase. Some examples of windfall gains are unexpected rise in profits caused due to unexpected upswing in business. Unexpected rise in the rate of return on investment in some company’s shares or debentures is also an example of windfall gain. All these windfall gains may cause increase in consumption.

5) **Fiscal Policy**: Changes in fiscal policy of the governments affected consumption. Certain type of changes in fiscal policy adversely affect consumption. For example, increase in income tax, capital gains tax, estate duty etc. On the other hand, increase in government spending in various ways (including deficit financing) would increase propensity to consume.

6) **Expectations about the Future Income**: If Future income is expected to increase people are likely to save less and consume more. On the contrary, if future income is

expected to fall, people may save more for the future and spend less on present consumption.

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

8) **Demographic Factor**: Size of population, family size would affect consumption.

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

3. Explain the law of EMU and its assumptions.

Ans. Law of Equi-marginal Utility

Introduction

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

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

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

1. Utility can be measured cardinally.

2. Consumer's behaviour is rational and he aims at maximum satisfaction.

Units of commodity	MU 'A'	Ratio = $\frac{MUA}{PA}$	MU 'B'	Ratio= $\frac{MUB}{PB}$	MU 'C'	Ratio= $\frac{MUC}{PC}$
1	24	$\frac{24}{2}$ = 12	30	$\frac{30}{3}$ = 10	32	$\frac{32}{4}$ = 08
2	20	$\frac{20}{2}$ = 10	24	$\frac{24}{3}$ = 08	24	$\frac{24}{4}$ = 06
3	16	$\frac{16}{2}$ = 08	18	$\frac{18}{3}$ = 06	16	$\frac{16}{4}$ = 04
4	12	$\frac{12}{2}$ = 06	12	$\frac{12}{3}$ = 04	08	$\frac{08}{4}$ = 02
5	08	$\frac{08}{2}$ = 04	06	$\frac{06}{3}$ = 02	00	$\frac{00}{4}$ = 00

3. Income of a consumer is fixed

4. A consumer spends his entire income on commodities - A, B & C respectively.

5. All units of each commodity are homogeneous

6. Prices of commodities are constant.

7. MU of money is constant.

8. A consumer knows marginal utility schedule and prices of commodities - A, B & C

Statement of law

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

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

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

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

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

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

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

The price of commodity A= ₹ 2/-, commodity B = ₹ 3/- and commodity C= ₹ 4/-

Let us suppose that, an individual has limited income of ` 25/-. A consumer will equate MU of money spent on various commodities with price.

In this case, rational consumers will purchase-

4 units of commodity A

+ 3 units of commodity B

+ 2 units of commodity C

So he will spend-

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

C	2	4	₹ 8
		Total	**₹ 25**

According to the law, a consumer is in equilibrium when

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

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

$\therefore \quad 6 = 6 = 6$

TU derived = TUA $\longrightarrow$ 24+ 20 + 16 + 12 = 72

TUB $\longrightarrow$ 30+ 24 + 18 = 72 units

TUC $\longrightarrow$ 32 + 24= 56 units

Total utility 200 units

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

4. Explain the difficulties faced while calculating national income.

Ans. DIFFICULTIES IN THE MEASUREMENT OF NATIONAL INCOME:

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

i) Theoretical difficulties

ii) Practical difficulties.

i) Theoretical difficulties:

This is also known as conceptual difficulties.

1) 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.

ii) **Practical difficulties/statistical:**

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

1) **Problem of double counting:**

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

2) **Existence of non-monetized sector:**

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

3) **Lack of occupational specialization:**

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

4) **Inadequate and unreliable data:**

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

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

5) **Capital gains or losses:**

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

6) **Depreciation:**

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

7) **Valuation of inventories:**

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

8) **Illiteracy and Ignorance**:

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

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