

J. K. SHAH CLASSES

SYJC - ECONOMICS

QUESTION PAPER – SET 2

Date: 25 /09/2016

Total Marks: 40

Total time: 1hour 30 minutes

SOLUTION

Ans.1. (A) Fill in the Blanks with appropriate alternative given in the brackets.

- (i) Substitute
- (ii) Zero
- (iii) Steeper
- (iv) Larger

(B) Match the column :

- 1) Horizontal supply curve
- 2) Potential Supply
- 3) Rightward shift in supply curve
- 4) Vertical supply curve

(C) State whether the following statements are True or False :

- i) True
- ii) True
- iii) False
- iv) False

Ans.2. Give reasons / explain the following Statement :

(1) Supply is directly related to price.

1. Direct relationship.

The law of supply explains the direct relationship between price and supply (i.e.) higher the price higher the supply.

2. Positive relationship.

It states that generally a seller prefers to supply more when the price increases and contracts supply when the price decreases. Thus price and supply have positive relationship.

3. Upward sloping supply curve. The positive relationship can be explained with the help of supply schedule and supply curve.

(2) Concept of Elasticity of Demand helps trade union leaders.

The concept of elasticity of demand is useful to trade union.

i. Knowledge of elasticity of demand is useful in wage determination.

Trade union uses the knowledge of elasticity of demand to claim higher rewards. Elasticity of demand influences the decisions of wage determination.

ii. Inelastic labour demands higher wages.

If the demand for particular type of labour is inelastic, it is easy for trade union to claim higher wages. The management has no option but to employ them irrespective of wages.

iii. Strikes are effective when the demand for labour is inelastic.

In case of inelastic demand, even a minor threat to go for strike will work effectively. The management response quickly and raises the wage immediately.

iv. **Highly skilled labour enjoys inelastic demand.**

In case of highly skilled labour like technicians the supply is limited while demand is inelastic. The employer is ready to pay the highest possible wage

(3) **Stock can exceed supply.**

1. **Supply is part of stock.**

Stock is the total quantity produced by seller. The seller may not be willing to supply the entire stock for sales. Thus a part of stock which the seller is ready to offer for sales becomes supply. Therefore stock can exceed supply.

2. **Stock is the source of supply.**

Stock determines the supply. Supply comes out of stock.

Stock being the source of supply, there is no question of supply exceeding stock.

3. **Reservation price determines supply.**

The seller determines the supply on the basis of reservation price.

When the market price is higher than reservation price the supply may reach maximum. Even under such a situation the supply can only be equal to stock. It cannot be more than stock.

4. **Supply may be equal but never exceed.**

In case of perishable goods, the supply is restricted to the

(4) **Demand for necessities in inelastic.**

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.**

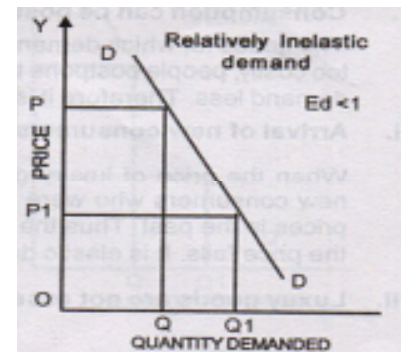
Salt, food and medicine and agricultural goods can be used only for a specific use and therefore their demand is inelastic.

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.



Ans.3. Do you agree with the following Statements? Give reasons

(1) **Various factors influence Elasticity of Demand.**

Yes, I agree with this statement.

Following are the factors which influence Elasticity of Demand.

1. **Nature of Commodities:** Commodities may be either necessities or luxuries. Normally, elasticity of demand for necessities is inelastic and for luxurious demand tends to be elastic.
2. **Durability:** The demand for durable goods is elastic, whereas the demand for perishable goods is inelastic.
3. **Substitute Goods:** Availability of substitutes also determine Elasticity of Demand. The larger the number of substitutes for a commodity in the market, demand tends to be more elastic.

4. **Uses of a Commodity:** When commodity can be put to several uses, its demand is elastic. The demand for electricity is elastic.
5. **Price:** Goods, which are very highly priced or very low price demand, is normally inelastic, e.g. Demand for match box is inelastic.
6. **Habits:** Habits influence Elasticity of Demand. The demand, which satisfy the habits, is normally inelastic. For instance, the demand for cigarettes is inelastic. Also consumption of essential goods cannot be postponed therefore demand for them is inelastic.
7. **Income of Consumer:** When income level is high demand is normally inelastic, and demand is elastic at a very low level of income.
8. **Proportion of Income Spent:** When proportion of income spent is large demand for goods tend to be, inelastic. For instance, demand for food grains is inelastic.
9. **Complementary Goods:** By and large, demand for complementary goods is inelastic. Because complementary goods such as motor car and petrol are demanded jointly.

(2) **Total outlay is one of the methods of measuring Elasticity of Demand.**
Yes, I agree with this statement.

The name of Dr. Marshall is associated with this method. This method is also known as Total Expenditure Method or Total Revenue Method. In this method, statistics of total expenditure is used to find out elasticity of demand. Total expenditure at the original price and total expenditure at the new price is compared with each other, and we come to know the elasticity of demand. When price falls or rises, total expenditure does not change or remains constant, demand is unitary elastic.

When price falls, total expenditure increases or price rises and total expenditure decreases, demand is elastic or elasticity of demand is greater than one.

When price falls and total expenditure decreases or price rises and total expenditure increases, demand is inelastic or elasticity of demand is less than one. Measurement of elasticity of demand with the help of total expenditure method can be better understood with the help of the following example.

Table No.3.5 - Total Expenditure Method

	Price (₹)	Demand (Units)	Total Outlay	Elasticity of Demand
A	10	12	120	Unitary or 1
B	8	15	120	
C	8	20	160	Elastic or >1
	10	12	120	Inelastic or <1
	8	14	112	

In example A, original price is ₹ 10 per unit and demand is 12 units. Therefore total expenditure incurred is ₹ 120/-. Price falls to the level of ₹ 8/- and demand rises up to 15 units. But total expenditure is still ₹ 120/-. In this case, total outlay does not , change even though there is change in price. Therefore, demand is unitary elastic.

In example B, at the price ₹ 10/-, 12 units are demanded. So total original expenditure is ₹ 120/-. Price falls to ₹ 8/- per unit and demand rises to the level of 20 units. Therefore, total expenditure incurred on commodity rises to ₹ 160/-. Total expenditure under this new condition of change in price, is greater than original expenditure. Hence, in this example, demand is elastic or elasticity of demand is greater than one.

In example C, original total outlay is ₹ 120/- with a change in price to ₹ 8/- per unit, demand expands to the extent of 14 units. Nevertheless, total expenditure ₹ 112/-, which is less than original expenditure. Therefore, in this example demand tends to be inelastic or elasticity of demand is less than one.

(3) **There is no difference between stock and supply.**

No. I disagree with the statement.

1. **Stock is the source of supply.**

Stock is the total volume of a commodity which can be brought into market for sale at a short notice. No seller would prefer to sell the entire stock at the same time. Depending upon the market price, he may like to change the amount of supply. He may release a part of stock for sale and the rest is kept as stock. It is more true in case of durable goods.

2. **Supply is the amount offered out of stock.**

Supply means the quantity which is offered for sales out of stock. Thus supply means the quantity which is actually brought into the market for sales. If the market price is high, larger quantities of durable goods are sold. If price is less, the sellers offer less quantity for sales.

3. **Supply is equal to stock in case of perishable goods.**

In case of perishable goods like fruits, vegetables and fish, the supply would be equal to stock. The reason is that there is a risk of unsold good getting rotten. It would bring losses to the sellers. Therefore the stock of perishable goods is equal to supply.

However, modern marketing make use of cold storage facility to store even perishable goods for sometime and sell later.

4. **Extent of market.**

In case of perishable goods like fruit and vegetables the demand is mostly restricted to local area. Therefore the demand for such goods is more or less same. Demand being the same, seller never takes risk by keeping more stock than what is demanded.

5. **Stock and supply depends upon Reservation price.**

Reservation price is the minimum price below which seller will refuse to sell any quantity of a product. In case of durable goods the reservation price is relatively higher. He will supply goods only when the market price is equal to reservation price.

Higher the market price, lesser the stock and vice versa.

Thus there is always a difference between stock and supply of durable goods.

However in case of perishable goods, the seller keeps relatively lower price and dispose off all the stock.

6. **Infrastructure.**

If the producer is able to build a large net work cold storage, he can keep stock of perishable goods. A strong system of transport also helps quick movement of goods From one place to another place. In the absence of better infrastructure even durable goods cannot be stored and transported.

7. **Seasonal demand.**

Some goods enjoy seasonal demand. During festival seasons, the demand increases and the difference between stock and supply would be least. During slack seasons, the demand declines and the difference between stock and supply would widen. In case of crackers the demand is seasonal. During Diwali the production and stock would be maximum. Once the season is over the production declines and the stock would be minimum.

(4) **Price is the only determinant of supply.**

No. I disagree with the statement.

There are several factors than price determining market supply.

(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 withhold 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.

Q.4. Define or explain the Following concepts:

(1) Income elasticity of demand

Income of the consumer is one of the major factors affecting demand. Income elasticity refers to a proportionate or percentage change in quantity demanded of a commodity due to the proportionate or percentage change in income. Income elasticity helps to measure the responsiveness of demand for a commodity to change in the consumer's income.

Income Elasticity = $\frac{\text{Proportionate change in quantity demanded}}{\text{Proportionate change in income of an individual}}$

$$Ed = \frac{\Delta Q / Q}{\Delta Y / Y}$$

(2) Total cost

Total cost is the total amount incurred by a firm on the factors of production required for the production of goods and services. Total cost is the sum total of total fixed cost (TFC) and total variable cost (TVC). Total Cost (TC) = Total Fixed Cost (TFC) + Total Variable Cost (TVC)

(3) Relatively Elastic Demand

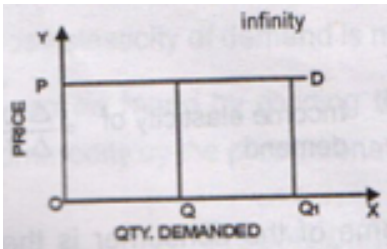
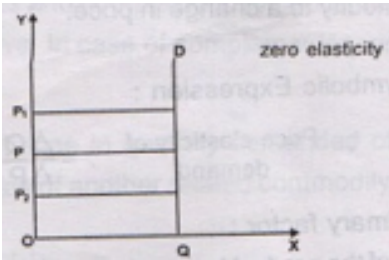
When the proportionate or percentage change in demand for a commodity is greater than a proportionate or percentage change in its price, it is called as a relatively elastic demand. In short, when a change in price has a greater effect on the quantity demand, then the demand for the product is relatively inelastic. Generally, luxury goods like T.V, washing machine, fridge, high-end watches, etc are said to have relatively elastic demand. In this case, $Ed > 1$.

$$Ed = \frac{\Delta Q / Q}{\Delta P / P} > 1$$

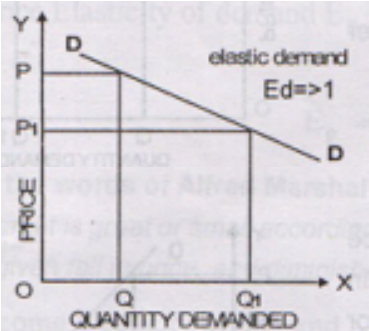
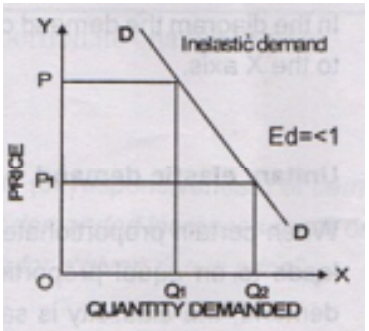
(4) Output : In simple words, output means quantity produced. Therefore, total output refers to total quantity produced. It is defined as "the total quantity of goods produced in a given period of time in an economy." This quantity is produced with the help of all factors of production.

Q.5. Distinguish between :

(1) Perfectly elastic demand and perfectly inelastic demand.

Perfectly elastic demand	Perfectly inelastic demand
1. Meaning	
It refers to a situation when a small or no change in price brings unlimited amount of change in demand.	It refers to a situation when a significant change in price fails to bring any change in quantity demanded
2. Zero/infinity	
The elasticity in this case is measured to be infinity.	The elasticity in this case is to be zero.
3. Diagram	
 <p>The diagram shows a coordinate system with a vertical Y-axis labeled 'PRICE' and a horizontal X-axis labeled 'QTY. DEMANDED'. A horizontal line segment labeled 'PD' is drawn at a constant price level 'P'. The X-axis has two points marked 'Q' and 'Q1'. The word 'infinity' is written above the line.</p>	 <p>The diagram shows a coordinate system with a vertical Y-axis and a horizontal X-axis. A vertical line segment labeled 'D' is drawn at a constant quantity level 'Q'. The Y-axis has three points marked 'P1', 'P', and 'P2'. The word 'zero elasticity' is written to the right of the line.</p>
4. The demand curve (PD) remains a horizontal straight line which is parallel to X axis.	4. The demand curve (QD) vertical straight line which is Parallel to Y axis.

(2) Relatively elastic demand and Relatively inelastic demand

Elastic Demand (More elastic) (Relatively Elastic Demand)	Inelastic Demand (Less elastic) (Relatively inelastic demand)
1. Meaning :	
Elastic demand refers to a situation When a lower proportionate change in price leads to a higher proportionate change in demand. Generally luxury goods like TV, Car etc. have elastic demand.	Inelastic demand refers to a situation when a higher proportionate change in price leads to lower proportionate change in demand. Generally necessary goods like food and medicine have inelastic demand
2. Flatter/Steeper Curve	
	
3. More than one/less than one	
In case of elastic demand, elasticity is said to be more than one One.	In case of inelastic demand, the elasticity is said to be less than
4.Elastic demand is indicated by demand curve DD which is flatter.	4.Inelastic demand is indicated by demand curve D D which is steeper

(3) Relatively Elastic Supply and Relatively Inelastic Supply.

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

(4) Average Revenue and Average Cost

Average Revenue	Average Cost
1. Meaning.	
Average revenue refers to revenue per unit of output.	Average cost refers to cost per unit of output.
2. Calculation.	
Average revenue is estimated by dividing total revenue by total output sold.	Average cost can be estimated by dividing total cost by total output
3. Formula	
$AR = \frac{\text{Total Revenue}}{\text{output}}$	$AC = \frac{\text{Total cost (TC)}}{\text{output (O)}}$
4. Indicator.	
Average revenue indicates the price per unit of the firm's product at each level of output.	Average cost indicates the level of profit. <ol style="list-style-type: none"> a. When there is normal profit AC=Price. b. When there is abnormal profit AC<Price. c. When there is subnormal profit (loss)AC >price.

(5) Individual Supply and Market Supply

Individual Supply	Market Supply
1. Meaning	
Individual supply refers to the different amounts of a commodity offered for sale by an individual firm at different prices.	Market supply refers to the total of various quantities of the commodities offered for sale by all the firms at different prices.
2. Narrow/wider concept	
Individual supply is part of market supply. It is a narrow concept.	Market supply includes individual supply. It is a wider concept.
3. Importance	
Individual supply is not useful for framing business policy. It has no practical significance.	Market supply is useful for sellers to frame business policy and plan their production targets.
