Very Short Answers

Q1] Micro Economics.

Ans. The word 'Micro' is derived from Greek word 'Micros' which means 'small'.

2. It was developed by Marshall.

3. It is the study of individual units like demand, price, supply etc.

Macro Economics.

The word 'Macro' is derived from Greek word 'Macros' which means 'Large'

2. It was developed by J.M. Keynes

3. It studies the aggregates or Economy as a whole like National income, Employment, general price level.

4. It is also called as "Income and Employment" theory

Q2] Capital goods.

Ans. Goods which are used in the production of some other goods are called as Capital goods.

2. These goods satisfy human wants indirectly.

3. Examples for Capital goods: Machinery, Buildings etc.

Q3] Wealth Concept.

Ans. Wealth means Stock of assets held by an Individual that has potential for yielding income in some form.

2. Wealth includes Money, Land, Shares of Companies etc.

3. Wealth has following four properties: utility, scarcity, transferability, value in exchange.

Q4] Intermediary Goods.

Ans. Semi - finished goods or goods which are still under the process of production are called as Intermediary goods. Ex: Bricks, cement in construction work.

Q5] Deductive Method.

Ans. Deductive method is a process from general to particular or from Universal to Individual.

2. This method is also known as Priority method.

Inductive Method.

Ans. Inductive method is a process from Particular to general or from Individual to the Universe.

2. This method is also known as Realistic method.

Q6] Economic statics

Ans. It refers to that type of analysis where we establish a functional relationship between two variables whose values belong to same period of time. Ex: Price determination under perfect competition.

Q7] Cardinal Utility.

Ans. Alfred Marshall developed Cardinal utility analysis.

2. According to this analysis, utilities derived from consumption of goods can be measured in terms of units called 'Utils'.

3. Utility can be expressed in terms of numbers such as 1,2,3,4 and so on.

Ordinal Utility.

Ans. Hicks and Allen developed Ordinal utility.

2. According to this analysis, utilities derived from consumption of goods cannot be measured in numbers

3. Utility can only be Ranked such as 1st, 2nd, 3rd, 4th, etc.

Q8. MRS (Marginal Rate of Substitution)

Ans. . The concept of MRS (Marginal Rate of Substitution) is the basis of indifference curves, the MRS may be defined as the rate at which an individual will exchange successive unit of one commodity for another.

Q9. Marginal Utility.

Ans. The addition made to the total utility by consuming one more unit of a commodity is called as Marginal Utility. It is expressed as

MUn = TUn – TUn-1.

Q10. Individual Demand Schedule / Individual Demand Curve

Ans. Individual Demand Schedule is a list of various quantities of commodity purchased by an individual consumer at different prices in the market.

INDIVIDUAL DEMAND SCHEDULE

Price of apples [in rupees]	Quantity demanded [in units]
50	5
40	10
30	15
20	20
10	25

Q11. Demand Function.

Ans. Demand function is a mathematical expression that shows the relationship between quantity demanded of a commodity and factors that determine it.

2. Demand function can be expressed as

Dx = f [Px, P1, …… Pn, Y, T]

Where Dx = Demand for commodity X.

F = Functional relationship.

Px = Price of commodity X

P1 – Pn = Prices of substitutes and complementary goods

Y = Income of consumer

T = Taste of consumer.

Q12. Cross demand/ Income Demand

Ans. **Cross demand** refers to the relationship between two goods which are either complementary or substitutes to each other.

Dx = f [Py]

D x = Demand for Commodity X

F = Functional relationship

P y = Price of commodity Y.

Income Demand shows the direct relationship between the income of the consumer and quantity demanded. When the other factors remain constant. There is direct relationship between income and demand for superior goods. Inverse relationship between income and demand for inferior goods. Dx = f(Y)

Q13 Characteristics of Land

Ans. Land means not only earth's surface alone but also refers to all free gifts of nature which include soil, water, air, natural vegetation.

The following are the Characteristics of Land

1. Free gift of nature.

2. Supply of land is perfectly inelastic.

3. Cannot be shifted from one place to another place.

4. Land provides infinite variation of degree of fertility.

Q14. Factors of Production.

Ans. Factors that help in production process are called as factors of production.

Example: Land, Labour, Capital, Organisation.

Q15. Supply Function

Ans. Supply of commodity depends upon a number of factors, the important among these can be presented in the form of supply function. It explains the functional relationship between supply of a commodity and other determinants of supply of the commodity. This can br explained as follows: Sx = f (Px, Py, Pf, T, Gf,Gp) where

Sx = supply of commodity x , f = Functional relationship, Px = Price of good x,

Py = Price of related good, T = Technical progress, Gf = Goal of the producer,

Gp = Government Policy.

Q16. Law of Supply.

Ans. Supply means quantity which is brought to market for sale.

2. The law of supply explains the relationship between price of the commodity and its quantity supplied.

3. Law of supply explains when price increases, supply increases and when price falls supply also falls.

4. There is a direct relation or positive relation between price and supply, other things remaining constant.

Q17Marginal Product/ Averag Product

Ans. **Marginal Product**

It is the additional product by employing an additional labour $MP = \frac{\Delta TP}{\Delta L}$

Average Product

It refers to the product per unit of labour. It is obtained by dividing total product by the number of labourers employed $AP = \frac{TP}{L}$

Q18. Area based market

Ans. On the basis of area, markets are classified into local, national and international. These markets tells us the size or extent of the market for a commodity. The size of the market for a good depends upon demand for the good, transportation facilities and durability of good etc.

Q19. Monopolistic competition.

Ans. It's a market where several firms produce same commodity with small differences.

2. Examples of monopolistic competition are soaps, cosmetics, tooth paste, smart phones etc.

3. Here advertisements take place to promote their goods.

Q20. Oligopoly/ Duopoly

Ans. **Oligopoly:** The word Oligopoly is derived from two Greek words 'Oligos' means few and 'Pollein' means to sell. Thus, oligopoly is a market with few sellers.

2. The products sold may be homogeneous or differentiated.

3. Examples: Automobiles, Electricals etc.

Duopoly: Duopoly is a market where only two producers exist.

2. Goods produced may be homogeneous or differentiated.

3. Example: Pepsi & coca cola, Canon & Nikon etc.

Q21. Equilibrium price.

Ans. Equilibrium price is that price where quantity demanded is equal to quantity supplied.

2. Equilibrium price = QD = QS.

3. The price is justified and equilibrium price gives normal profits to the producer.

Q22. Selling costs.

Ans. When a firm makes expenditure on sales like advertising in journals, newspapers, electronic media etc. to improve sales is called as Selling costs.

2. Selling cost is also called as Publicity costs

Q23. Product differentiation.

Ans. Product differentiation is one of the main features of monopolistic competition.

2. It's a market situation where there are many firms of a particular product, but the product of one firm is some way or the other different from the product of the other firm.

3. Product differentiation may take the form of brand name, trade mark etc.

Q24. Contract rent

Ans. Contract rent is a periodical payment for the use of durable commodities.

2. Example: Rent of cycle, rent of a house etc.

3. Contract rent is a periodical payment and a rental income.

Q25. Scarcity rent.

Ans. According to Alfred Marshall, rent for land arises due to its scarcity.

2. When there is population explosion, demand for land increases and it leads to rise in the price of the land.

3. This is called as scarcity rent.

Q26. Economic rent.

Ans. Economic rent is a pure rent payable as a reward for utilising the productivity of land.

2. It is derived by subtracting the elements like interest, wages, profits and depreciation from the gross rent or contract rent.

3. Economic rent is Economic surplus i.e. the earning of a factor of a product in excess of the minimum amount required to keep it in its present position.

Q27. Quasi rent.

Ans. The concept of quasi rent was first introduced by Marshall.

2. It is the surplus earned from the man -made factors of production such as Machinery, Land and Buildings etc.

3. It's a short - term concept,

Q28. Time wages.

Ans. If the wages are paid on the basis of time element, they are called as "Time wages"

2. Time wages are paid either daily or weekly or monthly or yearly, irrespective of their contribution to production.

3. Example: Rs. 10000/- paid to an employee per month .

Q29. Piece Wages

Ans. Piece Wage is the amount paid for labourers according to the volume of work done by them.

Q30. Gross profit.

Ans. Gross profit is the difference between total revenue and cost of production.

2. It includes implicit rent, implicit interest, implicit wage, depreciation charges and insurance charges

Q31. Gross interest.

Ans. Gross interest is the payment which the lender receives from the borrower excluding the principle amount.

2. Gross interest includes net interest, reward for risk taking, reward for inconvenience, reward for management.

Q32].Gross Domestic Product(GDP)/ Gross National Product(GNP)

Ans. GDP is the total value of all final goods and services produced within the boundaries of a country in a year.

2. GDP = C+I+G or GDP = GNP – Net Income from abroad.

Where C = Consumption, I = Investment, G = Government expenditure

Gross National Product

Ans. GNP is the total value of all final goods and services produced in a country in a year.

2. GNP = C+I+G+[X-M]

C = Consumption, I = Investment, G = Government expenditure, X = Exports, I = Import

Q33] Real National income.

Ans. It is national income expressed in terms of general prices of a particular year taken as a base.

Q34]. Transfer payment

Ans. The government may provide social security allowances like pensions, unemployment allowances, scholarships etc. These are incomes for some sections of the society even though no productive services are made by them. These are called transfer earnings.

Q35]. Disposable income.

Ans1. Personal income totally is not available for spending.

2. People have to pay direct taxes such as income tax, property tax etc from their personal income.

3. Disposable income is the income left out after deducting income tax and property tax from the personal income.

4. Disposable income = Personal income – Personal taxes.

Q36]. Fiscal deficit.

Ans. Fiscal deficit is the difference between the total expenditure and total revenue plus market borrowings.

2. Fiscal deficit = [Total revenue – Total expenditure] + Market borrowings and other liabilities.

Q37]. Deficit Budget.

Ans. Deficit Budget is the budget that shows the differences between total receipts and total expenditure

2. Deficit Budget arises when total expenditure exceeds total receipts.

3. Deficit Budget = Total receipts – Total expenditure.

Q38] Note on Finance Commission

Ans. The Finance commission of India came into existence in 1951. It was established under article 280 of Indian Constitution by President of India. It was formed to define financial relationship between centre and state. As per constitution commission is formed for every five years and consists of chairman, secretary and four other members.

The Finance Commission advices the president what percentage of Income tax should be retained by the centre and what principles should be adopted to distribute pool of income tax among states. The first Finance commission submitted its report in 1952. Till date fourteen Finance Commissions have submitted their reports.

Functions of Finance Commission: 1. Distribution of taxes among centre and states as per their contribution to taxes. 2. Determine factors governing grants in aid to states

Q39]. Wage cut policy.

Ans. According to classical economist, unemployment may occur in the short run.

2. This is not because demand is not sufficient but due to increase in wages forced by trade unions or interference of government.

3. A.C. Pigou suggested that reduction in wages will remove unemployment.

4. This is wage – cut policy

Q40]. Cost-push inflation and demand-pull inflation.

Ans. Inflation caused by rise in cost of production is called as cost-push inflation

Inflation caused by excess of aggregate demand over aggregate supply is called as Demand-pull inflation.

Q41]. Net Banking

Ans. Net Banking is also called as Internet Banking or Online Banking.

2. It's a process of conducting banking transactions over the internet.

3. Viewing bank statements, status of bank account online comes under the definition of Net banking.

Q42]. Savings deposits

Ans. These are the deposits made into savings bank account

2. Savings deposit is convenient to small businessmen, salaried employees, people belonging to low and middle class.

3. Interest paid on savings deposits is comparatively low and is around 4% p.a.

4. Money deposited in savings account can be withdrawn as and when required but the bank may impose restrictions on the amount and number of withdrawals

Q43]. Clearance house.

Ans. Businessmen and other customers get cheques of bank in which they do not have account. He has to deposit the cheque received in his bank which collects the amount from the bank on which the cheque has been issued.

2. Its termed as Inter-bank settlement of accounts.

3. All commercial banks maintain deposit accounts with Reserve Bank of India. RBI clears all the cheques to settle inter-bank transactions and make appropriate entries in accounts of commercial banks.

4. For this RBI has established clearing houses at different places.

Q44]. Overdraft.

Ans. Overdraft means allowing the depositor to over-draw his account upto a previous agreed limit.

2. Banks allow the facility of overdraft only to the customers of the bank [current account holders]

3. Overdraft is granted only for short period.

Q45]. Legal Tender Money

Ans. Legal Tender Money: If money is accepted as per law by everyone is called legal tender money.

Q46]. Note Issue

Ans. Reserve Bank of India has the monopoly of note issue in the country. It maintains gold and foreign exchange reserves of a minimum Rs 200 crores of which gold should be worth Rs 115 crores. There is a separate issue department to issue currency notes . At present RBI issues currency notes of the denomination RS 2000, Rs 500, Rs 100,Rs 50, Rs 20,Rs 10. Coins are issued by the Finance Ministry of the Government of India but circulated by the RBI

Q47]. Types of Inflation.

Ans. Inflation refers to persistent increase in general price level of commodities over a period of time.

2. Following are the types of inflation:

a. Creeping Inflation c. Running Inflation e. Cost – Push Inflation

b. Walking Inflation d. Hyper Inflation f. Demand – Pull Inflation

Q48] Price line / Budget line.

Ans. Price line / Budget line shows all possible combinations of two goods that a consumer can buy with given income of the consumer and the prices of two goods.

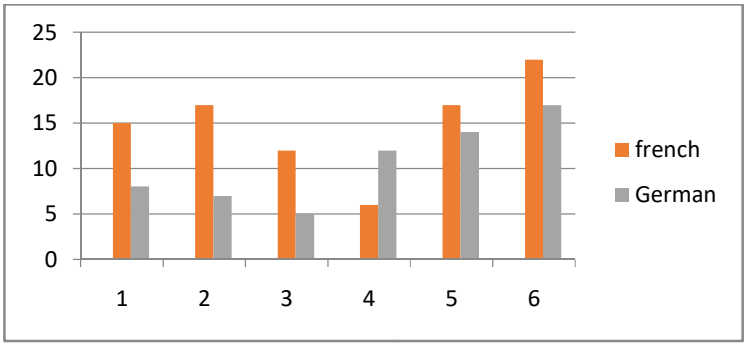
Q49]. Multiple Bar Diagram

Ans. . Multiple Bar Diagrams are used to compare two or more variables.

The method of drawing multiple bar diagram is shown below

Students studying French and German

Languages	1960	1970	1980	1990	2000	2010
French	15	17	12	6	17	22
Germany	8	7	5	12	14	17



Q50]. Arithmetic Mean

Ans. Arithmetic Mean(x) : Among all types of averages the arithmetic mean is most commonly and widely used measure of central tendency. It is normally expressed as "the sum total of the observations divided by the number of items observed". It is defined as the quotient of the sum of all items or entries divided by the number of items.

Q51]. Median

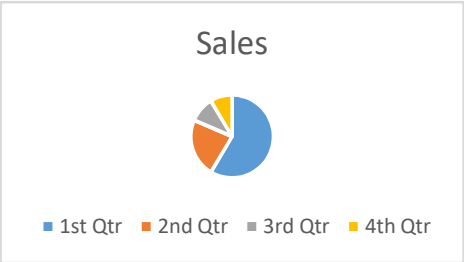
Ans. Median is the middle element when the data set is arranged in order of the magnitude. Median is that positional value of h variable which divides the distribution into two equal parts

Q52]. What is a Pie - Diagram

Ans. A pie diagram is also called as pie chart.

2. Circle is divided into as many parts as there are components by drawing straight lines from the centre to the circumference.

	Sales
1st Qtr	8.2
2nd Qtr	3.2
3rd Qtr	1.4
4th Qtr	1.2



Q53]. What is Dispersion.

Ans. According to Spiegel, "the degree to which numerical data tend to spread about an average value is called the variation or dispersion of the data."

A.L Bowley defined dispersion as "the measure of the variation of the item".

Q54]. Recurring deposits.

Ans. These deposits are very convenient to those who cannot save huge amount at a time.

2. A fixed amount in multiples of Rs.10 may be deposited every month for a period of one or more years

Q55]. Veblen goods or Prestigious goods.

Ans. This concept was explained by Veblen.

2. Veblen explained that some goods like diamonds, precious stones and car are demanded by rich people just to maintain their social prestige. If the prices of these goods fall they will not buy it because they will lose its prestige value.

3. Hence the demand curve for Prestigious goods slopes from left to right upwards.

Q56]. Co-efficient variation.

Ans. This concept was given by Karl Pearson and is very useful for studying dispersion in more than one series. A series in which co-efficient variation is higher would have greater dispersion than the one in which it is lower. This measure is used for a comparative study of variability in two or more series.

The formula to calculate co-efficient of variation is: C.V. = $\frac{\text{Standard Deviation}}{}$ x 100

Arithmetic Mean

Q57]. Discuss the importance of Statistics for the study of economics.

Ans. Statistical analysis gives valuable assistance in understanding economic problems and formulating economic policies.

2. Many economic problems like poverty, unemployment, rise in prices etc cannot be analysed without the help of statistics.

Q58]. Explain the concept of mode.

Ans1. Mode is that value in series which occurs most frequently.

2. Mode can also be divided into "bi-modal" series and "multi-modal" series.

3. Example: 5,7,7,7,8. Therefore Mode is 7.

Q59]. Compute Median 5,7,7,8,9,10,12,15,21

Ans. 5,7,7,8,9,10,12,15,21

Ascending order: 5,7,7,8,9,10,12,15,21

No. Of observations = 9

Median = N+1/2

9+1/2= 10/2 =5th term

Therefore, median =9

Q60]. What is Range

Ans1. Range is the difference between large value and the small value in a series.

2. Range = Large observation – Small observation.

3. Range is easy to understand and calculate.

4. Example: 25,30,35,40Range = Large observation – small observation

i.e. 40 – 25 = 15.

Q61]. Characteristics of good measure of dispersion

Ans. The following are the characteristics of good measure of dispersion:

1. It should be rigidly defined

2. It should be based on all the observations of the series.

3. It should be capable of further algebraic treatment.

4. It should be easy to calculate and simple to follow.

5. It should not be affected by fluctuations of sampling.

SHORT ANSWER QUESTIONS

Q1] What is utility. What are its types.

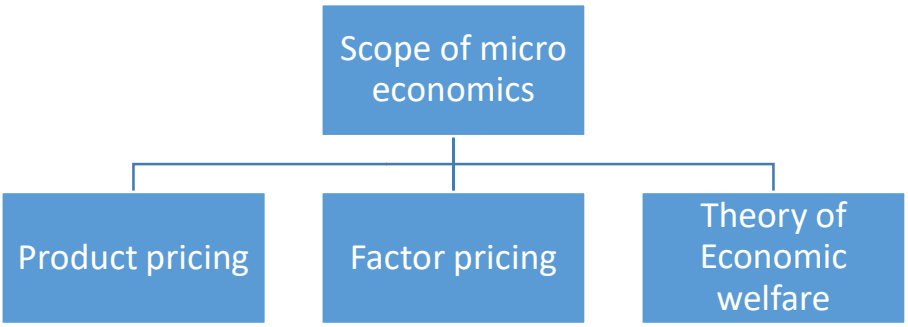
Ans. The want satisfying capacity of a commodity at a point of time is called as Utility. Utility is a subjective concept. There are four types of utility:

1. **Form utility:** If a commodity satisfies a consumer by its shape, colour, size etc. it is termed as Form utility.
   Example: A wood converted into chair.
2. **Place utility:** Some goods have utility because of place
   Example: Vegetables have no utility at place of production but when brought to market they get utility.
3. **Time utility:** Some goods get utility because of time.
   Example: Umbrella have utility during monsoon season.
4. **Service utility:** Services also satisfy human wants.
   Example: Teacher helps student to build his career.

Q2] What is Micro economics? Explain its scope.

Ans. The term Micro economics is derived from the Greek word 'micros' which means 'small'. It studies the individual units of the economy.

Scope of Micro economics: Prof. Marshall popularised micro economics. It is based on the assumptions of "Full employment" and "marginal analysis".



Theory of Demand

Theory of Production and cost

Theory of Distribution

Rent, Wages, Interest, Profits

Importance of micro economics:

1. Micro economics explains how free market economy works to allocate productive resources.

It helps Government to frame suitable policies to promote economic efficiency.

Q3]. Discuss the limitations and importance of Equi-Marginal Utility

Ans. Equalization of marginal utilities will maximize the consumer's satisfaction and consumer attains equilibrium.

Importance of Equi-Marginal Utility : The law of Equi-marginal utility is of great practical importance in economics.

1. Basis of Consumer Expenditure: The expenditure pattern of every consumer is based on this.

2. Basis for Savings and Consumptions: A prudent consumer will try to distribute his limited means between present and future consumption so as to have equi-marginal utility in each.

3. **In the field of Production**: To the businessman and the manufacturer the law is of special importance. He works towards the most economical combination of the factors of production. For this he will substitute one factor for another till their marginal productivities are same.

4. **Its application to Exchange**: In all our exchanges, this law works. Exchange is nothing but substitution of one thing for another.

5. **Price Determination**: This principle has an important bearing on the determination of value and price.

Limiations of the Law of Equi-Marginal Utility

1. The law is based upon the assumption of rationality on part of the consumer. But in real life, several obstacles may obstruct rational behaviour.

2. This law works out fully only if the goods are divisible. If goods happen to be large and indivisible, it is not possible to equate the marginal utility spent on them.

3. Prices of goods often fluctuate in the market

4. The law of maximum satisfaction will not be applicable to complementary goods.

5. It is assumed that the consumer has a perfect knowledge. But this is not correct.

Q4] What are the reasons for negative slope of demand curve.

Ans. The demand curve in case of normal goods slopes from left to right downwards. The negative slope in demand curve is due to inverse relationship between price and the quantity demanded for the commodity.

1. **Old and new buyers:** If the price of the commodity falls, real income of the old consumer will increase and the demand for the commodity will increase. New buyers who were unable to buy the commodity at a higher price will now be able to buy it after a fall in price. As a result, demand curve slopes from left to right.
2. **Income effect:** A fall in price of the commodity increases his real income although his income remains constant. For example, if a consumer spends his income of rs.10 on a commodity whose price is rs.2, he will get 5 units. If the price of that good decreases to rs.1, he can now buy 10 units. Hence if price of commodity falls real income of consumer increases. This is called as Income Effect.

3. **Law of Diminishing Marginal Utility:** The law of diminishing marginal utility states that "the additional benefit that a consumer derives from given increase in his stock of a thing diminishes with every increase in the stock that he already has". Thus, he will purchase more at lower price and less at higher prices.
4. **Substitution effect:** If the price of a commodity falls, he will buy more of this commodity by reducing the purchase of substitute goods. For instance, if the price of Colgate paste rises in relation to Close up paste then consumer will substitute Close up paste in place of Colgate paste.
5. **Multiple uses of commodity:** Some commodities like milk, electricity, coal etc have multiple uses. If the prices of these goods fall demand will increase for these goods and will be used for all purposes which were restricted only for a particular use.

Q5] Explain the importance of price elasticity of demand.

Ans. Price elasticity of demand is the ratio of percentage change in quantity demanded for a good and percentage change in its price.

Importance of price elasticity of demand:

1. **Monopoly market:** If the demand for a product has different elasticities in different markets, producer can fix different prices for different markets. Monopolist will fix high price in the market where demand is inelastic but he will fix a low price where demand is elastic.
2. **Joint products:** Elasticity of demand is useful in price fixation of joint products like sugar and molasses. So, if demand is inelastic price fixed will be higher and if demand is elastic price fixed will be low.
3. **Government:** The commodities of some industries have inelastic demand. Such industries are declared "Public utilities". For the welfare of people Government will undertake these industries which have inelastic demand. Example: Railways.
4. **International trade:** Terms of trade implies the rate at which one unit of domestic commodity will exchange for unit of a foreign commodity. In calculating terms of trade, both countries will take into accounts mutual elasticities of demand for their products.
5. **Ministry of finance:** Government imposes taxes for revenue. For imposing taxes, Finance minister selects different products based on their price elasticities. If Government wants more taxes then it will select those commodities which have inelastic demandfor tax imposition.
6. **Management:** If the demand for workers is inelastic, demand of trade unions for increase in wages will be fruitful but if the demand for workers is elastic then the demand of trade unions to increase wages will not be successful.
7. **Producers:** Producers produce goods in accordance with the demand for the commodity. If the demand for the commodity is inelastic producer will produce more of that commodity to take advantage of high price.

Hence based on the nature of demand, whether demand is elastic [changing] or inelastic [unchanged]prices are determined.

Q6] Describe Income and cross elasticity of demand.

Ans. Income elasticity of demand is defined as proportionate change in quantity demanded of a commodity [Increase or decrease] due to proportionate change in income of the consumer, other things being constant.

E_Y = Percentage change in quantity demanded [Q]

Percentage change in Income [Y]

Cross elasticity of demand: Cross elasticity of demand refers to change [Increase or decrease] in quantity demanded of a good in response to change [Increase or decrease] in prices of related goods i.e. substitutes and complementary goods, other things being constant because demand for a good not only depends on price of their prices but also on the prices of their related goods.

Ec = Percentage change in quantity demanded of X

Percentage change in price of Y

Q7] What are the factors that determine National Income

Ans. National income is the total market value of all goods and services produced in a country in a year.

1. **Natural resources:** Natural resources such as land, forest, rivers etc determine National income. National income will be high if natural resources are more and National income will be less if natural resources are less.
2. **Labour:** National income is also determined by labour. Production depends not only on labour but also his efficiency.
3. **Capital:** It's a key factor for determining National income. National income will be high if supply of capital and application of capital in production is high.
4. **Organisation:** Organisers introduce innovations and coordinate factors of production to maximise profits. Hence National income also depends on organisers.

Technology: Natural resources are fully utilised with advanced technology. Output can be increased with same capital with advanced technology

Q8] What are Real wages. What are the determinants of real wages.

Ans. Real wages refers to amount of goods and services that can be purchased with the money wage at any particular point of time. Real wage is the purchasing power that a labour gets through his money wage.

1. **Method of payment:** Besides money wage if the labourer gets extra facilities given by management like free or subsidised lunch, free housing, free medical facilities. The real wage of a labour will high.
2. **Purchasing power of money:** Purchasing power determines real wage. Increase in general price level result in fall of real wage. On the other hand, decrease in general price level rises real wage.
3. **Nature of payment:** Some occupations are dangerous and reduce life of workers which shortens the earning period of the worker. Real wage in such occupations will be low though money wage will be high.
4. **Future prospects:** People will like to join in organisations which have future prospects even at low money wage because real wage will be high.

Regularity of employment: Real wages will be low if employment is temporary, irregular. If employment is permanent and regular, real wages will be high.

Q9] What is Public revenue. What are the sources of Public revenue.

Ans. Government needs huge revenue to perform all its functions. Revenue received by government from different sources is called as Public revenue. It is classified into **1] Tax revenue and 2] Non- tax revenue.**

1] Tax revenue: Revenue received through collection of taxes from the public by centre and state government is tax revenue. Tax revenue is again divided into two types

A] Direct taxes: Taxes on income and expenditure ex: personal income tax.

Taxes on property and capital assets ex: Wealth tax, estate duty.

B] Indirect taxes: Taxes levied on goods and services. Ex: service tax, customs duty.

2] Non-tax revenue: Revenue received by government from sources other than taxes is called as non-tax revenue

A] Administrative revenue: Government receives money for administrative services ex: Licence fees, penalty etc.

B] Commercial revenue: Government receives revenue from public sector units which produce goods and services. Ex: Bharat Sanchar Nigam limited, Indian oil Corporation etc.

C] Loans and advances: When revenue is not sufficient to meet the requirements, government may receive loans from financial institutes within the country also from foreign government and international financial institutions.

D] Grants-in-aid: State government receives such grants from Central government. They are repaid. Central government receives it from foreign government. Grants are of two types:

1] General grant: They are given in general without specifying any purpose.

2] Specific grant: They are given for a specific purpose ex: Education grant.

Q10] Point out the Redemption methods of public debt.

Ans. When expenditure of Government exceeds revenue it resorts to public debt. Public debt is of two types. Internal debt [The debt raised from the public and institutions within the country] External debt [the debt raised from public and institutions and governments of other countries]. The public debt can be repaid in the following manner:

1. **Surplus Budget:** It means government revenue is more than government expenditure. Surplus budget can be used to repay public debt.
2. **Refunding:** It means issue of fresh bonds and securities so that matured loans can be used to repay.
3. **Annuities:** It means debt is cleared in instalments regularly till debt is completely cleared.
4. **Sinking fund:** It is best method for repayment of public debt. Government creates separate fund called sinking fund for repaying public debts.
5. **Conversion:** Existing loans are converted into new loans before date of their maturity. Its advantageous when interest rate on new loans is less than interest rate on existing loan.
6. **Additional taxes:** New taxes are imposed to raise funds for repayment of debts.
7. **Capital levy:** It's a one-time tax on capital assets.

Surplus balance of payments: Here Exports exceed imports by which foreign reserves can be utilised for repayment of public debt.

Q11]. Define Inflation. Explain its types.

Ans. Inflation means a general rise in the pries. It is rapid upward movement of prices.

Definition: According to Samuelson: "Inflation denotes a rise in the general level of prices".

Types of Inflation:

1. Creeping inflation: When rise in the pries is very slow and small, it is called creeping inflation.

2. Walking inflation: This is the second stage of inflation. The inflation rate will be between 2% and 4%.

3. Running inflation: When the rate of inflation is in the range of 4-10% per annum, it is called running inflation.

4. Galloping inflation or hyper inflation: If the inflation rate exceeds 10%, galloping inflation occurs. It may also as called hyper inflation.

Q12] What is Statistics? Explain its relation with Economics.

Ans. There is close relationship between statistics and economics. In the words of Tugwell "The science of economics is becoming statistical in its method". All the economic laws are pronounced on the basis of statistical facts and figure. Statistics helps the economics to become an exact science.

In the study of economics, the application and use of statistical methods are of great importance. Most of the doctrines of economics are based on the study of a large number of units and their analysis. This is done through statistical methods. Law of demand was formulated because of statistical methods.

Statistics and economics are closely related to understand qualitative and quantitative facts of economic problems like poverty, unemployment, inflation, etc. The increasing importance of statistics in the study of economic problems resulted in new branch of study called "Econometrics".

Q13] What are the characteristics of federal finance.

Ans. Finance of the state government, central government and the relationship between the two is called as Federal finance.

Federal finance features: 1. Sources of income and heads of expenditure are distributed among centre and state government according to constitution.

2.In federal system centre provides financial assistance to states.

3. Although state has administered autonomy yet it remains sub-ordinate to centre. No state is free to fall apart from centre on its own.

4. In case of any financial disputes among centre and state governments, solution is sought according to provisions of constitution.

5. Constitution should spell distinctly functions to be performed by respective governments and each government should be provided competent sources of raising revenue to discharge its functions.

6. In short financial independence and adequacy is backbone of federal finance system.

Q14] Write a note on Finance Commission

Ans. The Finance commission of India came into existence in 1951. It was established under article 280 of Indian Constitution by President of India. It was formed to define financial relationship between centre and state. As per constitution commission is formed for every five years and consists of chairman, secretary and four other members.

The Finance Commission advices the president what percentage of Income tax should be retained by the centre and what principles should be adopted to distribute pool of income tax among states. The first Finance commission submitted its report in 1952. Till date fourteen Finance Commissions have submitted their reports.

Functions of Finance Commission: 1. Distribution of taxes among centre and states as per their contribution to taxes.

1. Determine factors governing grants in aid to states

Q15. Define Inflation. Explain effects of Inflation.

] Ans. Inflation means a general rise in the pries. It is rapid upward movement of prices.

Definition: According to Samuelson: "Inflation denotes a rise in the general level of prices".

Effects of Inflation: Inflation affects economic activities such as production, distribution, social and political relations in economy adversely.

A) On production: 1. Mild inflation stimulates production as it increases the profit margin entrepreneurs.

2. High inflation rate hinders production.

3. Inflation discourages savings. This affects capital formation which in turn affects products.

B) On Distribution: The impact of inflation is not uniform on all sections of people. It affects certain sections of the people adversely while certain other sections gain because of inflation.

Fixed Income Group people suffer due to inflation as their income do not increase as prices of commodities rise.

Working Class: Workers and wage earners work for subsistence living. Their wages do not rise as and when prices rise.

Creditors lose as the value of money is higher when they have lent and less when they are repaid.

Debtors gain because the value of money is high when borrowed but low when they repay.

Consumers lose and entrepreneurs gain because of inflation.

C) On Social Justice Front: Economic inequality leads to unequal opportunities in matters of health, education and employment. This results in social injustice.

D) On Political Front: Inflation widens social and economic disparities which cause frustration among the sufferers. This provides opportunity for political movements and if the government is not responsive, the movements may threaten the stability of government.

Q16] Explain concept of Indifference curve. What are its Assumptions.

Ans. Indifference curve can be defined as "Locus of points each representing different combinations of two goods, which gives same level of satisfaction". It is also called ISO – utility curve or equi – utility curve.

Assumptions:

1. Consumer should act rationally to maximise satisfaction.
2. There are two goods X and Y.
3. The prices of two goods are given.
4. The consumer should have complete information of prices of goods in the market.
5. Consumer prefers more of X to less of Y.
6. Goods are divisible
7. Consumers taste, habits and preference and income should be constant.

Q17]. Describe Lorenz Curve

Ans. The Lorenz curve is a graphic method of measuring deviations from the average. It was devised by Max. O. Lorenz, an economic statistician for measuring the inequalities in the distribution of wealth.

This method can be applied to compare the distribution of profits among different groups of business, disparities of distribution of wages, turn over, production or population etc.

In drawing Lorenz curves, we use cumulative values of the variable an cumulative frequencies rather than their absolute values and frequencies. In a simple manner, we draw a table of cumulative values of the data and also their related cumulative frequencies. These cumulative are then converted into percentages of the totals and both these variables (cumulative percentage values) are then plotted as 'X' and 'Y' values of a graph.

Q18] "Supply creates its own demand". Explain the statement of J.B.Say.

Ans. Classical theory of employment or the theory of output and employment developed by economists such as Adam Smith, David Ricardo, Robert Malthus etc. It is based on the J.B. Say's law of market. According to this law 'supply creates its own demand'. The classical theory of employment assumes that there is always full employment of labour and other resources.

According to this law the supply always equals to demand it can be expressed as S=D. Whenever additional output is produced in the economy the factors of production which participate in the process of production earn income in the form of rent, wages, interest and profits.

The total income so generated is equivalent to the total value of the additional output produced. Such income creates additional demand necessary for the sale of the additional output. There

Q19] What is law of supply? Explain the factors that determine supply?

Ans. The law of supply explains the functional relationship between price of a commodity and its quantity supplied. The law of supply can be stated as follows " other things remaining the same, as the price of a commodity rise its supply is extended and as the price falls its supply is contracted".

Factors that determine supply:

1. Price of the commodity: The supply of the commodity depends upon the price of that commodity. When price falls, supply falls and when price rises, supply also rises. Thus price and supply are directly related

2. Factor prices: The cost of production of a commodity depends upon the prices of various factors of production

3. Prices of related goods: The supply of the commodity depends upon the prices of related goods. If the price of a substitute goods goes up, the producer will be induced to divert their resources.

4. State of technology: Technological improvements determine supply of a commodity. Progress in technology leads to reduction in the cost of production which will increase supply.

5. Government policy: Imposition of heavy taxes as a commodity discourages its production. Hence production decreases.

Q20] What are the internal economies of the scale

Ans. Economies of large scale production can be grouped into two headings: Internal economies and external economies.

Internal economies: Internal economies are those economies which accrue to the firm itself when it expands in production.

1. **Technical economies:** Large firm will have more resources. They can install machinery at low cost of production. Technical economies are of four types:
   A. Large scale machines B. Linking process C. Superior techniques D. Increased specialisation.
2. **Managerial economies:** When scale of production increases, firm can benefit by specialisation in managerial department. Each department is under the charge of an expert. A small firm lacks of specialisation.
3. **Marketing economies:** As firm increases its scale of production, benefits accrue to it in marketing due to its large scale and sale.
4. **Financial economies:** A large firm is better known to financial institutions and stock markets. Thus, it has a better credit access and can borrow more.
5. **Risk bearing economies:** Large firms will be in a position to bear risks or avoid risks. As they have diversified markets, the loss of one market can be covered by the profit of other market.
6. **Economies of research and development:** Large firms invest more in research and development than small firms which results in internal benefits to firms.

Economies of welfare: A large firm has large number of employees. Each employee is given a job which he is fit for. Therefore, workers get skilled and saves production time and encourages new ideas.

Q21]. Describe the characteristics features of Monopolistic competition.

Ans**. Monopolistic competition**: It is a market where considerable number of firms produce particular product with small differences. Prof. E.H Chamberlin and Mrs. Joan Robinson pioneered this market analysis.

Characteristics features of Monopolistic competition

1. Considerable Number of Firms: The number of firms in this market are less than that of perfect competition. These producers participate in production activity. Absence of control over output results in high competition.

2. Product Differentiation: One of the features of monopolistic competition if product differentiation. It take the form of brand names, trademarks etc. It cross elasticity of demand is very high.

3. Freedom of Entry and Exit of Firms: Entry into the industry is unrestricted. New firms are able to commence production of very close substitutes for the existing brands of the product.

4. Selling Costs: Advertisement or sales promotion technique is the important feature of Monopolistic competition. Such costs are called selling costs.

5. More Elastic Demand: Under this competition the demand curve slopes downward from left to the right. It is highly elastic.

Q22]. Explain the Gross Interest and Net Interest.

Ans. **Gross interest** is the payment which the lender receives from the borrower excluding the principle amount.

2. Gross interest includes net interest, reward for risk taking, reward for inconvenience, reward for management.

Net interest.

It is the payment made to the lender of capital for the service of capital only in the process of production.

2. Net interest = Gross interest – [reward for risk taking + reward for inconvenience + reward for management]

Q23]. Explain Primary and Secondary functions of Money.

Ans. Crowther defined money as "anything that is generally acceptable as a medium of exchange and which at the same time acts as a measure and store of value".

Primary Functions of Money:

1. Medium of Exchange: Money serves as a medium of exchange. It removes the inconveniences of barter system in which exchange of goods was possible if only there was double coincidence of wants. Any commodity can be exchange for money. People can exchange goods and services through the medium of money.

2. Measure of value: Money serves as a measure of value of goods and services. As common measure of value it has removed the difficulties of barter system and has made transactions simple and easy. The value of each commodity is expressed in the units of money.

Secondary Functions of Money:

1. Store of value: The value of commodities and services can be stored in the form of money. Certain commodities are perishable. If they are exchanged for money before they perish, their value be preserved in the form of money. Otherwise they perish and their value is lost forever. Even in the case of durable commodities, their value may diminish over a period of time. But their value can be stored, without any decline, in the form of money by exchanging them for money.

2. Standard of Deferred Payments: Money serves as a standard of deferred payments. In modern economies, most of the business transactions take place on the basis of credit. An individual

consumer or a businessman may now purchase a commodity and pay for it in future as this function makes it possible to express future payments in terms of money. Similarly one can borrow certain amount of money now and repay it in future.

3. Transfer of Money: Money can be transferred from one person to another at any time at any place.

Q24]. Explain different kinds of deposits accepted by commercial banks.

Ans. Commercial banks pay a very important role in economic growth of a country. Commercial banks are the most important source of institutional credit in the money market.

Commercial banks receives public money in the form of deposits. The deposits mainly are of the following types.

1) Current deposits: These deposits have two characteristics:

a) There is no restrictions with regard to the amount of the withdrawal and number of withdrawls.

b) Banks normally do not pay any interest on current account deposits.

2) Savings deposits: The sole aim of the bank in receiving these deposits is to promote the habit of thrift among low income groups. They have the following characteristics:

a) Two or three withdrawals per week are permitted.

b) Banks pay 4% to 5% interest per annum on savings deposits.

3) Recurring deposits: people will deposit their money in these deposits as monthly instalments for a fixed period of time. The bank after expiry of the said period will return the total amount with interest. The rate f interest will be higher than the savings deposits.

4) Fixed deposits: Deposits are fixed accounts are called fixed or time deposits. They are left with the bank for a fixed period. The following are the characteristics:

a) The amount cannot be withdrawn before expiry of fixed period.

b) Banks pay high rate of interest than any other deposits

Q25] What are the functions of RBI

Ans. Central bank is the apex institution of the banking system in a country. It controls, regulates and supervises the activities of the country's banking system. RBI is our central bank. It was established on 1st, April 1935 with a share capital of Rs. 5 crores. It was originally owned by private shareholders but was nationalised by the Government of India in 1949. It performs all the important functions of the central bank under the Reserve Bank of India Act, 1934.

Functions of RBI

1. Note Issue: Reserve Bank of India has the monopoly of note issue in the country. It maintains gold and foreign exchange reserves of a minimum Rs 200 crores of which gold should be worth Rs 115 crores. There is a separate issue department to issue currency notes . At present RBI issues currency notes of the denomination RS 2000, Rs 500, Rs 100,Rs 50, Rs 20,Rs 10. Coins are issued by the Finance Ministry of the Government of India but circulated by the RBI

2. Banker to the Government: RBI acts as the banker, agent and advisor to the Government of India and all the state governments except the Government of Jammu and Kashmir. It receives

money and makes payments on behalf of the government and keeps the cash balances as deposits without any interest. IT assists the government in floating new loans and the management of public debt. It acts as an advisor to the Government in all financial matters.

3. Banker's Bank: RBI serves a banker not only to the government but also to the banks. According to Banking Regulation Act, 1934 all the scheduled banks are bound by the law to maintain with the RBI a part of their total deposit amount as cash balances. This ratio is called the cash reserve ratio (CRR). RBI provides financial assistance to the commercial banks in times of their financial stringency by giving loans or for settlement of inter-bank accounts.

4. Lender of last Resort: In the times of financial stringency the scheduled banks can approach the RBI as last resort. The RBI grants them loans against the securities such as the treasury bonds, treasury bills and other approved securities. It may also provide financial assistance by rediscounting the eligible bills of exchange.

5. Clearing House: Businessmen and other customers get cheques of bank in which they do not have account. He has to deposit the cheque received in his bank which collects the amount from the bank on which the cheque has been issued.

2. Its termed as Inter-bank settlement of accounts.

3. All commercial banks maintain deposit accounts with Reserve Bank of India. RBI clears all the cheques to settle inter-bank transactions and make appropriate entries in accounts of commercial banks.

4. For this RBI has established clearing houses at different places.

Q26] What are the exceptions to Law of Demand.

Ans. The law of demand states that there is an inverse relationship between price and demand for the commodity. If the price of the good increases then demand decreases and if the price of the good decreases then demand increases other things being constant.

Exceptions to law of demand:

1. **Giffen paradox:** Sir Robert giffen observed that poor people will demand more of inferior goods even though the prices of those goods increases. He observed that poor people buy more bread instead of less meat in Britain. These goods are known as giffen goods.
2. **Veblen effect:** Veblen stated that some goods like diamond, cars are demanded by rich people to maintain their social prestige. If the price falls they will not buy it as they will lose prestige. In this case demand curve slopes left to right upwards.
3. **Speculation:** When prices are expected to increase in future people will buy more of it today even if its price is increasing at present. It is found in case of shares. Hence demand curve slopes left to right upwards.

Illusion: Some consumers have a false idea that high priced goods will have a better quality instead of low prised goods, they will purchase only when prices are high. Hence demand curve slopes left to right upwards.

Q27]. What is barter system? What are its difficulties.

Ans. Prior to the introduction of money, the barter system was in vogue. In that system one commodity was exchanged for another commodity. Under this system no one was able to produce all goods at their disposal. As a consequences they used to exchange commodities among themselves.

Difficulties of barter system

1. Lack of coincidence of wants: Under the barter system the buyer must be willing to accept the commodity which the seller is willing to offer in exchange. The wants of both the buyer and the seller must coincide. If there is no such coincidence direct exchange between the buyer and the seller is not possible.

2. Lack of store value: Some commodities are perishable. They perish within a short time. It is not possible to store the value of such commodities in their original form under the barter system. They should be exchanged before they actually perish.

3. Lack of divisibility of commodities: Depending upon its quantity and value it may become necessary to divide a commodity into small units and exchange one or more units for other commodity. But all commodities are not divisible.

4. Lack of common measure of value: Under the barter system there was no common measure value. To make exchange possible it was necessary to determine the value of every commodity in terms of every other commodity.

5. Difficulty in making deferred payments: Under barter system future payments for present transaction was not possible because future exchange involved some difficulties.

Q28]What is NNP at market price and NNP at factor price.

Ans. National income is the total value of all goods and services produced in a country in a year.

The net values of all goods and services produced in a country in a year is called as NNP. NNP can be obtained by deducting depreciation on capital goods from GNP.

So NNP = GNP – Depreciation charges.

It is the total income received by the four factors of production in the form of rent, wages, interest, profits.

The NNP is directly not available for distribution among factors of production. The amount of indirect taxes paid by the firms to the Government should be deducted and similarly companies also receive subsidies from the Government i.e. a part of the production cost is borne by the Government. Hence goods are sold in market at a price lower than the actual cost of production. Hence these subsidies are to be added to NNP

4. **NNP at Factor Price = NNP at market price – Indirect taxes + Subsidies**

Q29] Describe liquidity preference theory.

Ans. Keynes proposed a monetary explanation of rate of interest. He said that interest is determined by both demand and supply of money. He said interest is reward for parting with liquidity.

a. Supply of money: It refers to total amount of money in circulation. Supply of money is function of rate of interest to a degree, supply of money is fixed or inelastic at a given point of time it is by Central Bank [RBI]
b. Demand for money: People demand money due to its liquidity. The higher the liquidity preference, the higher will be the rate of interest to be paid. People demand money for three reasons

1. Transaction motive 2. Precautionary motive 3. Speculative motive

Q30] Characteristic features of wants

Ans. Human wants are basis for economic activity. Human wants depend on social and economic conditions of an individual.

1. **Wants are unlimited:** when one want is satisfied another want takes its place.
2. **Only one want is satiable:** All wants cannot be satisfied, only one want can be satisfied. Ex: Thirst can be satisfied by drinking water.
3. **Wants are competitive:** As wants are unlimited and resources are limited. Wants compete among themselves.
4. **Wants are alternative:** It means if a person is hungry, he can satisfy his hunger by eating rice or fruits.
5. **Wants recur:** Wants always reoccur though satisfied completely at particular time.
6. **Wants turn into habit:** If a want is satisfied regularly, it becomes a habit.
7. **Wants vary:** Wants vary from person to person, time to time, place to place

Q31] Differences between Micro and Macroeconomics?

Ans. Micro economics studies particular firm, particular household, individual price whereas Macro economics studies national income not individual income, general price level not individual price.

Following are the differences between Micro and macro economics

MICRO ECONOMICS	MACRO ECONOMICS
1. It is derived from the Greek word "micros" which means "small"	1. It is derived from the Greek word "macros" which means "large"
2. It studies the economy as individual unit	2. It studies the economy as a whole
3. It is known as "price theory"	3.It is known as "Income and employment" theory
4. It is developed by Alfred Marshall	4. It is developed by J.M. Keynes
5. It studies individual income, individual prices	5.It studies National income instead of individual income and general price level instead of individual price.

Q32] Explain concept of Indifference curve. Explain its properties.

Ans. Indifference curve can be defined as "Locus of points each representing different combinations of two goods, which gives same level of satisfaction". It is also called ISO – utility curve or Equi – utility curve.

Properties of Indifference curves:

1. Indifference curve slopes from left to right downwards: It slopes from left to right downwards because when amount of one good in indifference combination is increased, the amount of other good is reduced. It neither slopes positive towards up nor horizontal / vertical.
2. Indifference curve is always convex to origin: It implies diminishing marginal rate of substitution.
3. Indifference curves never intersect each other: Two IC curves never intersect each other because if they intersect each other it represents different level of satisfaction.

4. Higher Indifference curve represents higher level of satisfaction: High indifference curve gives high level of satisfaction than low indifference curve because IC to right represents more satisfaction.

Indifference curve neither touches X-axis nor Y-axis.

Q33] Explain various items of public expenditure.

Ans. Expenditure incurred by government on various economic activities is called as public expenditure. Generally, Government incurs expenditure on following items:

1. Defence 2. Police 3. Economic services [agriculture, industry, transport, science & technology] 4. Social services [education and health] 5. Other general services [tax collection] 6. Pensions 7. Subsidies 8. Grants to state government 9. Grants to foreign government 10. Loans to state government 11. Loans to foreign government 12. Loans to public enterprise 13. Repayment of loans 14. Assistance to states at times of natural calamities

Q34] Define Oligopoly? Explain its characteristics

Ans. Oligopoly is derived from the Greek words 'Oligos' means few and 'pollein' means to sell. Oligopoly refers to a market situation in which the number of sellers dealing in a homogenous or differentiated product is small.

Characteristics of Oligopoly

1. Very few sellers of the product.

2. Interdependence.

3. Presence of monopoly power.

4. Existence of price rigidity.

5. Excessive expenditure on advertisement.

Q35]. Define Duopoly? Explain its characteristics.

Ans. Duopoly is a market where only two producers exit in the market. It is a limited form of oligopoly. The goods produced by the producers may be homogenous or differentiated.

Characteristics of Duopoly

1. There will be two sellers.

2. Homogenous product.

3. Zero production cost.

4. Sellers do not understand their interdependence.

Q36] Scarcity definition of economics?

Ans. Scarcity definition of economics was given by Lionel Robbins. According to Lionel Robbins, "Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses".

Features of Scarcity definition:

1. **Human wants are Unlimited:** When one want is satisfied, new wants takes its place.
2. **Means are scarce:** the means of a person to satisfy his wants are limited. It leads to economic problems as all wants cannot be satisfied.
3. **Alternative uses:** Resources are not only scarce but have alternative uses. For example, a piece of land can be used to produce rice or wheat. Here man has to make decision for alternative use.
4. **Problem of choice:** Man has to make a choice between wants.

Q37]. Define National Income and Explain the various concepts of National Income.

Ans. National Income is the market value of all goods and services that are produced by a country during a given period of time. It is one of the important concept in macro economics..

1. Gross National Product (GNP)

GNP is the total value of all final goods and services produced in a country in a year.

GNP = C+I+G+[X-M]

C = Consumption, I = Investment, G = Government expenditure, X = Exports, I = Imports.

2. Gross Domestic Product. (GDP)

GDP is the total value of all final goods and services produced within the boundaries of a country in a year.

GDP = C+I+G or GDP = GNP – Net Income from abroad.

Where C = Consumption, I = Investment, G = Government expenditure

3. Net National Product (NNP)

The net values of all goods and services produced in a country in a year is called as NNP. NNP can be obtained by deducting depreciation on capital goods from GNP.

NNP = GNP – Depreciation charges

4. National Income (NNP) at factor cost

The amount of indirect taxes paid by firms should be deducted and subsidy received by firms from the government should be added to NNP to get NNP at factor cost.

NNP at factor cost = NNP at market price – indirect taxes + subsidy

5. Personal Income

It is the total of incomes received by all persons from all sources in a specific time period.

Personal Income = National Income at factors cost - Undistributed profits - Corporate taxes – Social security contribution + Transfer payments.

6. Disposable income.

1. Personal income totally is not available for spending.

2. People have to pay direct taxes such as income tax, property tax etc from their personal income.

3. Disposable income is the income left out after deducting income tax and property tax from the personal income

4. Disposable income = Personal income – Personal taxes

7. Per – capita income.

Per – capita income represents the average income of an individual person earned in a year in a country.

Per-capita income is obtained by dividing National income of a country by its population.

Per-capita income = National income / total population of a country.

Q38] What is meant by profit? Explain briefly various theories of profit.

Ans. Profit is the reward paid to the entrepreneur for his services as an organiser in the process of production.

Theories of Profit

1. Dynamic Theory of Profit: It was propounded by J.B. Clark. According to him, profit is the reward for dynamism of the entrepreneurs .

Profit arise due to dynamic changes that take place like changes in population, accumulative of capital, new methods of production, changes in business organisation and multiplication of wants.

2 Innovation Theory: It was propounded by Joseph Schumpeter. According to him, profit is the reward for the incentive skill of the entrepreneur. He has to introduce the following innovations.

a. Introduction of new goods.

b. Introduction of new methods of production.

c. Opening up new markets.

d. Inventing new raw materials.

e. Reorganisation of an industry.

If the above innovations are introduced. The cost of production remains below the selling price and leads to profit.

3. The Risk Theory of Profit: It was proposed by Prof. Hawley. According to this theory, Profits are rewarded to the entrepreneur for taking risk. Because fluctuations may involve in future prices, demand, unforeseen contingences etc. He gets only wages if these risks are insured.

4. Uncertainty Theory of Profit: It was formulated by Prof. Knight. According to this theory, profit is the reward for bearing uninsurable risks and uncertainties. He classified it into 2 types

a. Foreseen insurable risks like fire, natural calamities etc.

b. Unforeseen non insurable risks like changes in prices, demand and supply etc. Which cannot be calculated.

5. Walker's Theory of Profit: According to this theory, profit arise due to the differences in efficiency and ability of entrepreneurs like differences in fertility of soil. More efficient entrepreneurs of firm will be able to get more profits above the price.

Q39]. Explain Ricardian Theory of Rent.

Ans. David Ricardo defined Rent as "Rent is that portion of the produce of the earth which is paid by the tenant to the landlord for using the original and indestructible power of the soiled." He considered rent as a differential surplus earned by more fertile plots of land in comparison with the less fertile plots of land..

Features of Ricardian Theory of Rent.

1. Rent is a payment to the original and indestructible power of the soil.

2. Rent is a differential surplus.

3. The cost of production on marginal land determines the price.

4. Agriculture is subject to the law of diminishing returns.

5. Land is put only one use. i.e., for cultivation.

Q40] Describe the concept, components and types of Budget.

Ans. Budget is an annual statement showing the estimated receipts and expenditure of a government for a financial year (April to March). The government presents the budget to the legislature every year for its approval. The finance minister presents the budget.

Components of Budget: The budget consist of both receipts and expenditure of the government. The budget consist of two main components:

1. Budget Receipts : a) Revenue Receipts: this consists of tax revenue and non-tax revenue.

b) Capital Receipts: This consists of recoveries of loans, other receipts and borrowings and other liabilities.

2. Budget Expenditure: The budget expenditure is classified into plan expenditure and non-plan expenditure.

a) Plan expenditure

(i) Plan expenditure on revenue account (ii) Plan expenditure on capital account.

b) Non- plan expenditure

(a) Non- plan expenditure on revenue account (ii) Non-plan expenditure on capital account

Again the plan expenditure and the non-plan expenditure is summed up and shown as revenue expenditure and capital expenditure.

Types of budget: There are three types of budgets based on the difference between the receipts and expenditure.

1. Surplus Budget: This refers to the budget in which the total revenue is more than the total expenditure (R>E)

2. Deficit Budget: This refers to the budget in which the total expenditure exceeds the total revenue (R< E)

3. Balanced Budget: This refers to the budget in which the total expenditure and the total revenue are equal (R = E)

Q41. Compare Perfect competition and Monopoly

Ans. Perfect competition : A perfect competitive market is one in which the number of buyers and sellers is very large. All engaged in buying and selling a homogenous product without qny restrictions. Hence there is absence of rivalry among the individual firms. Eg: Agricultural markets.

Monopoly: Monopoly is said to exist when one firm is the sole producer of a product which has no close substitutes.

A comparison between Perfect competition and Monopoly

Perfect Competition	Monopoly
1. Large number of sellers and buyers.	1. Single seller and many buyers
2. Free entry and free exit of firms	2. No scope for entry and exit
3. Homogenous product	3. The product may or may not be homogenous
4. Perfect substitute goods	4. No substitute goods
5. Difference between industry and firm	5. Industry and firm are one & same.
6. Sellers and buyers are price takers and not price givers.	6. Seller can determine either price or quantity but not both.
7. Uniform price prevails for the same goods	7. Price varies depending on demand

Q42]. Explain the classification of Market based on Time and Area.

Ans. Market is a place where the activities of purchasing and selling of goods and services takes place. It refers to the conditions and commercial relationship facilitating transactions between buyers and sellers.

Classification of Markets

1. Time Based Markets: On the basis of time, markets are divided into three types:

a) Very Short Period Market: This is a period where producer cannot make any changes in the supply of goods. Hence the supply remains fixed.

b) Short Period Market: It is a period in which supply can be changed to a little extent. It is possible by changing certain variable inputs like labour.

c) Long Period: The market in which the supply can b changed to meet the increased demand by making change in the long period is called long period market.

2. Area Based Market: On the basis of area, markets are classified as follow:

a) Local Market: When a commodity is sold at its produced area it is called local market. Perishable goods like vegetables, flowers, fruits, etc. May be produced and marketed in the same area.

b) National Market: When a commodity is demanded and supplied by the people throughout the country it is called national market. Ex: wheat, rice cotton etc.

c) International Market: When buying and selling of commodities takes place all over the world, then it is called international market. Ex: gold, silver, petrol etc.

Q43]. Explain types of Distribution in Income.

Ans. The concept of distribution mainly deals with the essence and evaluation of the contribution of each factor of production.

The earnings in a market economy are distributed to the owners of the economy factors of production in the form of wages, rent, interest, and profits.

Hence, the theory of income distribution studies how income are determined in a market economy.

Distribution of Income: The distribution of income can be explained in two ways.

1. Functional Distribution: It refers to the distribution of national income among the factors of production as a reward for their services in the production of national income. In functional distribution we are no longer concerned with individuals and their individual income, but with factors of production land, labour, capital, and organisational activity.

2. Personal Distribution: Personal Distribution relates to individual person and their incomes. The way in which that income was acquired often remains in the background. Special attention is paid to income recipients as collective battery, in which regular patterns are sought.

Q44]. Explain the concept of transfer earning rent theory and quasi- rent.

Ans. **Transfer Earning Theory:** Mrs. Joan Robinson, in her book "The Economics of Imperfect competition", explained the concept of transfer earnings. It is also called opportunity cost of a factor. Transfer Earnings is the return that the factor earns in the next best alternative use. If a factor has no alternative use, its transfer earning will be 'Zero'. Any factor must be paid a payment equal to its transfer earnings in order to remain the factor in the present use or occupation.

According to Mrs. Joan Robinson, rent is the surplus by factor over and above its transfer earning. Rent is the different between the actual earnings (Current earnings) of a factor and its transfer earnings.

Rent = current earnings of the factor – Transfer earnings.

Quasi- Rent Theory: The concept of quasi rent was introduced by Alfred Marshall to, him Quasi-Rent refers to the surplus earned over and above the prices of the factors of production. It is the income derived from machine and other man made appliances of production. It appears only in the short run as their supply is inelastic and disappears in the long run.

Long Answer Questions

Q1. Describe the Law of Diminishing marginal utility, its limitations and importance.

Ans. The Law of diminishing marginal utility was explained by Hermann Heinrich Gossen in 1854. It is also called Gossen's first law. In 1890 Alfred Marshall popularised this law.

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

The law says that as a consumer takes more units of a good, the extra satisfaction that he derives from extra unit of a good goes on falling.

The law is base on following Assumptions:

1. Rationality: Consumer is a rational man which means he always tries to get maximum satisfaction.

2. Cardinal measurement of utility: Utility is a cardinal concept. i.e., utility can be measured and compared numerically.

3. No time lag: There should not be any time lag between the consumption of one unit and other

4. Homogeneous: Units of the commodity are similar in quantity, size, taste and colour.

5. Divisibility: The commodity is divisible into small units:

6. Constant Tastes: The consumer wants, tastes and preferences should remain the same.

Given these assumptions, the law can be illustrated with the following diagrammatic representation.

Units of X apples	Total utility	Marginal Utility ($TU_n - TU_{n-1}$)
1	40	40- 0=40
2	70	70- 0=30
3	90	90-70=20
4	100	100-90=10
5	100	100-100=0
6	90	90-100= -10

In the diagram 'X' axis measures units of apples and OY axis measures total utility and marginal utility. TU curve represents total utility and MU curve represents marginal utility. TU curve is maximum at 5th unit where MU curve will become zero. TU curve slopes downwards from 6th unit, while MU will become negative.

The relationship between total utility and marginal utility is explained as follows:

1. When Total utility increase at diminishing rate, marginal utility falls.

2. When total utility is Maximum, marginal utility becomes zero.

3. When total utility decreases, marginal utility becomes negative

Limitations:

1. Hobbies: The law does not operate in the case of hobbies like collection of stamps, old paintings, coins etc. Greater the collection of a person, greater is his satisfaction. Marginal utility will not diminish.

2. Size of the goods: The law of diminishing marginal utility is not subject to the size of the goods if the goods are too big or too small.

3. Miser: The law does not apply to money. The more money a person has the greater is the desire to acquire more of it.

4. Constant Income, Taste and Preference: This law does not hold good if any change in income, of the consumer, tastes and preference.

5. Durable goods: In the case of durable goods, it is not possible to calculate their utility.

Importance of the Law:

1. The law of diminishing marginal utility is the basic law of consumption.

2. The explains the theory of value that the price of a good falls when supply increases.

3. Diamond - water paradox can be explained with the help of this law.

4. This law helps the government while formulating taxation policies.

5. The changes in design, pattern and packing of goods will be brought by the producers by keeping this law in the view.

Q2. Discuss the consumer's equilibrium with the help of law of equi – marginal utility.

Ans. Law of equi – marginal utility is an important law of consumption. It is also called as Gossen's Second Law as its formulation is associated with the name of H.H. Gossen.

Definition: According to Alfred Marshall "If a person has a thing which can be put to several uses, he will distribute it among these uses in such a way that it has the same marginal utility in all uses. If it had a greater marginal utility in one use than in another, he would gain by taking away some of it from the second and applying it to the first".

Statement of the Law:

Equalisation of marginal utilities will maximize the consumer's satisfaction and consumer attains equilibrium.

$$\frac{MU_x}{P_x} = \frac{MU_y}{P_y} = \frac{MU_z}{P_z} = MU_m$$

Here MU_x, MU_y, MU_z and MU_m are marginal utilities of commodities x, y, z and money and

P_x, P_y, P_z are prices of x, y, z goods.

This law can be explained with the help of a following table: Suppose the consumer is prepared to spend whole of his money income on two goods, say X and Y.

Units X	MU_x	Units Y	MU_y
1	33	1	36
2	30	2	32
3	27	3	28
4	24	4	24
5	21	5	20

Consumer will be in equilibrium when he is buying 4 units of X and 2 units of Y and spending Rs. 20/- on them and gets total utility equal to 182 units which is maximum. if he spends his income in any other way, all the three conditions cannot be fulfilled simultaneously.

Assumptions to the Law:

1. This law is based on cardinal measurement of utility.

2. Consumer is a rational man always aiming at maximum satisfaction.

3. Marginal utility of money remains constant.

4. The prices of goods are unchanged.

5. Utilities are independent.

6. Consumer's income is limited and he is proposed to spent the entire amount on different goods.

Limitations of the Law:

1. The law is based upon the assumption of rationality on part of the consumer. But in real life, several obstacles may obstruct rational behaviour..

2. This law is not applicable when goods are indivisible.

3. The law is based on unrealistic assumption like cardinal measurement of utility and marginal utility of money remains constant. In real world MU of money does not remain constant.

4. This law is not applicable to complementary goods.

5. It is assumed that the consumer has a perfect knowledge. But this is not correct.

Importance of the Law:

1. It explains how a consumer maximizes his utility from limited resources.

2. It explains how a producer maximizes his profits and reduces cost of production.

3. Exchange is based on law of substitution.

4. Basing upon this law, the rewards for factors of production like labour, capital and organization are determined.

5. This law helps the government in the allocation of scarce resources to different sectors.

Q3. Explain the meaning of perfect competition. Illustrate the mechanism of price determination under perfect competition.

Ans. Perfect competition: Perfect competition is a market structure characterized by a complete absence of rivalry among the individual firms. It is a market situation in which large number of buyers and sellers are engaged in buying and selling homogeneous products without any artificial restrictions. Therefore, single price rules the market.

Price Determination under Perfect Competition: Under perfect competition, sellers and buyers cannot decide price, Industry decides the price of the good.

Market brings about a balance between the commodities that come for sale and those demanded by consumers. It means, the forces of supply and demand determine the price of the good.

The following schedule and diagram help us to understand changes in supply, demand an equilibrium price.

Demand and supply schedule.

Price (in Rs)	Quantity supplied (in KGs)	Quantity Demanded (in KGs)
10	20	60
20	30	50
30	40	40
40	50	30
50	60	20

The above table show the demand and supply schedules of a good. Changes in price always lead to change in supply and demand. As price increases, there is a fall in the quantity demanded. It means, price and quantity demanded have negative relationship. At the same, if price of a commodity increases there is an increase in the quantity supplied. Therefore, the relation between price and supply of goods is positive.

It can be observe from the table that when the price is Rs 10/-, market demand is 60kgs and supply is 20kgs. When price increase to Rs 20/-, the supply increases to 30kgs and demand falls to 50kgs. If the price increases to Rs 50/-, the supply increases to 60kgs and demand is only 20kgs. When the demand is less price tends to decrease towards equilibrium price. When the price is Rs 30/-, the demand and supply are equal to 40kgs. This is called equilibrium price which is Rs 30/-, and equilibrium output and demand is 40kgs.

This process is explained with the help of a figure.

In the figure, the demand and supply of a commodity are shown on OX axis and the price of the commodity on OY axis. As per the diagram, the equilibrium price is found at appoint where both demand and supply curves intersect each other at point E i.e. OP price is the equilibrium price and OQ is the equilibrium supply and demand.

Q4. Explain various Methods of calculating National Income.

Ans. Ans. National Income is the market value of all goods and services that are produced by a country during a given period of time. It is one of the important concept in macro economics.

Meaning: It is defined as the total market value of all final goods and services produced by the people of a country during a year.

Definition: According to Marshall, "Labour and capital of a country acting on its natural resources produce annually a certain net aggregate of commodities, material and immaterial, including services of all kinds", is called National Income.

There are three methods of measuring National Income.

1. Product method or Output method: It is also known as Inventory method or commodity service method. In this method, we find the market value of all final goods and services produced in a country during a period of time. The entire output of final goods and services are multiplied by their respective market prices to find out the **Gross National Product**.

NI= (P1 Q1 + P2 Q2 +..... $P_n Q_n$) – Depreciation – Indirect taxes + Net Income from abroad.

Where NI = National Income, P = Price of good or service, Q = Quantity of good or service produced, 1,2,.....n = the various commodities.

Here we find the value added in the different sectors like agriculture, government, professionals, industry and other service sectors.

Precautions:

a) Only final or finished goods should be taken into account.

b) Unfinished goods and raw material are excluded.

2. Income Method: In this method the income earned by all factors of production are added to gt the national income of a country. The four factors of production receive incomes in the form of wages, rent, interest and profits.

NI = W + I + R + P

Where: NI = National Income, W= Wages, I = Interest, R = Rent, P = Profit.

Precautions:

a) Only net interest, wages, and profit are to be considered.

b) Non – productive factor payments are to be exclude from national income.

c) Transfer payments are to be excluded from national income.

d) Undistributed profits are to be included in the national income.

3. Expenditure Method: In this method, the expenditure on final goods and services by individual, firms and Government etc., is considered for estimating the national income.

NI = EH + EF + EG+ Net exports + Net income

Where NI = National Income, EH = Expenditure of Households, EF = Expenditure of firms, EG = Expenditure of Government.

Q5. Explain the Keynesian theory of employment.

Ans. John Meynard Keynes in his famous book 'The General theory of Employment', 'Interest and Money' (1936) stated his employment theory, which deals with all levels of employment.

According to this theory, the point of effective demand which is determined by the aggregate supply and aggregate demand denotes the level of employment.

Aggregate supply Schedule: The aggregate supply schedule shows the various amounts of the commodity that will be offered for sale at a series of price. As the level of output increases with the level of employment. The aggregate supply price also increases with every increase in the level of employment. The aggregate supply curve slopes upwards from left to right. But when the economy reaches the level of the full employment, the aggregate supply curve becomes vertical.

Aggregate demand Schedule: The various aggregate demand prices at different level of employment is called aggregate demand price schedule. As the level of employment rises, the total income of the community also rises and therefore the aggregate demand price also increases. The aggregate demand curve slopes upward from left to right.

Equilibrium Level of Income: The two determinants of effective demand aggregate demand, aggregate supply and aggregate demand prices combined schedule is shown in the following table.

Level of employment (in lakhs of workers)	Aggregate supply price (in crores of Rs)	Aggregate demand price (in crores of Rs)
20	200	175
30	250	225
40	300	300 AD = AS

50	350	325
60	400	425

The table shows that as long as the demand price is higher than the aggregate supply price, the level of employment 40 lakh workers aggregate demand price is equal to aggregate supply prie i.e., 300 crores. So effective demand in the above table is Rs 300 crores.

This can be shown in the following diagram.

In the diagram 'X' axis represents the employment and 'Y' axis represents price, AS is aggregate supply curve AD is aggregate demand curve. The point of intersection between the two 'E_1' point. This is effective demand where all workers are employed at this point the entrepreneur expectation of profits are maximised. At any other points the entrepreneurs will either incur losses or earn sub-normal profits.

Q6. Explain the consumer's equilibrium using indifference curve analysis.

Ans. A consumer is said to be in equilibrium with given tastes, prices of the two goods and income on the purchase of two goods in such a way so as to get maximum satisfaction.

I. Assumption: The analysis of consumer's equilibrium is based on the following assumptions:

1. Consumer has an indifference map showing his scale of preferences which remains the same throughout the analysis.

2. Money income is given and constant.

3. Prices of two goods are given and constant.

4. The consumer is rational and thus maximizes his satisfaction.

5. There is no change in tastes, preferences and habits of the consumer.

6. There is a perfect competition in the goods market.

II. Conditions of Equilibrium: There are two conditions that must be satisfied for the consumer to be in equilibrium.

1. At the point of equilibrium, he budget line / price line mist be tangent to the indifference curve at its minimum point.

2. At the point of equilibrium, the consumer's MRS_{xy} and the price ratio must be equal i.e., $MRS_{xy} = P_x / P_y$.

This can be shown in the following diagram.

In the diagram 'AB' is consumer's budget line or price line. IC, IC_1, IC_2 are indifference curve. In the diagram the consumer is equilibrium OM of x and ON of y, At point E the price line touches to IC_1. At point S consumer will be on lower indifference curve IC will be getting les satisfaction than E on IC. IC_2 is beyond the capacity of consume. So it is outside to the budget line AB.

Superiority of the Indifference Curve Analysis:

1. The assumption of ordinal measurement of utility is less restrictive and more realistic.

2. Constant marginal utility of money is not assumed in IC analysis.

3. Indifference curve analysis illustrates price effects, income effect and substitution effect more realistically.

Q7.Critically Examine the law of variable proportions.

Ans. The law of variable proportions is called the Law of Diminishing Marginal Returns. It refers to the short run where factors are of two types i.e. fixed factors and variable factors. In the short run, changes in fixed factors are not possible or variable factors can be changed in order to increase output.

Definition: According to Alfred Marshall, "an increase in capital and labour applied in the cultivation of land cause in general less than proportionate increase in the amount of produce raised, unless it happens to coincide with an improvement in the arts of agriculture".

Assumption:

1. The state of technology remains constant.

2. The analysis relates to short period.

3. The law assumes labour in homogeneous.

4. Input prices remain unchanged.

Explanation of the Law: Suppose a farmer has 4 acres of land he wants to increase output by increasing the number of labourers, keeping other factors constant. The changes in total production, average product and marginal product can be observed in the following table.

Units of variable factor	Total product	Average product	Marginal product	Stages of output
1	50	50	50	1st Stage Increasing returns
2	110	55	60	
3	135	45	25	
4	150	37.50	15	
5	160	32	10	2nd Stage Diminishing returns
6	165	27.50	5	
7	165	23.50	0	
8	160	20	-5	#rd Stage Negative returns

In the above table total product refers to the total output produced per unit by all the labourers employed. Average product refers to the product per unit of labour. Marginal product refers to additional product obtained by employing an additional labour.

In the above table there are three stages of production.

1st Stage Increasing returns at 2 units, Total output increases, Average product increases and Marginal product reaches maximum.

2nd Stage Diminishing returns from 3rd unit onwards Total product increases diminishing rate and reaches maximum, Average product decreases continuously, Marginal product becomes zero

3rd Stage Negative returns from 8th unit Marginal product becomes zero decreases, Average product declines and Marginal product becomes negative.

This can be explained in the following diagram.

In the diagram on OX axis shows units of labourer and OY axis shows Total Product (TP), Average Product (AP) and Marginal Product (MP).

1st stage TP, AP increases MP is maximum, In the 2nd stage TP is maximum. AP decreases, MP is zero. At 3rd stage TP declines, AP also declines and Mp becomes negative.

Q8. Explain the Law of returns to scale.

Ans. The law of returns to scale relate to long run production function. In the long run it is possible to alter the quantities of all the actors of production. If all factors of production are increased in given proportion the total output has to increase in the same proportion, keeping the factor proportions constant. According to returns to scale concept, these possibilities are known as: **1. Increasing returns to scale:** It arises when a given percentage increase in inputs leads to greater percentage increase in output.

2. Constant returns to scale: It arises when the percentage increase in output will be equal to the percentage increase in input.

3. Decreasing returns to scale: It arises when the percentage increase in output is les than the percentage increase in inputs.

Assumptions:

1. All inputs are variable.

2. State of Technology remains the same

3. There is perfect competition in the market.

4. Production is measured in physical quantities.

The returns to scale is explained with the following table and diagram

Units	Combination of inputs	Total product	Marginal product	Returns
1	10 units of labour + 1 unit of capital	9	9	**Increasing returns**
2	20 units of labour + 2 units of capital	20	11	
3	30 units of labour + 3 units of capital	32	12	**Constant returns**
4	40 units of labour + 4 units of capital	44	12	
5	50 units of labour + 5 units of capital	55	11	**Diminishing returns**
6	60 units of labour + 6 units of capital	65	10	

The above table shows the three patterns of returns to scale. In the 1st place, when the scale is expanded upto 3 units, the returns are increasing. Later upto 4th units, it remains constant and finally from 5th unit onwards the returns go on diminishing.

In the diagram OX axis shows scale of production. OY axis shows total product, RR_1 represents increasing returns, R_1 –S constant returns, SS_1 represents diminishing returns.

Q9. Critically examine the classical theory of employment.

Ans. The theory of output and employment developed by economists such as Adam Smith, David Ricardo, Malthus is known as classical theory. It is base on the famous "Law of markets" advocated by J.B. Say. According to this law "supply creates its own demand". The classical theory of employment assumes that there is always full employment of labour and other resources. The classical economists ruled out ant general unemployment in the long run. These views are known as the classical theory of output and employment.

The classical theory of employment can be three dimensions.

1. Goods market equilibrium.

2. Money market equilibrium.

3. Equilibrium of the labour market.

1. Goods market equilibrium: The 1st part of Say's law market explains the goods market equilibrium. According to Say "supply creates its own demand". Say's law states that supply always equals demand. Whenever additional output is produced in the economy. The factors of production which participate in the process of production. The total income generated is equivalent to the total value of the output produced. Such income creates additional demand for the sale of the additional output. Thus there could be no deficiency in the aggregate demand in the economy for the total output. Here ever thing is automatically adjusting without need of government intervention.

The classical economists believe that economy attains equilibrium in the long run at the level of full employment. Any disequilibrium between aggregate demand and aggregate supply equilibrium adjusted automatically. This changes in the general price level is known as price flexibility.

2. Money market equilibrium: The goods market equilibrium leads to bring equilibrium of both money and labour markets. In goods market, it is assumed that total income spent. The classical economists agree that part of the income may be saved. But the savings is gradually spent on capital goods. The expenditure on capital goods is called investment. It is assumed that equality between savings and investment is brought by the flexible rate of interest. This can be explained by the following diagram.

In the diagram savings and investment are measured on the 'X' axis and rate of interest on 'Y' axis. Savings and investment are equal at 'Oi' rate of interest. So money market equilibrium can be automatically brought through the rate of interest flexibility.

3. Labour market equilibrium: According to the classical economists, unemployment may occur in the short run. This is not because the demand is not sufficient but due to increase in the wages forced by the trade unions. A.C. Pigou suggests that reduction in the wages will remove

unemployment. This is called wage – cut policy. A reduction in the wage rate results in the increase in employment.

According to the classical theory supply of and demand for labour are determined by real wage rate. Demand for labour is the inverse function of the real wage rate. The supply of labour is the direct function of real wage rate. At a particular point real wage rate, the supply of and the demand for labour in the economy become equal and thus equilibrium attained in the labour market. Thus there is full employment of labour. This can be explained with the help of diagram.

In the above diagram supply of and demand for labour is measured on the X axis. The real wage is measured on the Y axis. If the wage rate is OW_1 the supply of labour is more than demand for labour. Hence the wage rate falls. If the real wage is OW_2 the demand for the labour is more than supply of labour. Hence the wage rate rises. At OW real wage rate , the supply and demand are equal. This is equilibrium.

Assumptions:

1. There is no interference of government

2. Perfect competition in commodity and labour market.

3. Full employment.

Q10. What is Monopoly? Explain how price is determined under Monopoly?

Ans. Monopoly is a firm of imperfect competition. The word 'Mono' means single and 'Poly' means seller. Thus monopoly means single seller market. Monopoly is said to exist when one firm is the sole producer of a product which has no close substitutes. A monopolist can either control price or output but not both at same time.

Definition: According to Bilas, "Monopoly is represented by a market situation in which there is a single seller of a product for which there are no close substitutes; this single seller is unaffected by and does not affect the prices and outputs of other products sold in the economy."

Features of Monopoly: 1. A single firm produces the goods in the market.

2. No close substitutes to this good.

3. There is no difference between firm and industry.

4. The monopolist either Fix the price or output.

Price Determination: Under monopoly the monopolist has complete control over the supply of the product. He is price maker who can set the price to attain maximum profit. But he cannot do both things simultaneously. Either he can fix price and leave the output to be determined by consumer demand at a particular price or he can fix the output to be produced and leave the price to be determined by the consumer demand for his product.

This can be shown in the diagram

In the above diagram OX axis measures output and OY axis measures cost. AR is Average Revenue curve, AC is the Average Cost curve. In the above diagram at E point where MC= MR at that point the monopolist determine the output. Price is determined where this output line touches the AR line. In the diagram for producing OQ quantity cost of production is OCBQ and revenue is OPAQ.

Profit = Revenue – Cost

= PACB (shaded area is profit under monopoly).