XI- ECONOMICS NOTES

MICRO ECONOMICS

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MACRO ECONOMICS

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CHAPTER 1 NATURE AND SCOPE OF ECONOMICS

LISTS OF TOPICS

1- Defination Of Economics

*Economics is a science of wealth-Adam smith

*Economics is a science of material welfare-Marshall

*Economics is a science of scarcity and choice-Robbins

2- Scope of Economics

3- Methodology and formulating economic laws.

*The deductive method

*The inductive method

4- Micro and Macro Economics

5- Importance and utility of study of economics

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Topic-1 Definations of Economics

1- Economics is a science of wealth-Adam smith

Q.no-1. Define Adam smith definition of economics.? "Economics is a science of wealth".? (short question of exams).

Economics is a science of wealth-Adam smith

According to Adam Smith "Economics was concerned with, An Enquiry into the Nature and Causes of Wealth of Nations." As per definition of Adam Smith a key position was assigned to wealth in the study of Economics. The first person who introduced "Economics" as a subject was Adam Smith (1723-1790). He wrote the first book in economics entitled the

"wealth of nation" in 1976. In this book he considered economics as a subject in which we study production of wealth, distribution of wealth, consumption of wealth and exchange of wealth.

2- Economics is a science of material welfare-Marshall

Q. no-2. Define Marshall definition of economics.? "Economics is a science of material welfare".? (short question of exams).

Economics is a science of material welfare-Marshall Marshall gave the following definition of economics; "Political Economy or economics is the study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well-being.Three things are worth noting in the above definition provided by Marshall. First, it is a study of man as such and not of wealth. No doubt, according to this definition, economics is concerned with wealth but it is concerned with wealth the sense that it studies man's action regarding.how he earns wealth and how he spends it. It is thus clear that it is the study of man which occupies the prominent place in the economicstudy.

3-Economics is a science of scarcity and choice-Robbins

Q. no-3. Define Robbins definition of economics.? "Economics is a science of scarcity and choice". ? (short question of exams).

Economics is a science of scarcity and choice-Robbins

Robbins at London School of Economics (1929-1961), is one of the modern economists who gave the most scientific and logical definition of economics. He published his book,"An Essay on the Nature of Significance of Economic Science", 1932. In which, he gives a new definition of economics. On the 20th page of his book, he says,"Economics is the science which studies human behaviour as a relationship between ends and scarce means which have

alternative uses."
Robbins has defined economics as a human science dealing with alternative use or selection of scarce means and ends concernd with human behaviour. This definition is take as an analytical definition, which is supported by modern economists like:Alec Macfic, Eric Roll, etc.

MainIdeas:

Robbins definition has been accepted as a standard definition of the scope of economics. It has the following aspects:
Human wants or ends are unlimited.
Means or resources that are used to meet the unlimited wants, ends are scarce or limited in supply.
A choice has to be made from among the multiple wants.
Such scarce resources can be used alternatively.

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Topic 2 Scope of Economics

Q. no-1. Write down the scope of economics? (Short question of exams)

Scope of Economics

The scope of a subject refers to the fields they actually cover. The scope of economics can be finely understood if we classify it into heads viz:
1.Subject matter
2.Nature
3.Limitations
These headings are discussed as under:

Subject Matter

It can be further studied as:

According to Adam Smith

The classical economist Adam Smith considered wealth as the subject matter of economics. According to him economics deals with the activities of man in earning his income me and spending it among different objects in

order to obtain the maximum benefit for satisfaction of his wants.

According to Marshal

The neo classical economist Alfred Marshal regarded material welfare it be the subject matter of economics. According to him the activities of man kind as a social being and in the ordinary business of life which are related to the attainment of economic well being through the use of the material requisite are considered to be the subject matter of economics.

According to Robbins

According to Robbins those activities, which originate because of the imbalance relation between human wants and available resources constitute the subject matter of economics.

According to Keynes

Keynes is of the view that economics problems constitute the subject matter of economics.

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Nature of Economics

The nature of economics includes study or discussion that weather economics is arts or science?

Economics as a Science

Economics as a Positive Science

Economics as a Normative Science

Economics is an Art

Limitations of Economics

Un-Employment can be Eradicated

Distribution of Money

Utility to Individual

It can be studied as:

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1. Utility to Producers
2. Utility to Consumers
3. Utility to Laborer

Topic3 Methodology and formulating economic laws.

Q.no-1 Write down the deductive and indeductive method of economics laws? (short question of exams)

***The deductive method**

***The inductive method**

An economic theory derives laws or generalizations through two methods:

(1) Deductive Method and (2) Inductive Method.

These two ways of deriving economic generalizations are now explained in brief:

(1) Deductive Method of Economic Analysis:

The ***deductive method*** is also named as ***analytical***, ***abstract*** or ***prior*** method. The deductive method consists in deriving conclusions from general truths, takes few general principles and applies them draw conclusions.

For instance, if we accept the general proposition that man is entirely motivated by self-interest. In applying the deductive method of ***economic analysis***, we proceed from general to particular.

The classical and neo-classical school of economists notably, Ricardo, Senior, Cairnes, J.S. Mill, Malthus, Marshall, Pigou, applied the deductive method in their economic investigations.

(2) Inductive Method of Economic Analysis:

Inductive method which also called ***empirical method*** was adopted by the "Historical School of Economists". It involves the process of reasoning from particular facts to general principle.

Topic 4- Micro and Macro Economics

Q.no.1 Differentiate between Micro economics and Macro economics? (short question of exams).

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Microeconomics

Microeconomics focuses on issues that affect individuals and companies. This could mean studying the supply and demand for a specific product, the production that an individual or business is capable of, or the effects of regulations on a business.

Macroeconomics

Macroeconomics focuses on issues that affect the economy as a whole. Some of the most common focuses of macroeconomics include unemployment rates, the gross domestic product of an economy, and the effects of exports and imports.

Topic 5- Importance and utility of study of economics

Q. no-1 what are the importance and utility of study of economics? (short question of exams)

Importance and utility of study of economics

1. Economic Forecaster.
2. You can always give advice.
3. Diminishing Returns.
4. Rational Behavior.

5. Economics is a very humorous subject.
6. Economics gets you a high paid job.
7. It's better than studying Geography.
8. Economies of Scale

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CHAPTER 2 PRODUCTION AND FACTORS OF PRODUCTION

LIST OF TOPICS

1. Meaning of Production
2. Factors of Production.

*Land-natural resource.

*Labour-human resource.

*Capital-produced means of production.

*Organisation-enterpreneurship.

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Topic 1 . Meaning and Defination of production

Q no-1 what is mean by factors of production? Give the names of factors of production? (short question of exams)

Meaning and Defination of production

"The processes and methods used to transform tangible inputs (raw materials, semi-finished goods, subassemblies) and intangible inputs (ideas, information, knowledge) into goods or services. Resources are used in this process to create an output that is suitable for use or hasexchange value."

Topic 2. Factors Of Production

Q no-1 Describe in detail factors of production? (long question of exams)

"The factors of production are resources that are the building blocks of the **economy**; they are what people use to produce goods and services. Economists divide the factors of production into four categories: land,**labor**, capital, and entrepreneurship."

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Land

Land is the economic resource encompassing natural resources found within a nation’s economy. This resource includes timber, land, fisheries, farms and other similar natural resources. Land is usually a limited resource for many economies. Although some natural resources, such as timber, food and animals, are renewable, the physical land is usually a fixed resource. Nations must carefully use their land resource by creating a mix of natural and industrial uses. Using land for industrial purposes allows nations to improve the production processes for turning natural resources into consumer goods.

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EFFICIENCY OF LAND.

land comprises all naturally occurring resources whose supply is inherently fixed[1]. Examples are any and all particular geographical locations, mineral deposits, forests, fish stocks, atmospheric quality, geostationary orbits, and portions of the electromagnetic spectrum. Natural resources are fundamental to the production of all goods, includingcapital goods. Location values must not be confused with values imparted by fixed capital improvements. In classical economics, land is considered one of the three factors of production (also sometimes called the three producer goods) along with capital, and labor. Land is sometimes merged with capital to simplify micro-economics. However, a common mistake is combining land and capital in macro-analysis. Income derived from ownership or control of natural resources is referred to as rent.

Labour

Labor represents the human capital available to transform raw or national resources into consumer goods. Human capital includes all able-bodied individuals capable of working in the nation’s economy and providing various services to other individuals or businesses. This factor of production is a flexible resource as workers can be allocated to different areas of the economy for producing consumer goods or services. Human capital can also be improved through training or educating workers to complete technical functions or business tasks when working with other economic resources.

EFFICIENCY OF LABOUR :- The working capacity of the labour is called his efficiency being given the same time limit and given the same type of work.

FACTORS DETERMINING THE EFFICIENCY OF LABOUR

1. PERSONAL QUALITIES
2. EDUCATION.
3. TRAINING AND SKILL
4. CLIMATIC CONDITIONS
5. WAGES AND BENEFITS
6. COMBINATION OF PRODUCTION FACTORS
7. WORKING HOURS
8. ENVIRONMENT
9. RACIAL QUALITIES

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Capital

Capital has two economic definitions as a factor of production. Capital can represent the monetary resources companies use to purchase natural resources, land and other capital goods. Monetary resources flow through a nation’s economy as individuals buy and sell resources to individuals and businesses. Capital also represents the major physical assets individuals and companies use when producing goods or services. These assets include buildings, production facilities, equipment, vehicles and other similar items. Individuals may create their own capital production resources, purchase them from another individual or business or lease them for a specific amount of time from individuals or other businesses.

Entrepreneurship-Organisation

Entrepreneurship is considered a factor of production because economic resources can exist in an economy and not be transformed into consumer goods. Entrepreneurs usually have an idea for creating a valuable good or service and

assume the risk involved with transforming economic resources into consumer products. Entrepreneurship is also considered a factor of production since someone must complete the managerial functions of gathering, allocating and distributing economic resources or consumer products to individuals and other businesses in the economy.

Types of organization

1- Solproprietorship
2- Partnership
3- Joint stock company
4- Co-operative societies
5- Public or state enterprises

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CHAPTER 3

CONSUMPTION OR THEORY OF CONSUMER'S BEHAVIOUR

LIST OF TOPICS

1-Importance of consumption
2-Meaning of utility
3-Characteristics of utility
4-Concepts of Total utility or Marginal Utility
5-The Law of Diminishing Marginal Utility
6-Exceptions or Limitations of the law
7-The Law of Equi – marginal utility

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Topic1 Importance of consumption

Q. no-1 what is consumption? Or Describe importance of consumption? (short question of exams)

"Consumption means the direct and final use of goods and services in the satisfaction of human wants. People many consume such single-use goods as foodstuffs, fuel, and durable-use goods such as tables, scooters, watches, clothes, etc"

The importance of consumption is explained as under.

1. Beginning of all Economic Activities:
2. End of all Economic Activities:
3. Index of Standard of Living:
4. Consumption is the Source of Production:
5. Importance in Economic Theory
6. Importance for the Government:
7. Importance in Income and Employment Theory:

Topic 2 Utility

Q. no-1 what is utility? (short question of exams)

Defination

In **economics**, **utility** is a measure of preferences over some set of goods and services. The concept is an important underpinning of rational choice theory in **economics** and game theory, because it represents satisfaction experienced by the consumer of a good. A good is something that satisfies human wants.

Topic 3 Characteristics of Utility:

Q. no-1 what are the main characteristics of utility? (short question of exams)

Characteristics of Utility:

The following are the important characteristic features of utilities

1 Utility has no Ethical or Moral Significance
2. Utility is Psychological:
3. Utility is always Individual and Relative:
4. Utility is not Necessarily Equated with Usefulness:
5. Utility cannot be Measured Objectively:
6. Utility Depends on the Intensity of Want:
7. Utility is Different from Pleasure:
8. Utility is also Distinct from Satisfaction:

Psychological:

Topic 4 Concept of Total Utility and Marginal Utility

Q. no-1 what is main difference between total utility and marginal utility? (short question of exams)

Concept of Total Utility and Marginal Utility

Total Utility and Marginal Utility. As there is increase in the unit of a particular commodity, the Marginal Utility goes on diminishing and Total Utility goes on

increasing. Total Utility goes on increasing up to that extent till the Marginal Utility becomes Zero. When Marginal Utility is zero Total Utility is maximum. **After Zero Marginal Utility comes to negative and the result is that Total Utility starts reducing relationship between Total Utility and Marginal Utility can be started as follows:**

(i) When Marginal Utility is reducing, the Total Utility will increase so long Marginal Utility does not become zero.

(ii) When Marginal Utility becomes zero; Total Utility will be maximum.

(iii) After zero when Marginal Utility is negative then there is reduction in Total Utility.

Relationship between Marginal Utility and Total Utility can be studied from the following:

Unit of Bread	Marginal Utility	Total Utility
1	16	16
2	12	(16 + 12) = 28
3	8	(28 + 8) = 36
4	4	(36 + 4) = 40
5	0	(40 + 0) = 40
6	- 4	(40 - 4) = 36
7	- 8	(36 - 8) = 28

From the above table it is clear that up to fourth bread Marginal Utility is positive and there is no regular increase in the Total Utility. And on fifth bread the Marginal Utility is zero and on this point the increase in Total Utility stops. This is point of safety. As Prof. Bounding has said that "Point of full satisfaction and point of full safety is that point where consumption increases but there is no increase in Total Utility." If after fifth bread, extra bread is consumed then there will be dis-utility and Marginal Utility will be negative. Sixth and seventh bread shows dis-utility.

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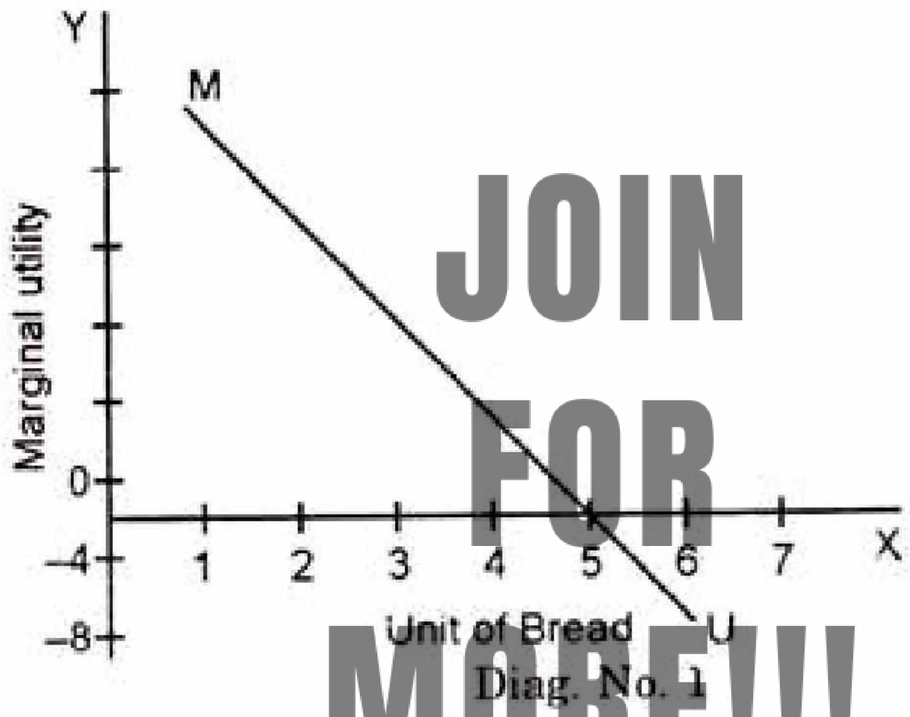
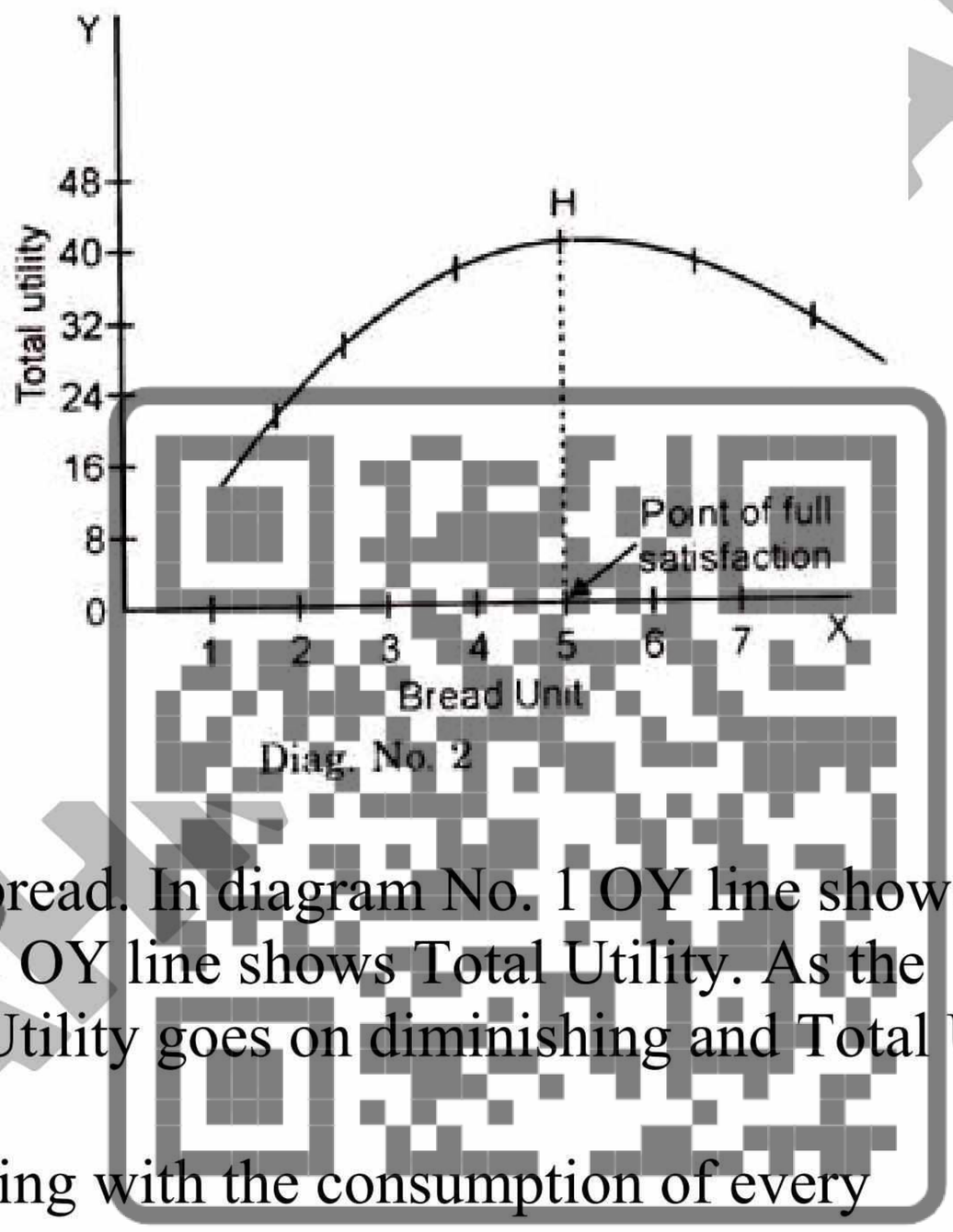
The relationship between Marginal Utility and Total Utility will be shown by diagram as follows:



Diag. No. 1



Diag. No. 2

In both the diagrams OX line shows bread. In diagram No. 1 OY line shows Marginal Utility and is diagram No. 2 OY line shows Total Utility. As the number of bread increases Marginal Utility goes on diminishing and Total Utility goes on increasing—To remember:

(1) Marginal Utility goes on diminishing with the consumption of every additional unit of bread.

(2) Total Utility goes on increasing with the consumption of every additional unit but at a diminishing rate.

(3) Marginal Utility is equal to the increase in the Total Utility. Total Utility is the sum total of the Marginal Utilities derived from all the units consumed.

(4) When Marginal Utility becomes 0, total utility does not increase.

(5) When Marginal Utility becomes negative, Total Utility decreases.

(6) Increase in Total Utility depends on Marginal Utility.

(7) Since Marginal Utility diminishes, Total Utility increases at a diminishing rate.

(8) When Marginal Utility is Zero, Total Utility is maximum.

(9) When Marginal Utility is negative, Total Utility declines.

Topic 5 The Law of Diminishing Marginal Utility

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Q. no-1 State law of diminishing marginal utility with the help of schedule and diagram? (long question of exams)

The Law of Diminishing Marginal Utility

Marginal Utility:

Definition:
Marginal utility is the utility derived from the last or marginal unit of consumption. It refers to the additional utility derived from an extra unit of the given commodity purchased, acquired or consumed by the consumer.
It is the net addition to total utility made by the utility of the additional or extra units of the commodity in its total stock. It has been said—as the last unit in the given total stock of a commodity.
According to Prof. Boulding—"The marginal utility of any quantity of a commodity is the increase in total utility which results from a unit increase in its consumption."

For example:
Suppose Mr. Alferd is consuming bread and he takes five breads. By taking first unit he derives utility up to 20; second unit 16; third unit 12; fourth unit 8 and from fifth 2. In this example the marginal unit is fifth bread and the marginal utility derived is 2. If we will consume only four bread then the marginal unit will be fourth bread and utility will be 8.

Kinds of Marginal Utility—Marginal utility is of three kinds:

(i) Positive Marginal Utility,
(ii) Zero Marginal Utility,
(iii) Negative Marginal Utility.
It is a matter of general experience that if a man is consuming a particular goods, then receiving of next unit of goods reduces the utilities of the goods and ultimately a situation comes when the utility given by the goods become zero and

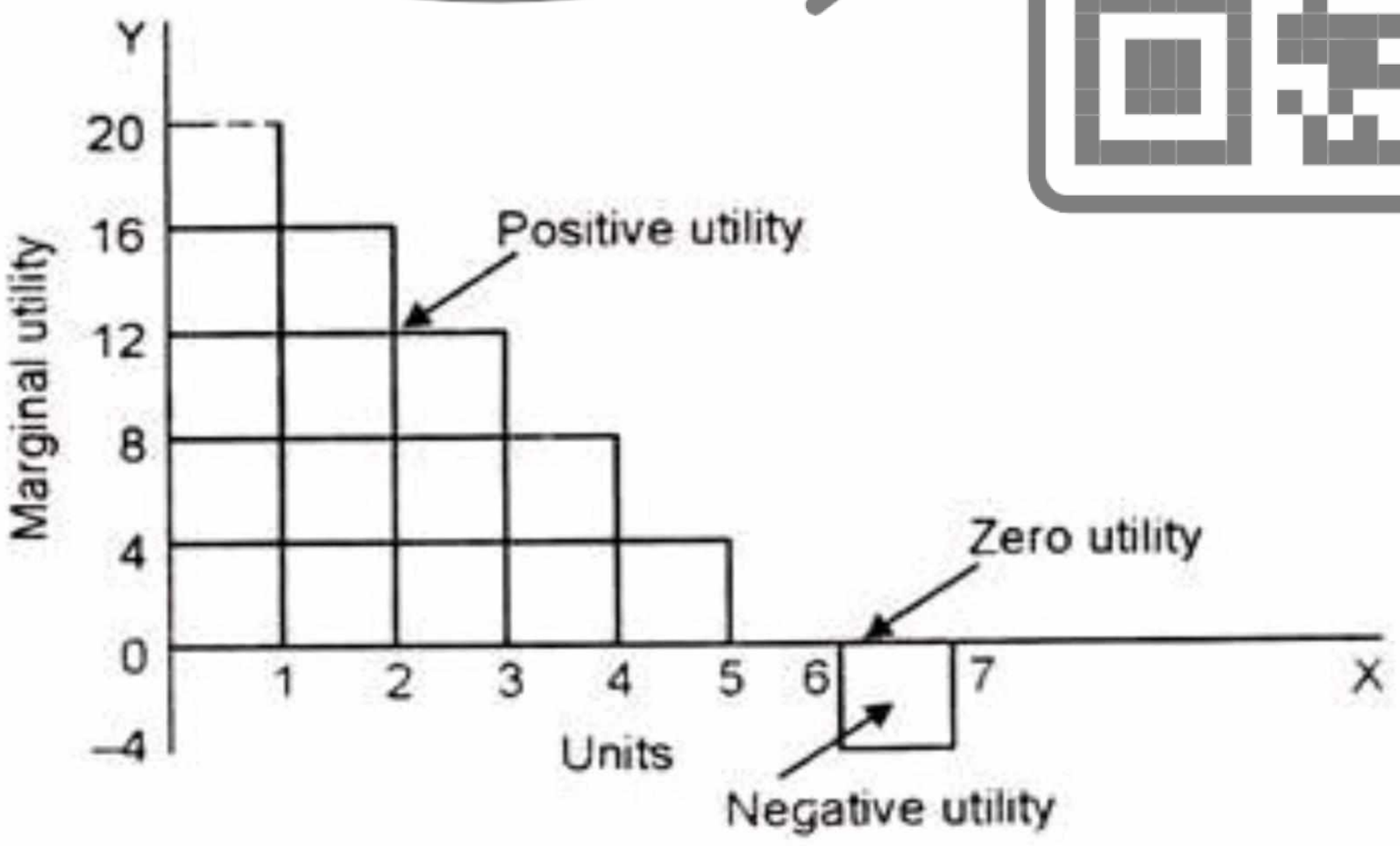
if the use of the goods still continues, then the next unit will give dis-utility. In other words it can be said that we will derive "negative utility"

This can be studied better by the following table:

Marginal Utility Table

Number of bread	Marginal Utility	Kinds of Marginal Utility
1	20	Positive Utility
2	16	
3	12	
4	8	
5	4	
6	0	Zero Utility
7	-4	Negative Utility

From the table given above it is clear that up to the consumption of the fifth bread we receive positive utility; 6th unit is the unit of full satisfaction i.e., Utility derive from that unit is zero. From 7th unit the utility received will be negative utility. The table can be represented in shape of diagram as follows: In diagram No. 1 OX axis (line) shows unit of bread and OY line shows the Marginal Utility received. From the figure it is clear that from the first unit of bread utility received are 20 which has been shown on the top of the line.



Similarly 2, 3, 4, 5 Unit of bread's utility is 16, 12, 8, 4 respectively All these have been shown on OX line which shows positive marginal utility. Utility of the sixth bread is zero and that of the seventh bread is negative and negative rectangle has been shown below OX line.

Zero Utility:
When the consumption of a unit of a commodity makes no addition to the total utility, then it is the point of Zero Utility. In our table the total utility, after the 6th unit is consumed. This is the point of Zero Utility. It is thus seen that the total utility is maximum when the Marginal Utility is zero.

Negative Utility:
Negative Utility is that utility where if the consumption of a commodity is carried to excess, then instead of giving any satisfaction, it may cause dis-satisfaction. The utility is such cases is negative. In the table given above the marginal utility of the 7th unit is negative.

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Topic 6 **Exceptions and Limitations of Law of Diminishing Marginal Utility**

Q. no-1 Give the Exceptions and Limitations of the law of diminishing marginal utility? (short question of exams)

Exceptions and Limitations of Law of Diminishing Marginal Utility

Limitations of Law of Diminishing Marginal Utility:
Some of the important limitations of the law are discussed as follows:
i. Unrealistic assumptions:
ii. Inapplicability to certain goods:
iii. Constant marginal utility of money:
iv. Change in other people's stock:

Exceptions to the Law of Diminishing Marginal Utility:
i. Hobbies:
ii. Misers:

Topic 7 Law Equi Marginal Utility:

Q. no-1 State the Law of Equi-Marginal Utility? (short question of exams)

Law Equi Marginal Utility:

The **law of equi marginal utility** was presented in 19th century by an Australian economists H. H. Gossen. It is also known as law of maximum satisfaction or law of substitution or Gossen's second law. A consumer has number of wants. He tries to spend limited income on different things in such a way that marginal utility of all things is equal. When he buys several things with given money income he equalizes marginal utilities of all such things. The law of equi marginal utility is an extension of the law of diminishing marginal utility. The consumer can get maximum utility by allocating income among commodities in such a way that last dollar spent on each item provides the same marginal utility.

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Definition:

"A person can get maximum utility with his given income when it is spent on different commodities in such a way that the marginal utility of money spent on each item is equal".

It is clear that consumer can get maximum utility from the expenditure of his limited income. He should purchase such amount of each commodity that the last unit of money spend on each item provides same marginal utility.

Assumptions of the Law of Equi Marginal Utility:

1. There is no change in the prices of the goods.
2. The income of consumer is fixed.
3. The marginal utility of money is constant.
4. Consumer has perfect knowledge of utility obtained from goods.
5. Consumer is normal person so he tries to seek maximum satisfaction.
6. The utility is measurable in cardinal terms.
7. Consumer has many wants.
8. The goods have substitute

CHAPTER 4 THEORY OF DEMAND

LIST OF TOPICS

1- Meaning of demand

2- Change in demand and change in quantity demand

3- Demand schedule and demand curve

4- Law of demand

5- Assumptions and limitations of the law

6- Exceptions of the law

7- Elasticity of demand

8- Kinds of elasticity of demand (price, income, cross)

9- Price elasticity of demand

10-Measurement of price elasticity of demand

11-Income elasticity of demand

12-Cross elasticity of demand

13-Importance of the Concept of Elasticity of Demand

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Topic 1 Meaning of Demand

Q. No-1 what is meaning of Demand? (short question of exams)

Meaning of Demand

"Demand is an **economic** principle that describes a consumer's desire and willingness to pay a price for a specific good or service. Holding all other factors constant, an increase in the price of a good or service will decrease **demand**, and vice versa."

Topic 2 Change in demand and change in quantity demand

Q. No-1 Differentiate between change in demand and change in quantity demand? (short question of exams)

Change in demand and change in quantity demand

In economics the terms change in quantity demanded and change in demand are two different concepts.

Change in quantity demanded refers to change in the quantity purchased due to increase or decrease in the price of a product.

In such a case, it is incorrect to say increase or decrease in demand rather it is increase or decrease in the quantity demanded.

On the other hand, change in demand refers to increase or decrease in demand of a product due to various determinants of demand, while keeping price at constant.

Changes in quantity demanded can be measured by the movement of demand curve, while changes in demand are measured by shifts in demand curve. The terms, change in quantity demanded refers to expansion or contraction of demand, while change in demand means increase or decrease in demand.

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Topic 3 Demand schedule and Demand Curve

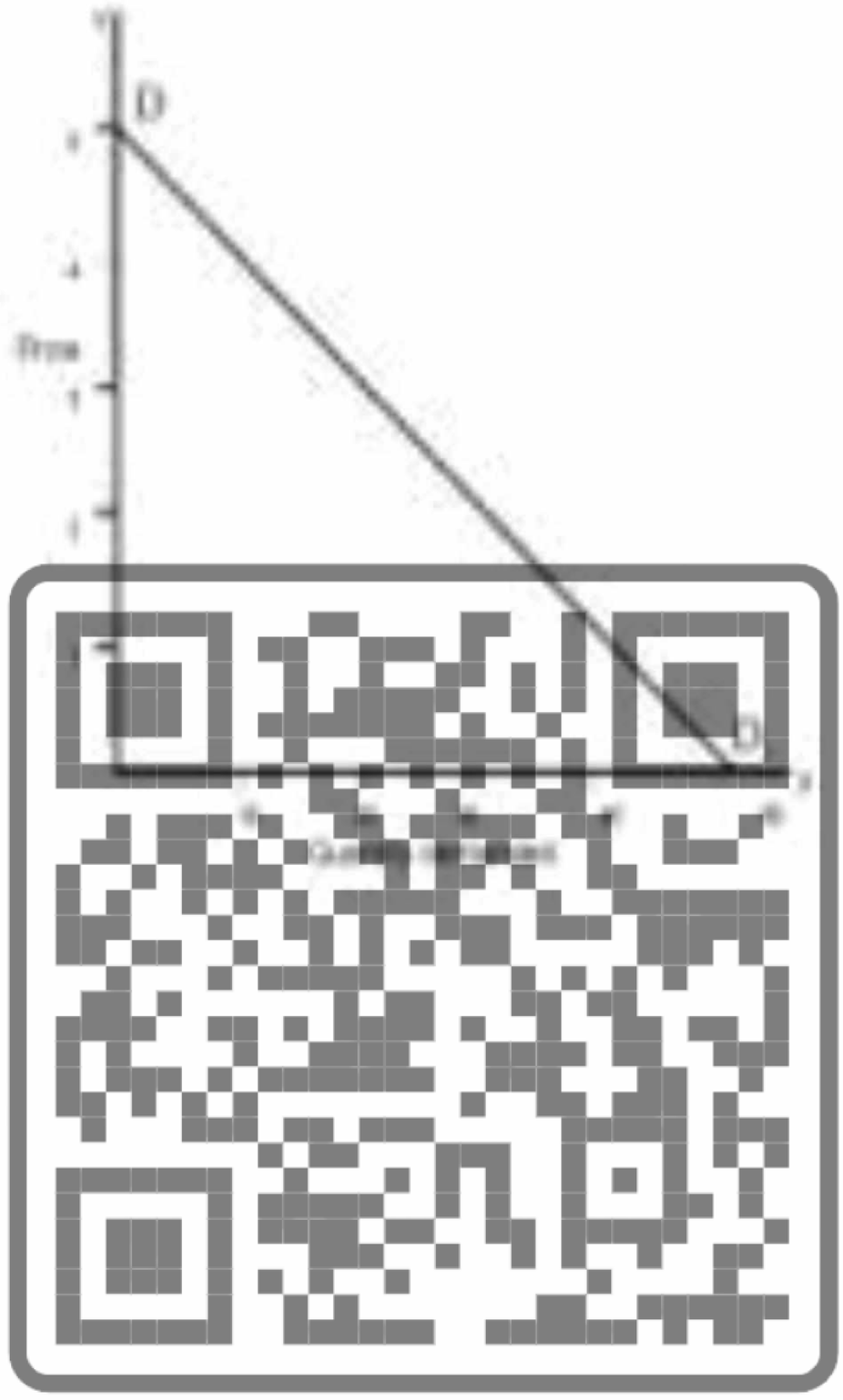
Q. no-1 Differentiate between demand schedule and demand curve? (short question of exams)

Demand schedule and Demand Curve

Demand schedule

Price (Rs)	Quantity Demanded (Units)
5	10
4	20
3	30
2	40
1	50

Demand Curve



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Topic 4 Law of demand

Q. no-1 state law of demand? (short question of exams)

OR

Q. no-2 state law of demand with the help of schedule and diagram? (long question of exams)

Law of demand

There is an inverse relationship between quantity demanded and its price. The people know that when price of a commodity goes up its demand comes down. When there is decrease in price the demand for a commodity goes up. There is inverse relation between price and demand . The law refers to the direction in which quantity demanded changes due to change in price.

A consumer may demand one dozen oranges at 5rs per dozen . He may demand two dozens when the price is 4rs per dozen. A person generally buys more at a lower price. He buys less at higher price. It is not the case with one person but all people liken to buy more due to fall in price and vice versa. This is true for all commodities and under all conditions. The economists call it as **law of demand**. In simple words the law of demand states that other things being equal more will be demanded at lower price and lower will be demanded at higher price.

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Definition

1. Alfred Marshal says that " the amount demanded increase with a fall in price, diminishes with a rise in price".
2. C.E. Ferguson says that "according to law of demand, the quantity demanded varies inversely with price".
3. Paul A. Samuelson says that "law of demand states that people will buy more at a lower prices and buy less at higher prices, other things remaining the same".

Explanation of the law

The relationship between price of a commodity and its demand depends upon many factors. The most important factor is nature of commodity. The demand schedule shows response of quantity demanded to change in price of that commodity. This is the table that shows prices per unit of commodity ands amount demanded per period of time. The experts are concerned with market demand schedule. The market demand schedule means 'quantities of given commodity which all consumers want to buy at all possible prices at a given moment of time'. The demand schedules of all individuals can be added up to find out market demand schedule.

Demand schedule

Price in rupees.	Demand in Kg.
5	100
4	200
3	300
2	400

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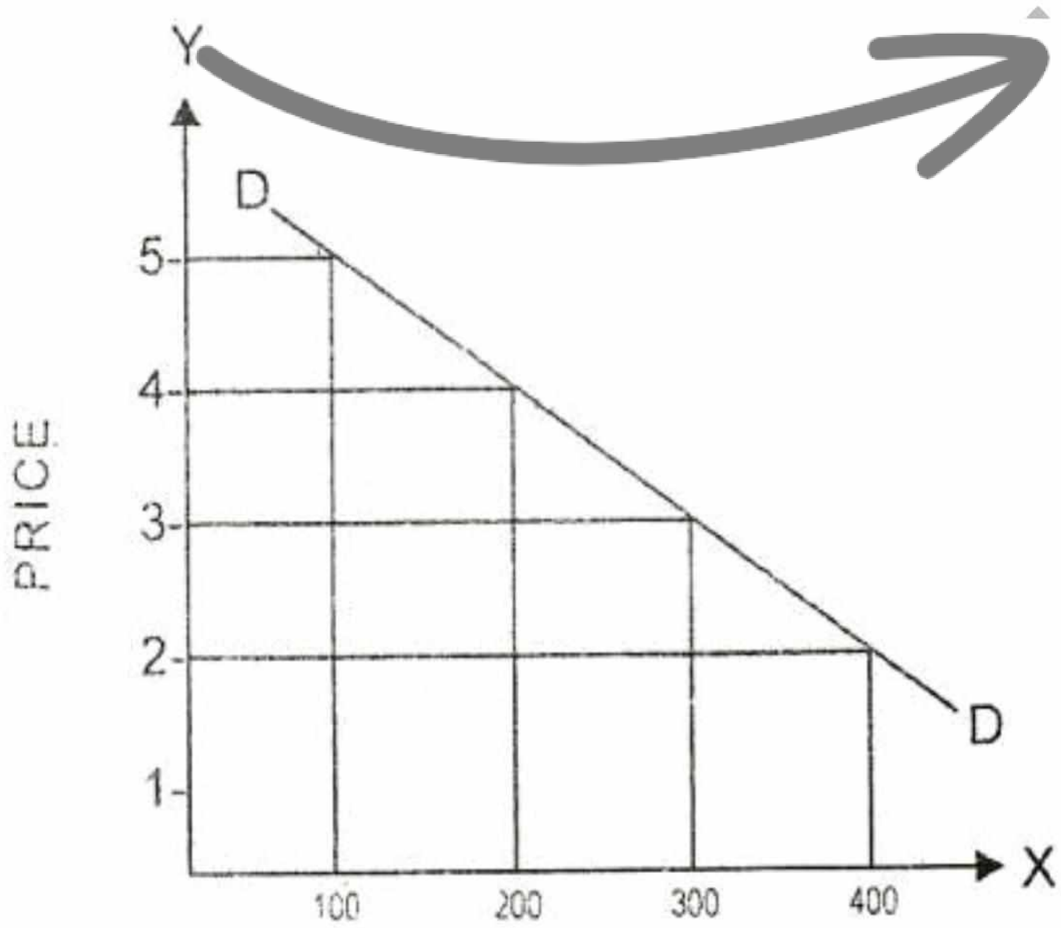
The table shows the demand of all the consumers in a market. When the price decreases there is increase in demand for goods and vice versa. When price is 5rs demand is 100 kilograms. When the price is 4rs demand is 200 kilograms. Thus the table shows the total amount demanded by all consumers various price levels

Diagram



There is same price in the market. All consumers purchase commodity according to their needs. The market demand curve is the total amount demanded by all consumers at different prices. The market demand curve slopes from left down to the right.

Why demand curve falls

Marginal utility decreases:

Price effect:
Income effect
Same price of substitutes
Demand of poor people
Different uses of goods

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Importance of the law of Demand

Price determination
Tax on commodities
Agricultural prices
Planning

Topic 5 Assumptions or Limitation of the law

Q.no-1 Give the Assumption and Limitation of "Law of demand"? (short question of exams)

Assumptions or Limitation of the law

1. There is no change in income of consumers.
2. There is no change in the price of product.
3. There is no change in quality of product.
4. There is no substitute of the commodity.
5. The prices of related commodities remain the same.
6. There is no change in customs.
7. There is no change in taste and preference of consumers.
8. The size of population remains the same.
9. The climate and weather conditions are same.
10. The tax rates and other fiscal measures remain the same.

Topic 6 Exceptions to the law

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Q. no-1 Give the Exceptions of the "Law of Demand"? (short question of exams)

Exceptions to the law

Inferior goods
Demonstration effect
Ignorance of consumers
Less supply
Depression
Speculation
Out of fashion

Topic 7 Elasticity of Demand:

Q. no-1 what is "Elasticity of Demand"? and explain about the "kinds of Elasticity of demand"? (long question of exams)

Elasticity of Demand

Demand extends or contracts respectively with a fall or rise in price. This quality of demand by virtue of which it changes (increases or decreases) when price changes (decreases or increases) is called Elasticity of Demand.

"The elasticity (or responsiveness) of demand in a market is great or small according as the amount demanded increases much or little for a given fall in price, and diminishes much or little for a given rise in price". – Dr. Marshall.

Topic 8 Kinds of Elasticity of Demand

Q .no-1 Name the "Kinds of elasticity of demand"? (short question of exams)

1. Perfectly Elastic Demand:

In perfectly elastic demand, the demand curve is represented as a horizontal straight line, which is shown in Figure-2:

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Figure-2: Perfectly Elastic Demand

2. Perfectly Inelastic Demand:

In case of perfectly inelastic demand, demand curve is represented as a straight vertical line, which is shown in Figure-3:

Figure-3: Perfectly Inelastic Demand

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3. Relatively Elastic Demand:

The demand curve of relatively elastic demand is gradually sloping, as shown in Figure-4:

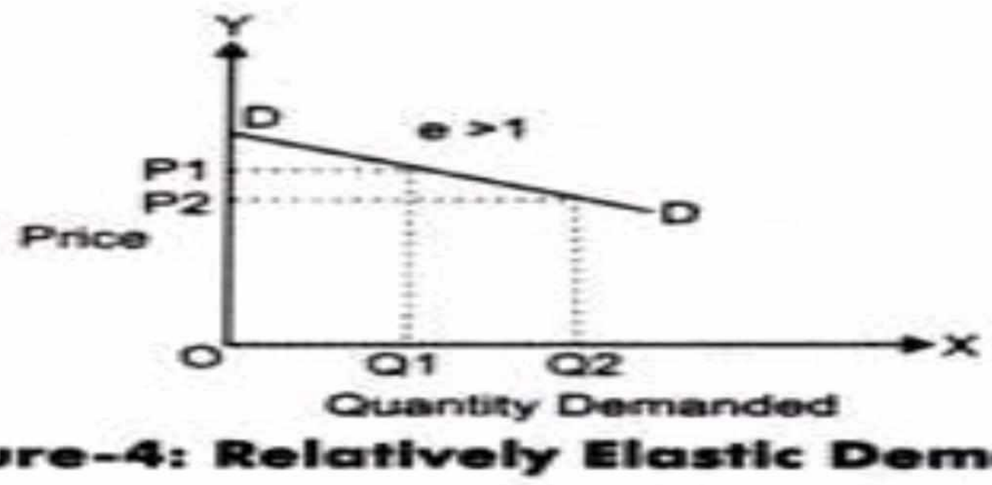

Figure-4: Relatively Elastic Demand

4. Relatively Inelastic Demand:

The demand curve of relatively inelastic demand is rapidly sloping, as shown in Figure-5:

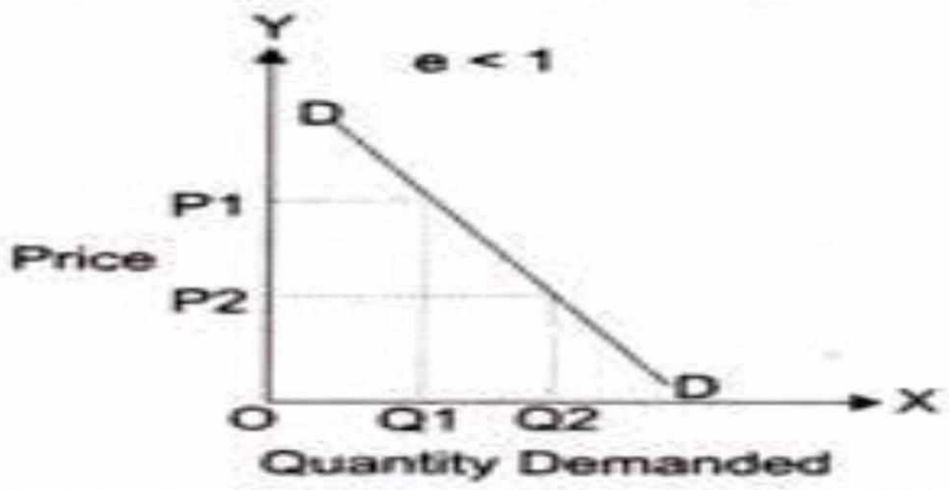

Figure-5: Relatively Inelastic Demand

5. Unitary Elastic Demand:

The demand curve for unitary elastic demand is represented as a rectangular hyperbola, as shown in Figure-6:

Figure-6: Unitary Elastic Demand

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Topic 9,10,11

Types of Elasticity:

Distinction may be made between Price Elasticity, Income Elasticity and Cross Elasticity. Price Elasticity is the responsiveness of demand to change in price; income elasticity means a change in demand in response to a change in the consumer's income; and cross elasticity means a change in the demand for a commodity owing to change in the price of another commodity.

Topic 9 Price Elasticity of Demand

Q. no-1 Define "Price Elasticity of Demand". Explain the various methods of the "measurement of Elasticity of Demand? (short and long question both of exams)

Price Elasticity of Demand

When the **price elasticity of demand** for a good is relatively inelastic , the percentage change in quantity demanded is smaller than that in **price**. Hence, when the **price** is raised, the total revenue increases, and vice versa.

Topic10 Measurement Methods of Price elasticity Of Demand

Q. no-1 Define "Price Elasticity of Demand". Explain the various methods of the "measurement of Elasticity of Demand? (short and long question both Of exams)

Measurement Methods of Price elasticity Of Demand

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The following three methods are usually used by the economists for measuring it:
(i) Total Expenditure Method,
(ii) Proportional Method,
(iii) Geometrical Method.

Total Expenditure Method:

Under this method, we measure elasticity of demand by examining the change in the total expenditure due to a change in price.Look at the following demand schedule relating to handkerchiefs:

Price per handkerchief Rs. P.	*No. demanded*	*Total amount spent*
7.00	2	Rs. 14.00 ...(1)
4.00	3	Rs. 12.00 ...(2)
3.00	4	Rs. 12.00 ...(3)
2.00	8	Rs. 16.00 ...(4)

Unity Elasticity:

When the total amount of money spent remains the same (e.g., between Nos. 2 and 3 above), the elasticity is said to be unity.

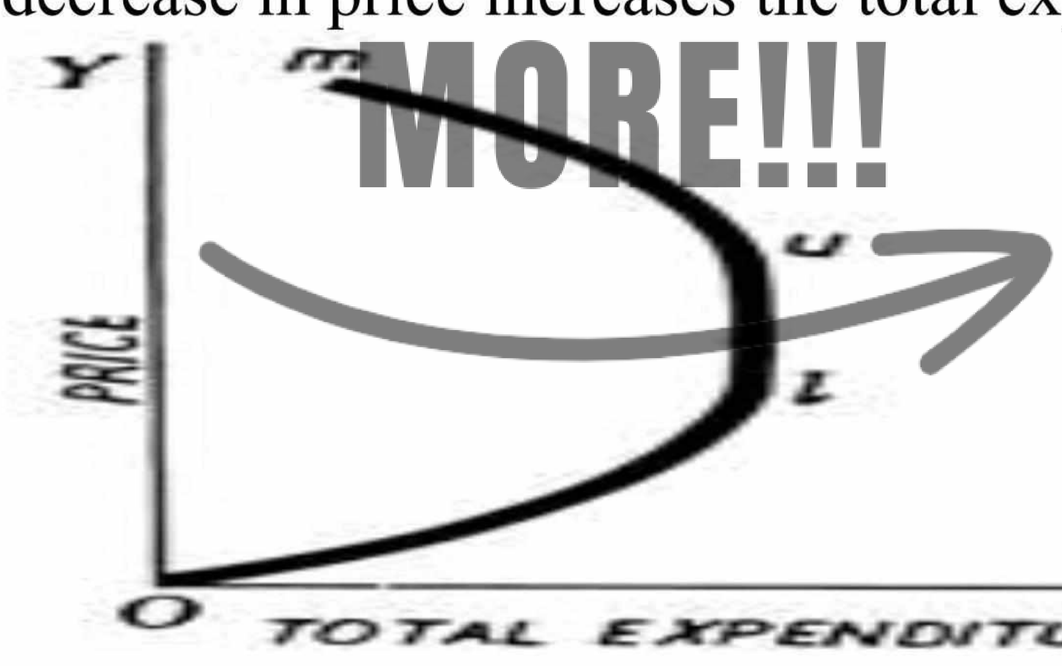
Greater Than Unity:

When the total amount of money spent increases with a fall in price (or decreases with a rise in price), the elasticity is said to be greater than unity (as between the two prices Nos. 3 and 4).

Less than Unity:

When the total amount of money spent decreases with a fall in price (or increases with a rise in price), the elasticity is said to be less than unity (e.g., between the two prices Nos. 1 and 2). We can also represent this method diagrammatically (Fig. 10.5). Take total expenditure along the X-axis and price along the Y-axis. We get a backward bending curve Olum. The portion O1 represents less than unity elasticity, because an increase or decrease in price increases or decreases the total expenditure.

The portion um represents unity elasticity because a change in price has got no effect on total expenditure; it remains the same. Portion um represents more than unity elasticity because an increase in price decreases the total expenditure and a decrease in price increases the total expenditure.



Total Expenditure Method
Fig. 10.5

Proportional Method:

Under this method, we measure elasticity by comparing the percentage in price with the percentage change in demand. The elasticity of demand is unity, greater than unity, or less than unity, according as the change in demand is proportionate, more than proportionate, or less than proportionate to the change in price respectively. The elasticity is the ratio of the percentage change in the quantity demanded to the percentage change in the price charged.

The formula is:

Elasticity = Proportionate change in demand/ Proportionate change in price
= Change in Demand/ Amount demanded + Change in price/ Price

This formula will be better understood with the help of mathematical illustration. Suppose mangoes are selling at the price 25 P. each and a consumer demands 10 mangoes at this price. If the price falls to 20 P. each and the consumer now demands 15 mangoes, find out his elasticity of demand for mangoes.

According to the above formula:

15—10/10 ÷ 25—20/25

= 5/10 ÷ 5/25

= 5/10 × 25/5

= 25/10 = 2.5

In other words, the elasticity of demand of our hypothetical consumer for mangoes is high; it is much greater than unity (2.5).

Let us now take an example of low elasticity.

Suppose that the demand for common salt is 5 kilogram per month at the price of 20 P. per kg. Now suppose that its price is doubled, i.e., it rises to 40 P. per kg. and now only 4 kg. are demanded.

According to our above formula:

Elasticity = 5-4/5 ÷ 40/-20/20

= 1/5 ÷ 20/20

= 1/5 × 1/1

= 1/5

Geometrical Method: Point Elasticity:

This method is used to measure the elasticity of demand at any given point on the demand curve. Look at Fig. 10.6

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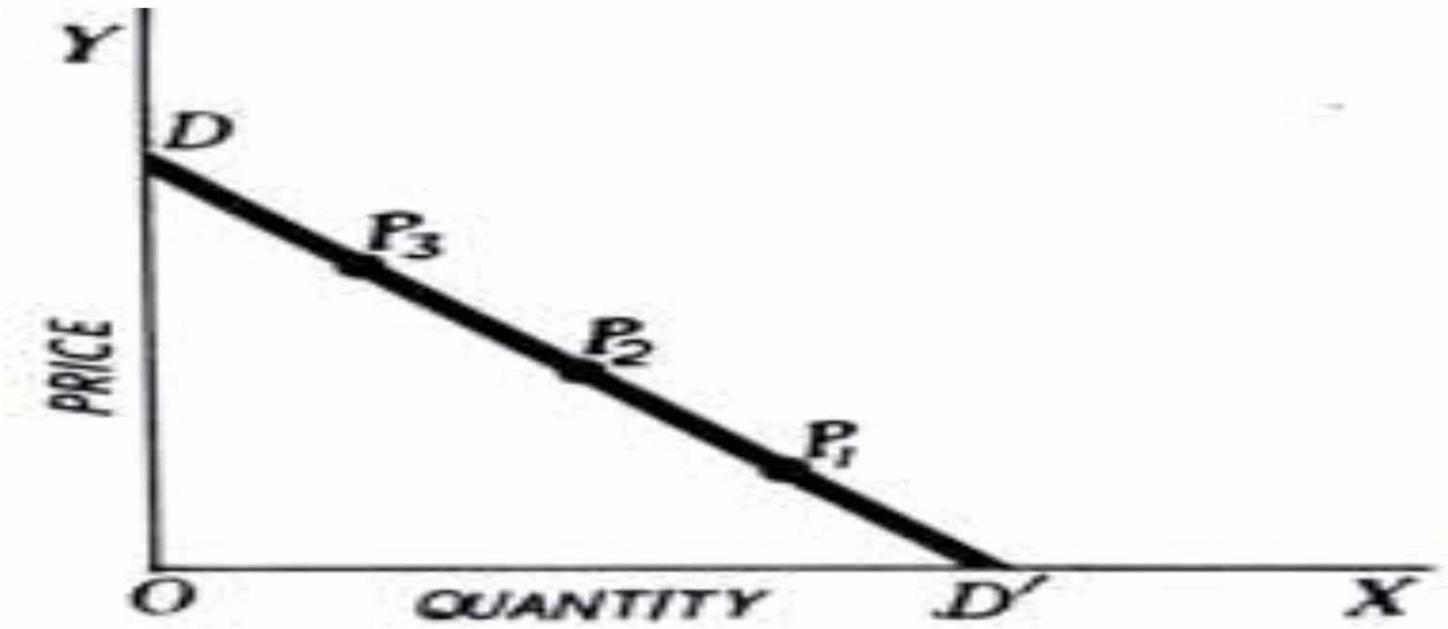


Point Elasticity:
St. Line Demand Curve
Fig. 10.6

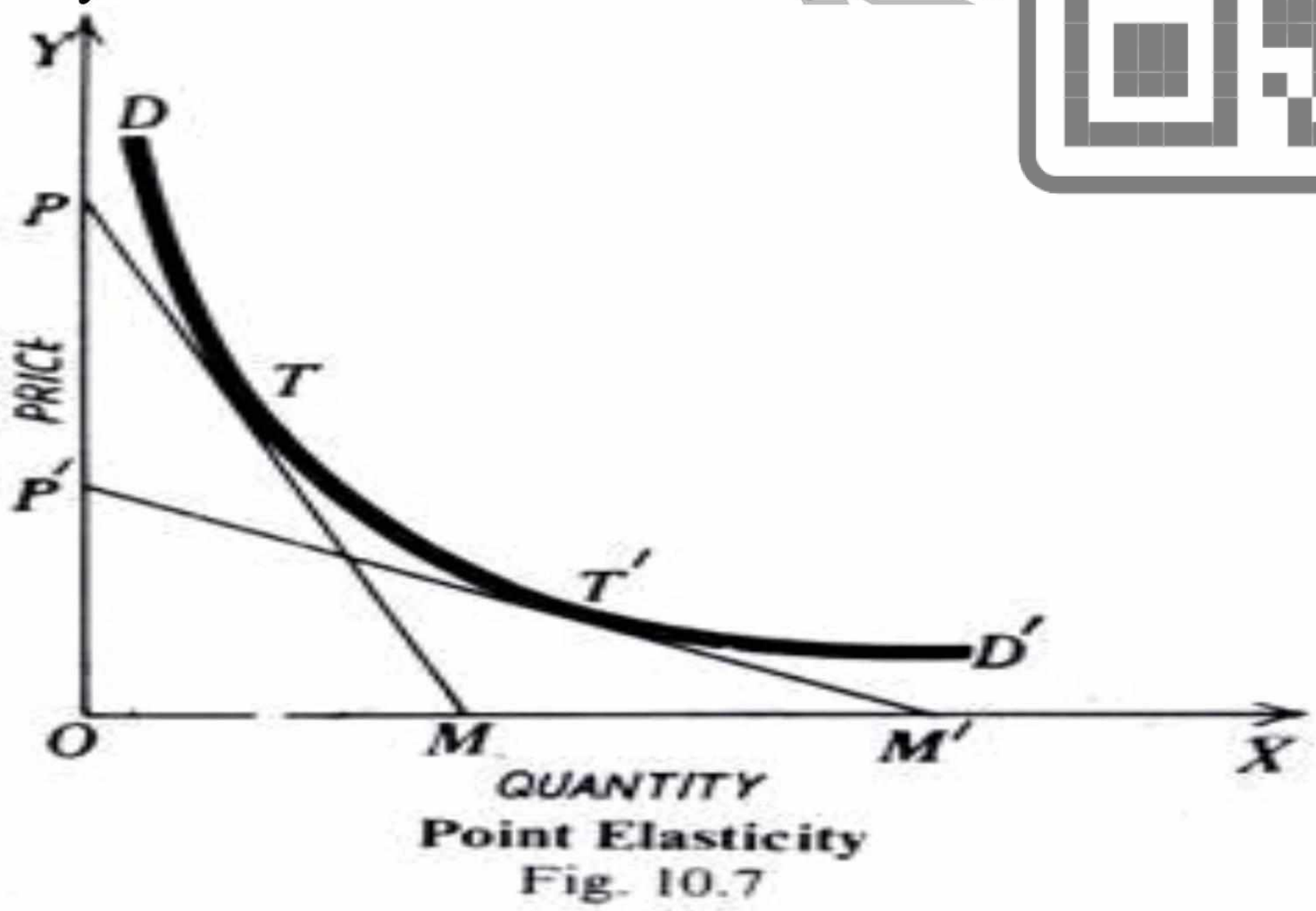
DD' is the straight-line demand curve. Elasticity is represented by the fraction: distance from D' to the point on the curve divided by the distance from the other end to that point.

Thus, elasticity of demand on the points P i, Pi, and P_1 is respectively.

$D'P_1$ $D'P_2$/DP1 DP2 and $D'P_3$/DP_3

If P_2, is the middle point of DD', then elasticity at P_2, will beD P_2, = 1,($D'P_2$, being equal to DP,)

i.e., elasticity at P_2, the middle point, is unity. At any point lower than P_2, elasticity will be less than unity and at any point above P_2, it will be greater than unity.



Point Elasticity
Fig. 10.7

Even if the demand curve is not a straight line, the above formula will apply. A tangent will, however, have to be drawn at the point on the curve where elasticity

is to be measured. It is illustrated in the diagram (Fig. 10.7) given on the previous page.

DD' is the demand curve, and two tangents PM and P'M' are drawn respectively at the points T and T' At point T, elasticity will be equal to TM/PT. This will apply only so long as the tangent and the curve coincides, which means for an infinitesimally short distance. If there is any departure from point T, a new tangent will have to be drawn and elasticity ascertained accordingly. At point T' elasticity = M/P' T'/T. Clearly, elasticity at T is greater than elasticity at T'.

Topic 11: Income Elasticity of Demand:

Q. no-1 what is "Income Elasticity of Demand"? (short question of exams)

Income Elasticity of Demand:

Elasticity of demand means the price elasticity of demand. As already pointed out, income elasticity of demand must be clearly distinguished from the price elasticity of demand. Whereas the price elasticity of demand refers to the change in quantity demanded as a result of change in price, the income elasticity of demand means the change in demand which occurs as a result of change in income.

Thus income elasticity of demand may be defined as:

Proportionate change in the quantity purchased/ Proportionate change in income while price remains constant. Generally speaking, when our income increases, we desire to purchase- more of the things than we were previously purchasing, unless the commodity happens to be an "inferior" one.

Topic 12: Cross Elasticity of Demand:

Q. no-1 what is "Cross Elasticity of Demand"? (short question of exams)

Cross Elasticity of Demand:

There is another concept of elasticity of demand which is called cross elasticity of demand. Cross elasticity of demand refers to the change in demand for a good as a result of change in the price of another goods. Proportionate change in

quantity demanded of X /Proportionate change in the price of Y Cross elasticity of demand arises in cases of inter-related goods, such as substitutes and complementary goods.

Topic 13: Importance of the Concept of Elasticity of Demand

Q. no-1 write down the importance of the Elasticity of Demand? (short question of exams)

Importance of the Concept of Elasticity of Demand

The concept of elasticity of demand has great practical importance:

1.For Businessmen and Monopolists:
2.For the Finance Minister:
3.Joint Products:
4.In Industrial Production:
5.Paradox of Poverty in Plenty:
6.Determination of Wages:
7. International Trade

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CHAPTER 5 THEORY OF SUPPLY

LIST OF TOPICS

1. MEANING OF SUPPLY
2. STOCK VS. SUPPLY
3. THE LAW OF SUPPLY

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TOPIC 1 MEANING OF SUPPLY

Q. no-1 what is meaning of supply? (short question of exams)

MEANING OF SUPPLY

"Economists have a very precise definition of supply. Economists describe supply as the relationship between the quantity of a good or service consumers will offer for sale and the price charged for that good. More precisely and formally supply can be thought of as "the total quantity of a good or service that is available for purchase at a given price."

TOPIC 2 STOCK VS. SUPPLY

Q. no-1 Differentiate between stock vs supply? (short question of exams)

STOCK VS. SUPPLY

Stock is the quantity of output which a seller/business has with him and has not yet been brought for sale: where supply is the quantity of output brought from the existing stock of sale at a certain price in the market.

e.g. (i) stock = 1000 kg of rice
(ii) supply = 200 kg for sale at Rs. 40 per kg.

TOPIC 3 THE LAW OF SUPPLY

Q.no-1 state "law of supply" with the help of schedule and diagram? (short and long both question of exams)

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THE LAW OF SUPPLY

It is observed in markets that when more price of commodities are offered to sellers. They increase the quantity supplied of these commodities and when the level of prices decreases, the sellers decrease the quantity supplied. This behavior of seller is called law of supply.

Definition

"Other things remaining the same, if the price of a commodity increases its quantity supplied increases and if the price of a commodity decreases, quantity supplied also decreases".

There exists a direct and positive relationship between price and quantity supplied of a commodity. The functional relationship between quantity supplied and the price of a commodity can be expressed as:

$Q_s = f(P)$

Where Q_s = quantity supplied

P = price of commodity

Assumptions

The assumptions of the law of supply are as under:

No change in cost of production
No change in technology
No change in climate
No change in prices of substitutes
No change in natural resources
No change in price of capital goods
No change in political situation
No change in tax policy

ExplanationThe slope of the supply function i.e. $\Delta Q/\Delta P$ is positive. Regarding the assumptions, the standard supply function is written as $Q_s = - c + d P$

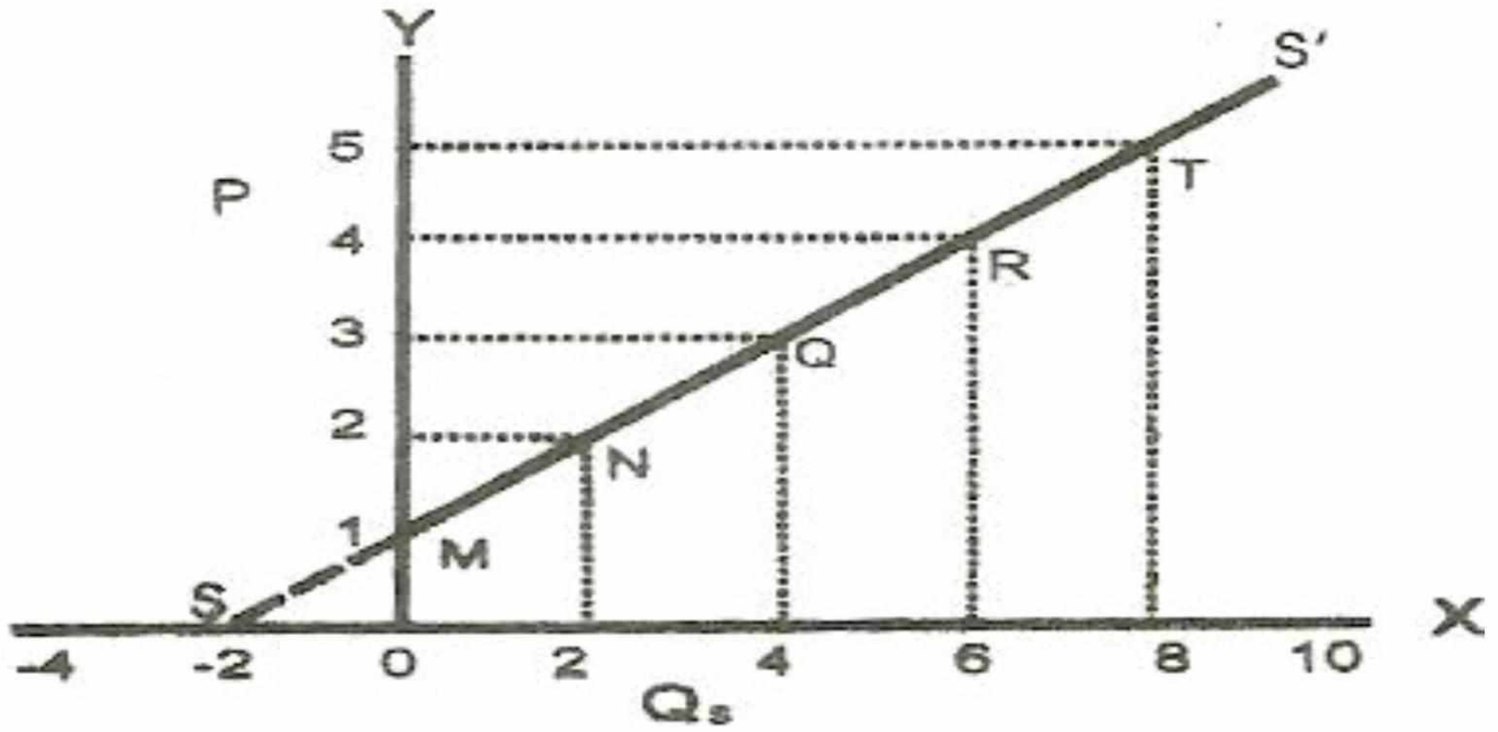
Where c and d are parameters while P and Q_s are independent and dependent variables, respectively. The positive sign represents direct relationship between P and Q_s.

The supply function is expressed with the help of following example: $Q_s = - 2 + 2 P$

By assuming different values of P, we can calculate the different values of Q_s as shown below.

Price (P)	Quantity supplied Q_s
0	-2
1	-0
2	2
3	4
4	6
5	8

As we assumed the different values of 'P' from zero to 5, then the calculated values of Qs increases from - 2 to 8.



The quantity supplied is expressed on X-axis while price is measured on Y-axis. The law of supply can be illustrated through the supply schedule as shown in the above supply curve SS'. By plotting the various combinations of price and quantity supplied, we get different points S, M, N, Q, R and T.

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CHAPTER 6. SCALE OF PRODUCTION AND LAWS OF RETURNS OR LAWS OF COSTS

LISTS OF TOPICS

1- LARGE AND SMALL SCALE OF PRODUCTION

2- INTERNAL AND EXTERNAL ECONOMICS

3- THE LAWS OF RETURNS AND THEIR REVERSE LAW OF COSTS.

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TOPIC 1 LARGE AND SMALL SCALE OF PRODUCTION

Q.no-1 Differentiate between Large and Small scale of production? (short question of exams)

Definition:

"Scale of production is set by the size of plant, the number of plants installed and the technique of production adopted by the producer".

Classifications/Types:

The scale of production is classified as under:

(i) Small Scale Production. (ii) Large Scale Production.

(i) Small Scale Production: If a firm produces goods with small sized plants, the scale of production is said to be small scale production. Small scale of production is associated with low capital output and capital labor ratios. In small scale of production, the economies of scale do not occur to the firm.

(ii) Large Scale of Production: If a firm uses more capital and larger quantities of other factors, it is said to be operating on large scale production. Large scale production enjoys both internal and external economies of scale.

TOPIC 2 INTERNAL AND EXTERNAL ECONOMICS

Q. no-1 Define Internal Economics and External Economics? (short question of exams).

The economics of large scale production are classified by Marshall into –

1.Internal Economics, and 2. External Economics

Internal Economics of Scale

Internal economics of scale are those economics which are internal to the firm. These arise within the firm as a result of increasing the scale of output of the firm. A firm secures these economics from the growth of the firm independently. The main internal economics are grouped under the following heads:
(i) Technical Economics
(ii) Managerial Economics (iii) Economics of information (iv) Financial Economics
(v) Risk Bearing Economics: (vi) Economics of Scale

External Economics of Scale:

External economics of scale are those economics which are not specially availed of by .any firm. Rather these accrue to all the firms in an industry as the industry expands. External economics of scale can also be realized from the above-mentioned inputs as a result of the company's geographical location. Thus all fast food chains located in the same area of a certain city could benefit from lower transportation costs and a skilled labor force. Moreover, support industries may then begin to develop, such as dedicated fast food potato and/or cattle breeding farms.
External economics of scale can also be reaped if the industry lessens the burdens of costly inputs, by sharing technology or managerial expertise, for example. This spillover effect can lead to the creation of standards within an industry.

The main external economics are as under:

(i)Economics of localization.
(ii) Economics of vertical disintegration.
(iii) Economics of information -
(iv) Economics of byproducts –

TOPIC 3

THE LAWS OF RETURNS AND THEIR REVERSE LAW OF COSTS.

There are three laws of return
1-law of increasing return
2-law of diminishing return
3-law of constant return

Q.no-1 State "law of increasing return" with the help of schedule and diagram?(long question of exams)

Law of Increasing Return:

Definition:

In a given state of technology when the units of variable factors are increased with the units of other fixed factors, the marginal productivity increases, it is called **law of increasing returns**.

Assumptions of the law:

The assumptions of this law are as follows:

1. At least one factor of production is assumed to be indivisible.
2. Some factors (labor and capital) are assumed to be divisible.
3. There is a scope of further improvement in the technique of production.
4. There is no change in the prices of factors of production.
5. All units of variable factors are equally efficient.

Schedule:

In the light of above assumptions the following schedule is presented for law of increasing returns.

Fixed Factor (Land)	Units of variable factor (labor, capital)	Marginal product (MP)	Total product (TP)
10 units	1	2	2
10 units	2	4	6
10 units	3	6	12
10 units	4	8	20
10 units	5	10	30

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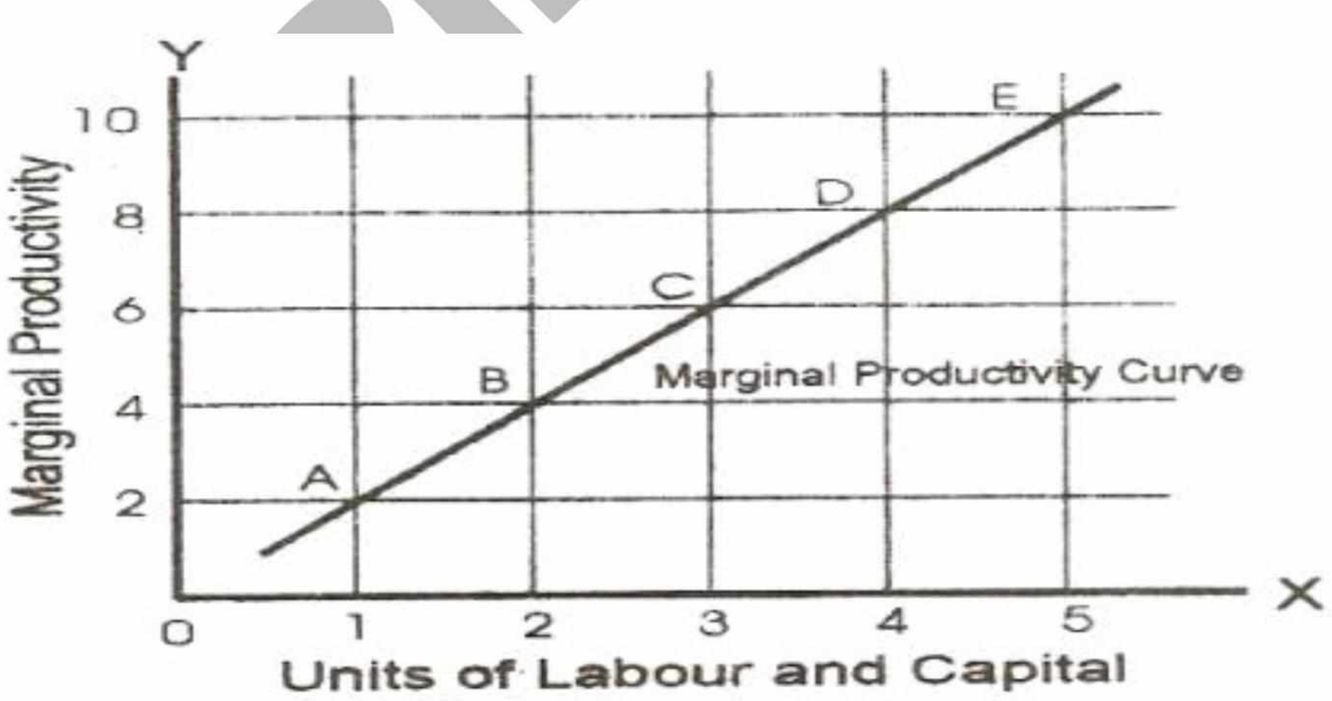
In the above schedule, the units of variable factors (labor and capital) are employed with fixed 10 units of land. The producer goes on expanding his business by investing successive units of inputs, and then marginal productivity goes on increasing up to the fifth unit of the variable inputs. At the 5th unit, the plant is working to its full capacity and it is not possible further to reap the economies of large scale of production. Thus the total productivity increases at increasing rate.

Diagram:



In terms of cost, the law of increasing returns means the lowering of the marginal costs as industry expanded. So, by increasing returns, we are moving towards the optimum business unit.The units of labor and capital (variable inputs) are measured on X-axis, while marginal productivity of these inputs on y-axis. By schedule we have taken A, B, C, D and E points in the figure above. By joining these points we get the desired marginal productivity curve of increasing returns to scale having positive slope.

Application of the Law:

The law of increasing return operates in such manufacturing industries where:

1. Factors of production are combined and substituted up to some extent.
2. An industry is expanded by getting the internal and external economies of large scale of production.
3. The law is also applicable in that unit which is producing below its capacity. The increase in marginal returns continues till the plant begins to produce to its full capacity.
4. The principle of specialization is applicable in industrial units The marginal productivity increases due to specialization.
5. In industrial sector human factors are more involved than natural factors. Due to this reason natural obstacles are less effective.

Therefore the law of increasing returns operates in an industry to increase its output and the price of the product falls.

Law of Diminishing Returns:

Q.no-2 State "Law of Diminishing Return" with the help of Schedule and diagram? Or Why does "Law of diminishing marginal return specially apply to the agriculture sector? (long question of exams)

Definition:

In a given state of technology when the units of variable factors of production are increased with the units of other fixed factor, the marginal productivity decreases it is called **law of diminishing returns**.

Assumptions:

The assumptions of the law of diminishing returns are as follows:

1. Units of capital and labor are used as variable factors.
2. The prices of the factors do not change.
3. All units of variable factors are equally efficient.
4. There is no change in technique of production.
5. Best combination of factors of production has crossed the level of optimum point.
6. There is no change in the fixed factor of production.

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Schedule:

The following schedule explains this law:

Fixed Factor (Land)	Units of variable factor (labor, capital)	Marginal product (MP)	Total product (TP)
10 units	1	10	10
10 units	2	3	18
10 units	3	6	24
10 units	4	4	28
10 units	5	2	30

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In the above schedule the marginal rate of return is at its maximum i.e. 10 tons. When an additional unit of labor and capital is employed, the marginal productivity comes down from 10 tons to 8 tons and so on decreasing. This

tendency of marginal productivity to decrease as successive units of variable factors are employed to fixed factor is called the law of diminishing returns.

Diagram:

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Why dose law of diminishing returns specially apply to the agriculture sector

The law of diminishing returns has its wide application. But is is especially applicable to agricultural sector. In this sector, there is the supremacy of nature plays in production corresponds to diminishing returns. Due to the following reasons, the agricultural sector is subject to law of diminishing returns.

1. The natural factors have more role than human factors in agricultural sector and marginal productivity decreases.
2. The sector has very wide area and supervision cannot be very effective.
3. Scope of specialized machinery is limited.
4. There are other limitations of seasonal nature e.g. rain, climate changes etc.
5. The fertility land also declines

The application of this law is not confined to agriculture but it applies every where. If the industry is expanded too much, the supervision will become inefficient and costs will go up. In agriculture it sets in earlier and in industry much later. Agriculture has also increasing returns in the beginning.

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Law of Constant Returns:

Q.no-3 state "law of constant returns" with the help of Schedule and diagram? (long question of exams)

Definition:

With the addition of successive units of variable inputs to fixed amount of other factors, there is a proportionate increase in total output. In other words, when the units of variable factors are increased with the units of other fixed factors, the marginal productivity remains constant. It is called constant return.

Assumptions:

This law is based on the following assumptions:

1. Some factors (labor and capital) are assumed to be variable.
2. There is no increase in the price of raw materials.
3. There is no change in the price of factors of production.
4. The supply of various factors for an industry should be perfectly elastic.
5. All units of variable factors of production are equally efficient.

Schedule:

For explanation of the law see the following schedule:

Fixed Factor (Land)	Units of variable factor (labor, capital)	Marginal product (MP)	Total product (TP)
10 units	1	8	8
10 units	2	8	16
10 units	3	8	24
10 units	4	8	32

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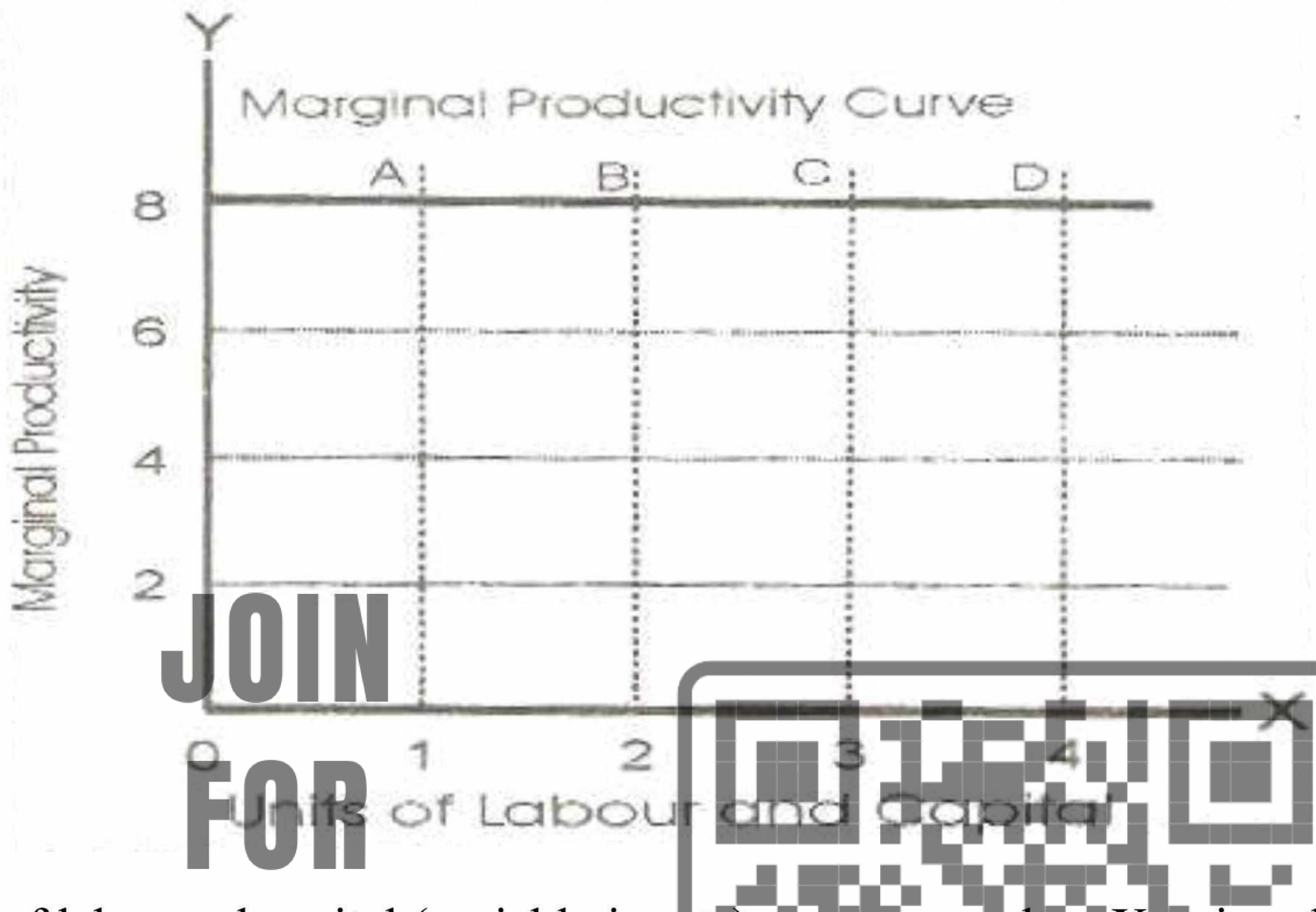
At the optimum level of production, the managerial productivity of the variable factors remains constant with the increased units of these factors are shown in the above schedule. With the further application of the units of labor and capital, the marginal productivity remains constant i.e., 8 units. Then the total productivity of the product increases with the proportionate increments.

Diagram:



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The unit of labor and capital (variable inputs) are measured on X-axis, while marginal productivity of these inputs on Y-axis. By schedule, we have taken A, B, C and D points. Marginal productivity curve of constant returns is obtained by joining these points. This curve has zero slope and parallel to X-axis. This law operates for a very short period when the marginal returns move towards optimum level of production and remains constant for short period, then begins to decline.

Application of the Law:

For the application of this law, the following points are very important:

1. This law is applicable in those sectors where human and natural factors play their role, for example, in industry making blankets, pure natural wool is used while blankets are prepared in the presence of human factors.
2. Such factors where economies of human and natural factors are presented which counter balanced each other and productivity is provided with constant rate.
3. This law is more applicable in such sectors where labor's role is greater than other factors of production. The law of constant returns operates by increasing the units of labor force.

Reverse Laws of Cost:

Q.no-4 State "Reverse laws of cost" with the help of Schedule and diagram? (long question of exams)

There are three laws of costs in terms of cost against the three laws of returns. These are:

1. Law of decreasing cost
2. Law of constant cost
3. Law of increasing costs

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These laws are briefly explained below:

Law of Decreasing Costs:

In terms of costs, the law of increasing returns means the lowering of the marginal costs as successive units of variable factors are employed. Se we are moving towards the optimum business point. It is called law of decreasing costs. Therefore, the other name of law of increasing returns is the law of decreasing costs.

Law of Constant Costs:

In terms of costs, the law of constant returns means the constant marginal costs as the industry is expanded by employing more units of variable factors. By constant costs, the industry moves on the path of optimum business unit. Therefore, the other name of the law of constant is known as the law of constant costs.

Law of Increasing Costs:

The law of decreasing returns means the increasing of the marginal cost. So we are moving afterwards the optimum business unit. The tendency on the part of marginal cost to rise is called the law of increasing cost. Therefore, the other name of law of decreasing returns is known as the law of increasing costs.

Schedule:

The three laws of costs are explained with the help of the schedule. Let us suppose that the cost of each unit of factor applied is worth 10rs only.

Units of variable factor (labor, capital)	*Marginal* product (MP)	Total product (TP)	Marginal cost (MC)	Phases
1	2	2	5.00	
2	4	6	2.50	*(I) Decreasing*
3	6	12	1.66	
4	8	20	1.25	
5	8	28	1.25	*(II) Constant*
6	8	36	1.25	
7	6	42	1.66	
8	4	46	2.50	*(III) Increasing*
9	2	48	5.00	

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By employing successive units of variable factors, the marginal cost goes on decreasing up to 4th unit. At the optimum level of production, the marginal productivity remains constant. Therefore the marginal cost also remains constant till the 6th unit of variable factor. When we employ more units of labor and capital the marginal productivity comes down which causes the increase in marginal cost.

Diagram:

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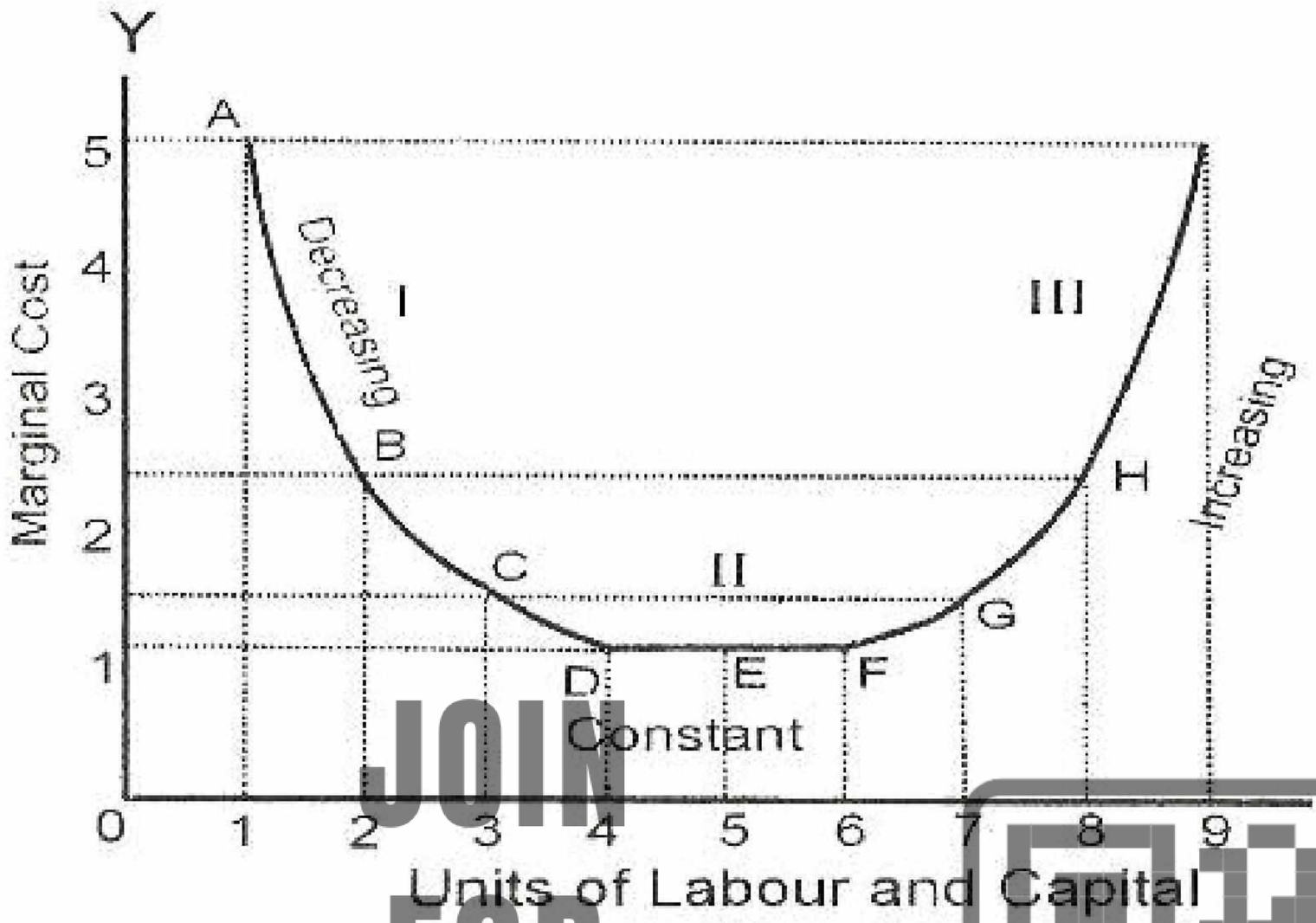

The falling curve with negative slope from point A to D, represents the operation of the law of decreasing costs. The straight line with zero slopes from point D to F shows the operation of the law of constant cost. The increase in cost starts after point F.

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CHAPTER 7. PRODUCT, COST OF PRODUCTION AND REVENUE CONCEPTS

LIST OF TOPICS

1- Total, average and marginal product.
2- Cost of Production
   (i) Fixed cost
   (ii) Variable cost
3- Classification of money-cost according to its nature of source.
   (iii) Explicit costs
   (iv) Implicit costs.
4- Average fixed cost, Average variable cost, Average total cost.
5- Marginal Cost (MC).
6- The Concept of Revenue.

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Total, average and marginal concepts are tools of economic analysis. They are very important concepts
Which are frequently used by the economists in relation to

i) Product or input
ii) Cost or inputs, and
iii) Revenue or income

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Topic 1 Total, average and marginal product

Q.no-1 Define TOTAL PRODUCT,AVERAGE PRODDUCT AND MARGINAL PRODUCT? (short question of exams)

Total product (also known TPP) is defined as the total quantity of output produced by a firm in the given inputs. Total product identifies the specific outputs which are possible using variable levels of counts. An understanding of total product is essential to the short-run analysis of a firm's production. Changes

in total product are taken into account closely when there are changes in variable costs (labor) of production .

Average Product is defined as the product produced by every worker.
when we divide the the total product by output we get average product .
(Total Product)/(Variable Inputs Employed)=Average Product

Marginal Product "The net change in total production by using the additional units of labour is known as Marginal Product of Labor" '*Marginal Product* is similar to average product but is looked at from another perspective. Discrete marginal product is defined as the change in total product that comes as a result of a one unit increase in the variable input/capital level of a firm. Continuous marginal product is calculated as the derivative of total product with respect to the variable input employed.

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Topic 2: Costs of production

Q.no-1 Define Fixed cost and Variable cost? (short question of exams)

(i) Fixed costs

Fixed costs are those that do not vary with output and typically include rents, insurance, depreciation, set-up costs, and normal profit. They are also called *overheads*.

(ii) Variable cost

Variable costs are costs that do vary with output, and they are also called direct costs. Examples of typical variable costs include fuel, raw materials, and some labour costs.
An example
Consider the following hypothetical example of a boat building firm. The total fixed costs, TFC, include premises, machinery and equipment needed to construct boats, and are £100,000, irrespective of how many boats are produced.
Total variable costs
(TVC) will increase as output increases.

OUTPUT	TOTAL FIXED COST	TOTAL VARIABLE COST	TOTAL COST
1	100	50	150
2	100	80	180
3	100	100	200
4	100	110	210
5	100	150	250
6	100	220	320
7	100	350	450
8	100	640	740

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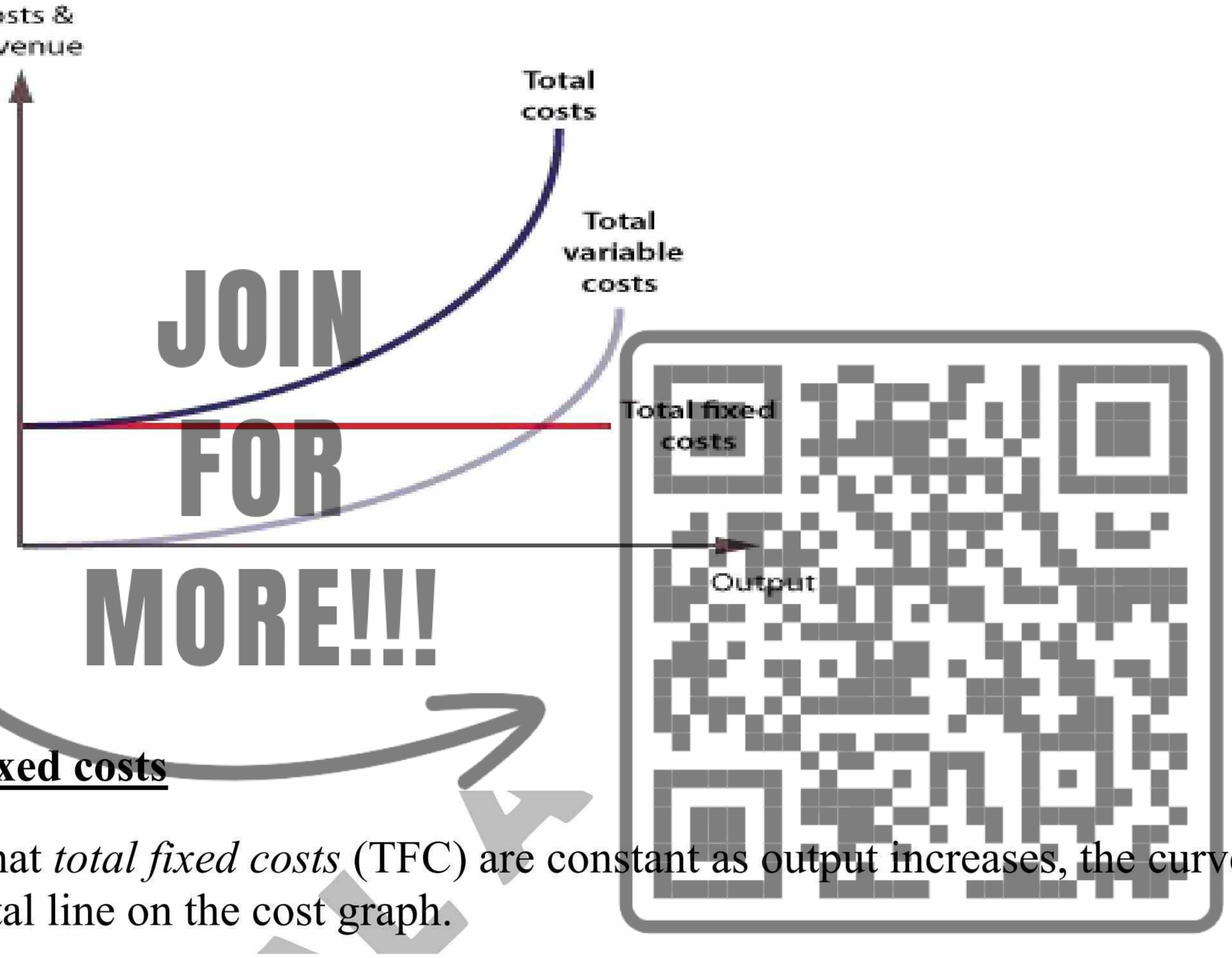
Plotting this gives us Total Cost, Total Variable Cost, and Total Fixed Cost.



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Total fixed costs

Given that *total fixed costs* (TFC) are constant as output increases, the curve is a horizontal line on the cost graph.

Total variable cost

The *total variable cost* (TVC) curve slopes up at an accelerating rate, reflecting the **law of diminishing marginal returns**.

Total costs The *total cost* (TC) curve is found by adding total fixed and total variable costs. Its position reflects the amount of fixed costs, and its gradient reflects variable costs.

Topic- 3: Classification of money-cost according to its nature of source

Q.no-1 Define Explict Costs and Implict Costs? (short question of exams)

(iii) <u>Explicit Costs</u>

Explicit costs are paid out costs. They are those money expenses which a firm has to pay to outsiders who supply different inputs and services. They includes
Wages and salaries.
Payment for raw materials.

(iv) <u>Implicit Costs</u>

Implicit costs consist of firm's self-owned and self employed resources. These are the expenses which are not paid to outsiders who supply different inputs and services rather paid to the owner of the firm for providing his self-owned, self-employed resources.
Implicit costs are also called imputed costs.
They includes:
Salary of the owner; working as a manager,
Interest of capital provided by the owner by his own sources,

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<u>Topic 4 Average fixed cost, Average variable cost, Average total cost</u>

Q.no-1 Explain the relationship between Average Total Cost, Average variable cost and Average Fixed Cost? (long question of exams)

<u>Average Fixed Cost</u>

average fixed cost (**AFC**) is the <u>fixed costs</u> of production (FC) divided by the quantity (Q) of output produced. Fixed costs are those costs that must be incurred in fixed quantity regardless of the level of output produced.

Average Fixed Cost =Total Fixed Cost Total / Units of Output

Average fixed cost is a per-unit-of-output measure of fixed costs. As the total number of units of the good produced increases, the average fixed cost decreases because the same amount of fixed costs is being spread over a larger number of units of output

Average variable Cost

In economics, **average variable cost** (AVC) is a firm's**variable costs** (labor, electricity, etc.) divided by the quantity of output produced. **Variable costs** are those**costs** which vary with output.

$$\mathrm{AVC} = \frac{\mathrm{VC}}{\mathrm{Q}}$$

where VC = variable cost, AVC = average variable cost, and Q = quantity of output produced

Average Total Cost

When economists, production managers, or others refer to **average total cost**, they are referring to the per unit cost that includes all fixed costs and all variable costs. Knowing average total cost is critical in making pricing decisions, as any price below average total cost will result in a financial loss.

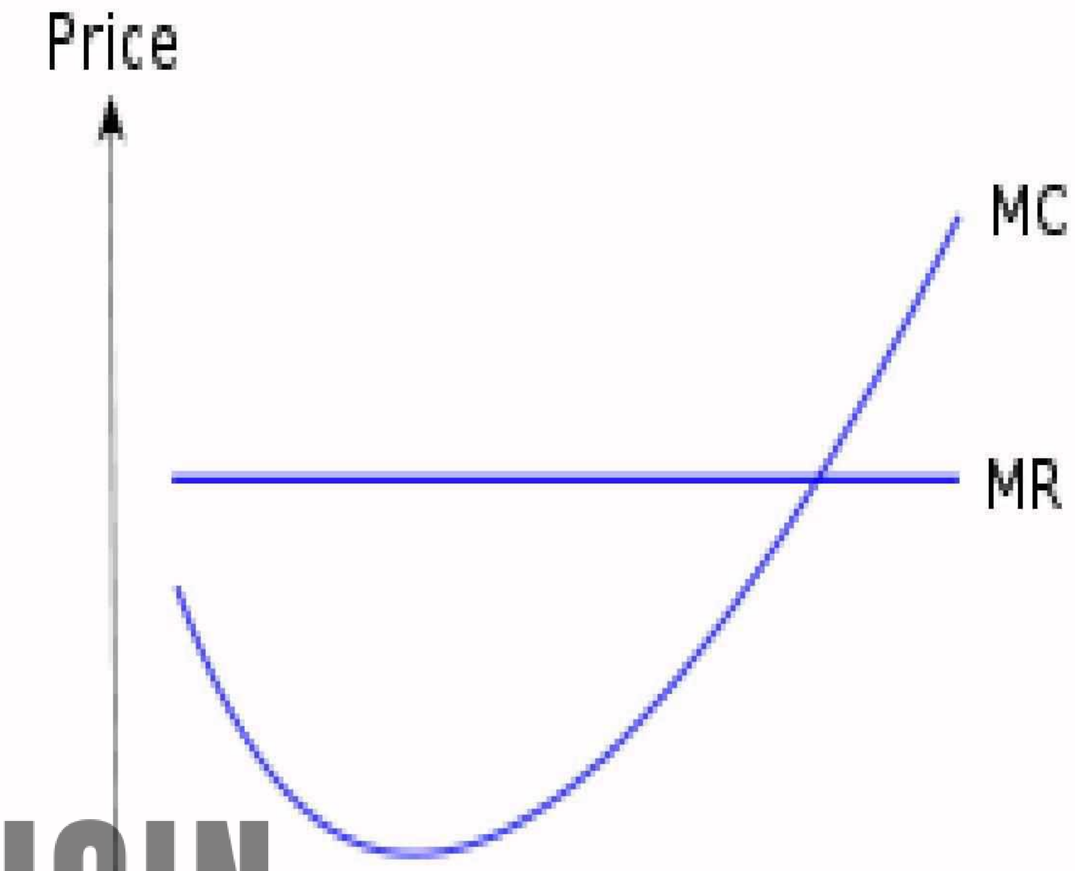
The average total cost is sometimes referred to as the **per unit total cost** since it is calculated by taking the total cost of production and dividing that by the number of units produced (quantity). In variable form, it looks like this:

$TC / Q = ATC$

Where fixed costs + variable costs (quantity) = TC

Topic5 Marginal cost

Q.no-1 Define and Illustrate Marginal Cost? (short and long both question of exams)



A typical marginal cost curve withmarginal revenue overlaid

In economics, **marginal cost** is the change in the total cost that arises when the quantity produced is incremented by one unit, that is, it is the cost of producing one more unit of a good.[1] In general terms, marginal cost at each level of production includes any additional costs required to produce the next unit. For example, if producing additional vehicles requires building a new factory, the marginal cost of the *extra* vehicles includes the cost of the new factory. In practice, this analysis is segregated into short and long-run cases, so that, over the longest run, all costs become marginal. At each level of production and time period being considered, marginal costs include all costs that vary with the level of production, whereas other costs that do not vary with production are considered fixed.

The graph is plotted with Price, Cost and Revenue on the Y-axis and Quantity on the X-axis.

If the good being produced is infinitely divisible, the size of a marginal cost will change with volume; so a non-linear and non-proportional cost function includes the following:

- variable terms dependent on volume,
- constant terms independent on volume and occurring with the respective lot size,

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- jump fix cost increase or decrease dependent on steps of volume increase.

In practice the above definition of marginal cost as the change in total cost as a result of an increase in output of one unit is inconsistent with the differential definition of marginal cost for virtually all non-linear functions. This is as the definition finds the tangent to the total cost curve at the point q which assumes that costs increase at the same rate as they were at q. A new definition may be useful for marginal unit cost (MUC) using the current definition of the change in total cost as a result of an increase of one unit of output defined as: TC(q+1)-TC(q) and re-defining marginal cost to be the change in total as a result of an infinitesimally small increase in q which is consistent with its use in economic literature and can be calculated differentially.

If the cost function is differentiable joining, the marginal cost is the cost of the next unit produced referring to the basic volume.

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Topic 6 Concept of Revenue

Q.no-1 State "The concepts of Revenue"?with the heip of schedule and diagram? (short and long both question of exams)

Revenue is the income a firm retains from selling its products once it has paid indirect tax, such as VAT. Revenue provides the income which a firm needs to enable it to cover its costs of production, and from which it can derive a profit. Profit can be distributed to the owners, or shareholders, or retained in the business to purchase new capital assets or upgrade the firm's technology.

Revenue is measured in three ways:

Total revenue Total revenue (TR), is the total flow of income to a firm from selling a given quantity of output at a given price, less tax going to the government. The value of TR is found by multiplying price of the product by the quantity sold.

Average revenue revenue (AR), is revenue *per unit*, and is found by dividing TR by the quantity sold, Q. AR is equivalent to the price of the product, where P x Q/Q = P, hence AR is also *price*.

Marginal revenue Marginal revenue (MR) is the revenue generated from selling one extra unit of a good or service. It can be found by finding the change in TR

following an increase in output of one unit. MR can be both positive and negative.

Revenue schedule

A revenue schedule shows the amount of revenue generated by a firm at different prices.

PRICE (rs) (000)	QUANTITY DEMANDED	TOTAL REVENUE (000)	MARGINAL REVENUE (000)
10	1	10	
9	2	18	8
8	3	24	6
7	4	28	4
6	5	30	2
5	6	30	0
4	7	28	-2
3	8	24	-4

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2	9	18	-6
1	10	10	-8

Revenue curves

Total revenue

Initially, as output increases total revenue (TR) also increases, but at a decreasing rate. It eventually reaches a maximum and then decreases with further output.Less competition in a given market is likely to lead to higher prices and the possibility of higher super-normal profits.

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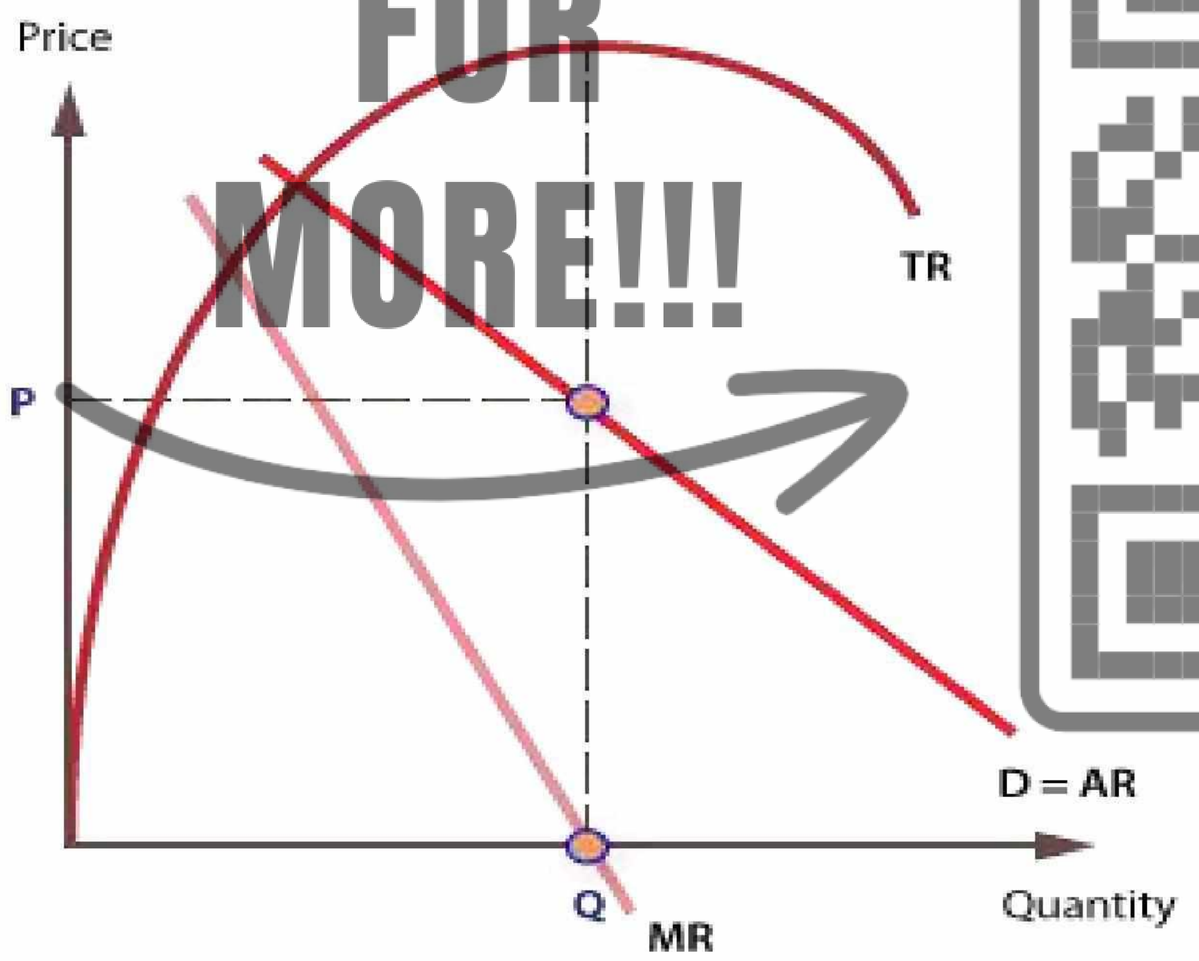

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Average revenue

However, as output increases the average revenue (AR) curve slopes downwards. The AR curve is also the firm's demand curve.

Marginal revenue

The marginal revenue (MR) curve also slopes downwards, but at twice the rate of AR. This means that when MR is 0, TR will be at its maximum. Increases in output beyond the point where MR = 0 will lead to a negative MR.

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CHAPTER 8

EQUILIBRIUM OF THE FIRM AND INDUSTRY UNDER PERFECTCOMPETITION

LIST OF TOPICS

1. What is perfect competition?
2. Necessary assumption or condition of perfect competition.
3. Equilibrium of the firm.
4. Firm's short-run equilibrium.
5. Firm's long-run equilibrium.

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Topic 1 what is Perfect Competition?

Q.no-1 what is perfect competitions? (short question of exams)

Definition

"Perfect competition is a market structure in which the following five criteria are met: 1) All firms sell an identical product; 2) All firms are price takers - they cannot control the market price of their product; 3) All firms have a relatively small market share; 4) Buyers have complete information about the product being sold and the prices charged by each firm; and 5) The industry is characterized by freedom of entry and exit. Perfect competition is sometimes referred to as pure competition."

Perfect competition is the opposite of a monopoly, in which only a single firm supplies a particular good or service, and that firm can charge whatever price it wants because consumers have no alternatives and it is difficult for would-be competitors to enter the marketplace. Under perfect competition, there are many buyers and sellers, and prices reflect supply and demand. Also, consumers have many substitutes if the good or service they wish to buy becomes too expensive or its quality begins to fall short. New firms can easily enter the market, generating additional competition. Companies earn just enough profit to stay in

business and no more, because if they were to earn excess profits, other companies would enter the market and drive profits back down to the bare minimum.

Topic 2: Necessary assumption or condition of perfect competition

Q.no-1 Give the necessary assumption or conditions of perfect competition? (short question of exams)

Necessary assumption or condition of perfect competition

1. Many sellers
2. Many individual buyers -Perfect freedom of entry and exit from the industry.
3. Homogeneous product
4. Perfect knowledge –
5. Perfectly mobile factors of production
6. No externalities
7. Perfectly mobile factors of production

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Topic 3 Equilibrium of the Firm

Q.no-1 what are the meaning of the firms equilibrium? (short question of exams)

Equilibrium of the Firm

Meaning:

A firm is in equilibrium when it has no tendency to change its level of output. It needs neither expansion nor contraction. It wants to earn maximum profits. In the words of A.W. Stonier and D.C. Hague, "A firm will be in equilibrium when it is earning maximum money profits."

Equilibrium of the firm can be analysed in both short-run and long-run periods. A firm can earn the maximum profits in the short run or may incur the minimum loss. But in the long run, it can earn only normal profit.

Topic 4: Short-run Equilibrium of the Firm:

Q.no-1 Explain in detail "short run equilibrium of the firm? (short and and long both question of exams)

Short-run Equilibrium of the Firm:

The short run is a period of time in which the firm can vary its output by changing the variable factors of production in order to earn maximum profits or to incur minimum losses. The number of firms in the industry is fixed because neither the existing firms can leave nor new firms can enter it.

It's Conditions:

The firm is in equilibrium when it is earning maximum profits as the difference between its total revenue and total cost.

For this, it essential that it must satisfy two conditions:

(1) MC = MR, and (2) the MC curve must cut the MR curve from below at the point of equality and then rise upwards.

The price at which each firm sells its output is set by the market forces of demand and supply. Each firm will be able to sell as much as it chooses at that price. But due to competition, it will not be able to sell at all at a higher price than the market price. Thus the firm's demand curve will be horizontal at that price so that P = AR = MR for the firm.

1. Marginal Revenue and Marginal Cost Approach:

The short-run equilibrium of the firm can be explained with the help of the marginal analysis as well as with total cost-total revenue analysis. We first take the marginal analysis under identical cost conditions.

This analysis is based on the following assumptions:

1. All firms in an industry use homogeneous factors of production.
2. Their costs are equal. Therefore, all cost curves are uniform.
3. They use homogeneous plants so that their SAC curves are equal.
4. All firms are of equal efficiency.
5. All firms sell their products at the same price determined by demand and supply of the industry so that the price of each firm is equal to AR = MR.

Determination of Equilibrium:

Given these assumptions, suppose that price OP in the competitive market for the product of all the firms in the industry is determined by the equality of demand curve D and the supply curve S at point E in Figure 1(A) so that their average revenue curve (AR) coincides with the marginal revenue curve (MR).

At this price, each firm is in equilibrium at point L in Panel (B) of the figure where (i) SMC equals MR and AR, and (ii) the SMC curve cuts the MR curve from below. Each firm would be producing OQ output and earning normal profits at the maximum average total costs QL. A firm earns normal profits when the MR curve is tangent to the SAC curve at its minimum point.

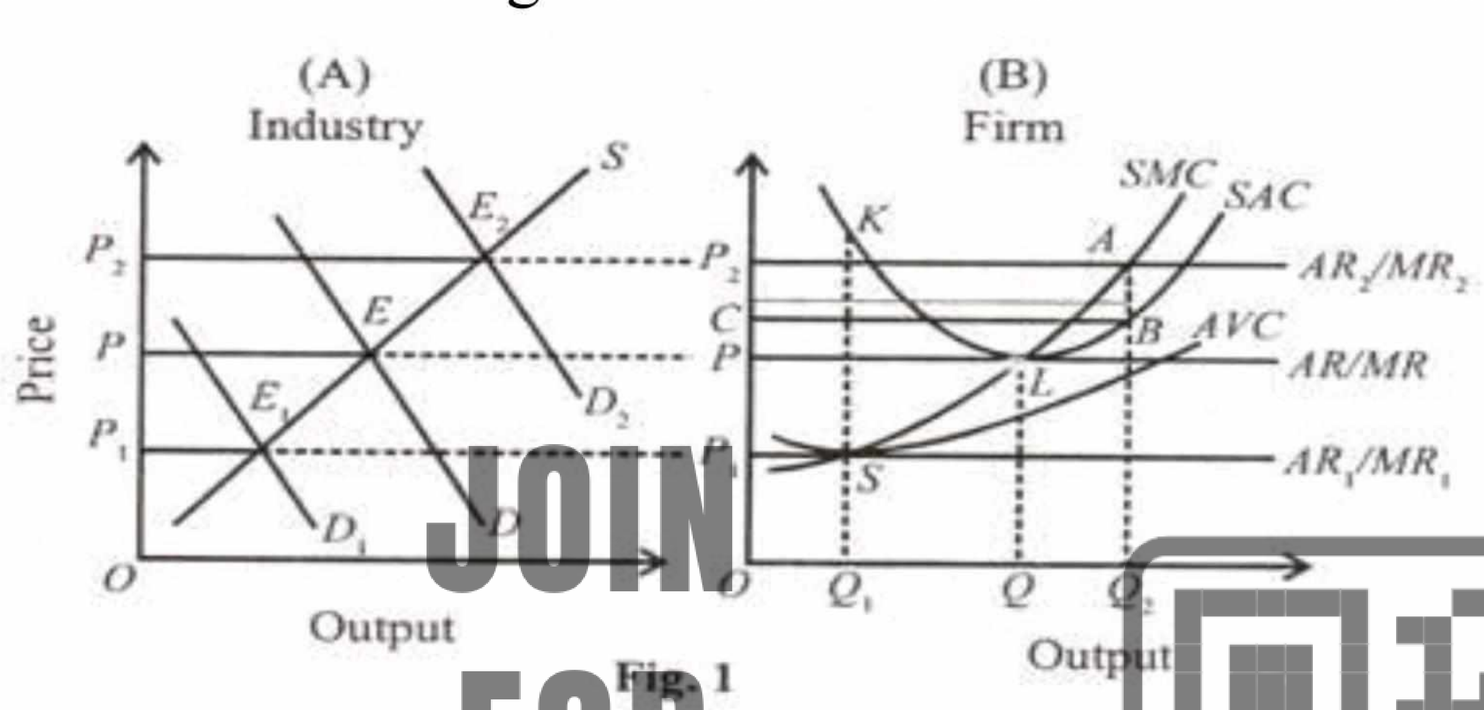

Fig. 1

If the price is higher than these minimum average total costs, each firm will be earning supernormal profits. Suppose the price rises to $0P_2$ where the SMC curve cuts the new marginal revenue curve MR_2 (=AR_2) from below at point A which now becomes the equilibrium point. In this situation, each firm produces OQ_2 output and earns supernormal profits equal to the area of the rectangle P_2ABC.

If the price falls below $OP_1$the firm would make a loss because the SAC would be higher than the price. In the short-run, it would continue to produce and sell OQ_1 output at OP_1price so long as it covers its AVC. S is thus the shut-down point at which the firm is incurring the maximum loss equal to SK per unit of output. If the price falls below OP_1 the firm will close down because it would fail to cover even the minimum average variable cost. OP_1 is thus the shut-down price.

We may conclude from the above discussion that in the short-run each firm may be making either supernormal profits, or normal profits or losses depending upon the price of the product.

2. Total Cost Revenue Analysis:

The short-run equilibrium of the firm can also be shown with the help of total cost and total revenue curves. The firm is able to maximize its profits at that level of output where the difference between total revenue and total cost is the maximum. This is shown in Figure 2 where TR is the total revenue curve and TC total cost curve.

The total revenue curve is an upward sloping straight line curve starting from O. This is because the firm sells small or large quantities of its product at a constant price under perfect competition. If the firm produces nothing, total revenue will be zero. The more it produces, the larger is the increase in total revenue. Hence the TR curve is linear and slopes upward.

The firm will maximize its profits at that level of output where the gap between the TR curve and the 1C curve is the maximum. Geometrically, it is that level at which the slope of a tangent drawn to the total cost curve equals the slope of the total revenue curve. In Figure 2, the maximum amount of profit is measured by TP at OQ output. At outputs smaller or larger than OQ between A and B points, the firm's profits shrink. If the firm produces OQ_1 output, its losses are the maximum because the TC curve is i above the TR curve. At Q_1 its profits are zero. Similar situation prevails at Q_2.

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Fig. 2

Since the marginal revenue equals the slope of the total o revenue curve and the marginal cost equals the slope of the tangent to the total cost curve, it follows that where the slopes of the total cost and revenue curves are equal as at P and T, the marginal cost equals the marginal revenue. It should be clear of that the point of maximum profits lies in the region of rising marginal cost (when TC is below TR) and of maximum loss in the falling marginal cost region (where TC is above TR).The explanation of the equilibrium of the firm by using total cost-revenue curves does not throw more light than is provided by the marginal cost-marginal revenue analysis. It is useful only in the case of certain marginal decisions where the total cost curve is also linear over a certain range of output.

But it makes the equilibrium of the firm a cumbersome and difficult analysis particularly when one has to compare the change in cost and revenue resulting from a change in the volume of output. Further, maximum profits cannot be

known at once. For this, a number of tangents are required to be drawn which is a real difficulty.

Topic 5: Long-run Equilibrium of the Firm:

Q.no-1 Explain in detail long run equilibrium of the firm? (short and long question of exams)

Long-run Equilibrium of the Firm

In the long-run, it is possible to make more adjustments than in the short-run. The firm can adjust its plant capacity and scale of operations to the changed circumstances. Therefore, all costs are variable. Firms must earn only normal profits. In case the price is above the long-run AC curve firms will be earning supernormal profits.

Attracted by them, new firms will enter the industry and supernormal profits will be competed away. If the price is below the LAC curve firms will be incurring losses. As a result, some of the firms will leave the industry so that no firm earns more than normal profits. Thus "in the long-run firms are in equilibrium when they have adjusted their plant so as to produce at the minimum point of their long-run AC curve, which is tangent (at this point) to the demand (AR) curve defined by the market price" so that they earn normal profits.

It's Assumptions:

This analysis is based on the following assumptions:

1. Firms are free to enter into or leave the industry.
2. All firms are of equal efficiency.
3. All factors are homogeneous. They can be obtained at constant and uniform prices.
4. Cost curves of firms are uniform.

Determination: Given these assumptions, each firm of the industry will be in the following two conditions.

(1) In equilibrium, its short-run marginal cost (SMC) must equal to its long-run marginal cost (LMC) as well as its short-run average cost (SAC) and its long-run

average cost (LAC) and both should be equal to MR=AR=P. Thus the first equilibrium condition is:

SMC = LMC = MR = AR = P = SAC = LAC at its minimum point, and

(2) LMC curve must cut MR curve from below.

Both these conditions of equilibrium are satisfied at point E in Figure 3 where SMC and LMC curves cut from below SAC and LAC curves at their minimum point E and SMC and LMC curves cut AR = MR curve from below. All curves meet at this point E and the firm produces OQ optimum quantity and sell it at OP price.

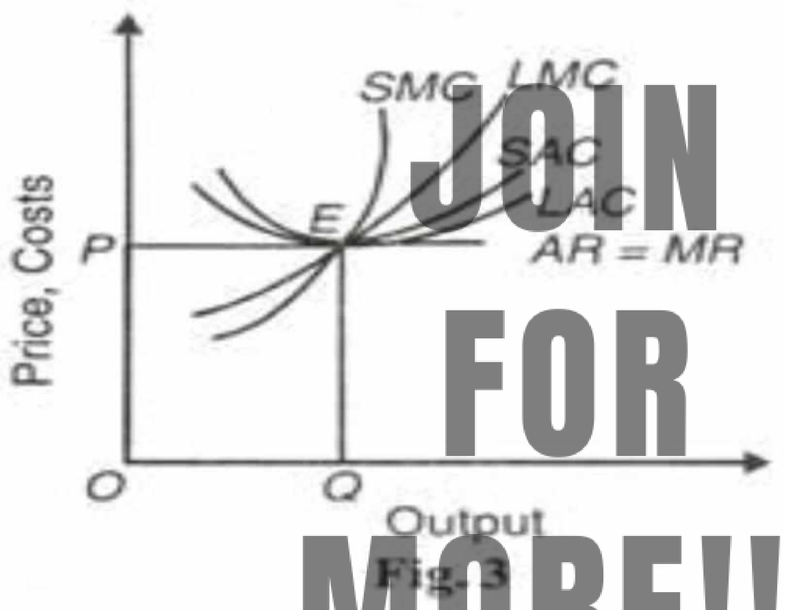

Fig-3

Since we assume equal costs of all the firms of industry, all firms will be in equilibrium m the long-run. At OP price a firm will have neither a tendency to leave nor enter the industry and all firms will earn normal profit.

Equilibrium of the Industry under Perfect Competition:

Conditions of Equilibrium of the Industry:

An industry is in equilibrium:

(i) When there is no tendency for the firms either to leave or enter the industry, and (ii) when each firm is also in equilibrium. The first condition implies that the average cost curves coincide with the average revenue curve of all the firms in the industry. They are earning only normal profits, which are supposed to be included in the average cost curves of the firms. The second condition implies the equality of MC and MR. Under a perfectly competitive industry, these two conditions must be satisfied at the point of equilibrium, i.e.,

SMC = MR

SAC = AR

P = AR = MR

SMC = SAC = AR = P

Such a situation represents full equilibrium of the industry.

Short-Run Equilibrium of the Industry:

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An industry is in equilibrium in the short run when its total output remains steady, there being no tendency to expand or contract its output. If all firms are in equilibrium, the industry is also in equilibrium. For full equilibrium of the industry in the short run, all firms must be earning only normal profits. The condition for this is SMC = MR = AR = SAC. But full equilibrium of the industry is by sheer accident because in the short run some firms may be earning supernormal profits and some incurring losses.

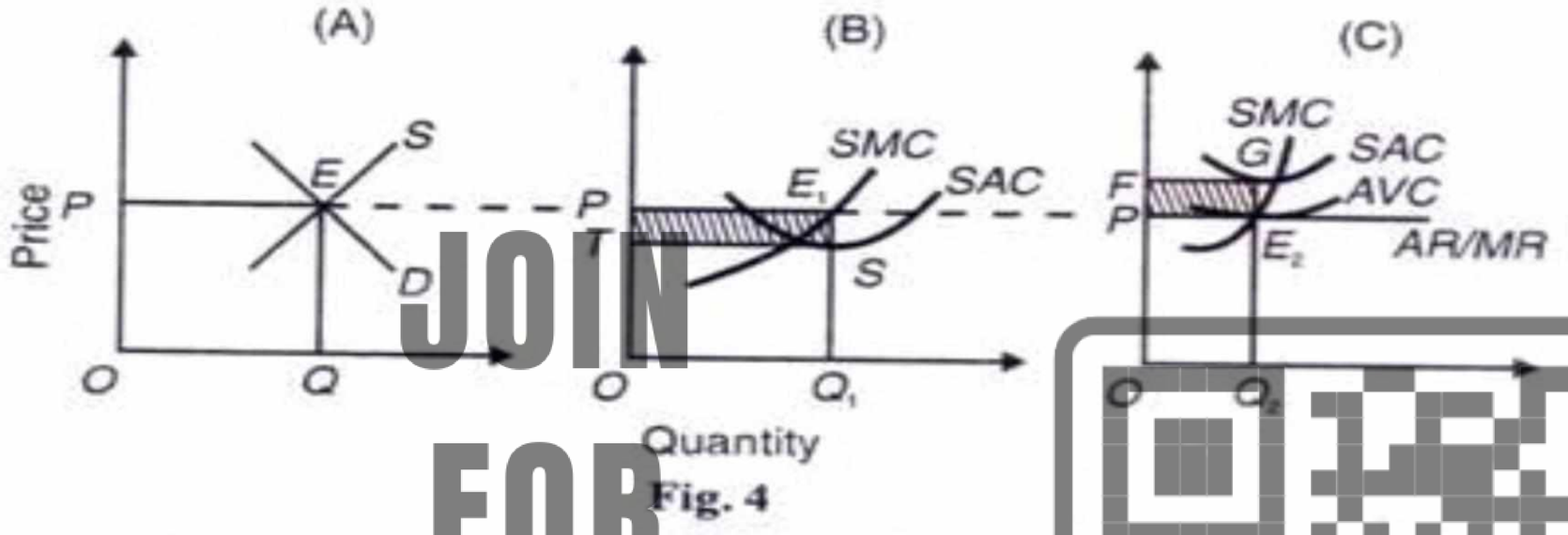

Fig. 4

Even then, the industry is in short- run equilibrium when its quantity demanded and quantity supplied are equal at the price which clears the market. This is illustrated in Figure 4, where in Panel (A), the industry is in equilibrium at point E where its demand curve D and supply curve S intersect which determine OP price at which its total output OQ is cleared. But at the prevailing price OP some firms are earning supernormal profits PE_1ST as shown in Panel (B), while some other firms are incurring FGE_2P losses as shown in Panel (C) of the figure.

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CHAPTER 9. EQUILIBRIUM OF THE FIRM AND INDUSTRY UNDER MONOPOLY.

LIST OF TOPICS

1- Equilibrium of the firm under monopolistic competition.
   (a) Short run equilibrium.
   (b) Long run equilibrium.

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TOPIC-1 Equilibrium of a Firm under Monopolistic Competition

Q.no-1 Describe equilibrium of the firm under monopolistic competition. (A) short run equilibrium (B) long run equilibrium ? (short and lon both question of exams)

Let us learn about the short run and long run equilibrium of a firm under monopolistic competition.

(a)Short Run Equilibrium:

Equilibrium of a firm under monopolistic competition is often couched in terms of short period and long period. In the short run, Chamberlin's model of monopolistic competition comes closer to monopoly.That is to say, there is virtually no difference between monopolistic competition and monopoly in the short run. Thus, Chamberlin's firm may earn supernormal profit, normal profit, or incur loss in the short run—since entry and exit are not allowed during this time period.In Fig. 5.15, the short run marginal cost curve, SMC, is equal to MR at point E. Thus E is the equilibrium point. Corresponding to this equilibrium point, the firm produces OQ output and sells it at a price OP. Thus, the firm earns pure profit to the extent of PARB since total revenue (OPAQ) exceeds total cost of production (OBRQ).

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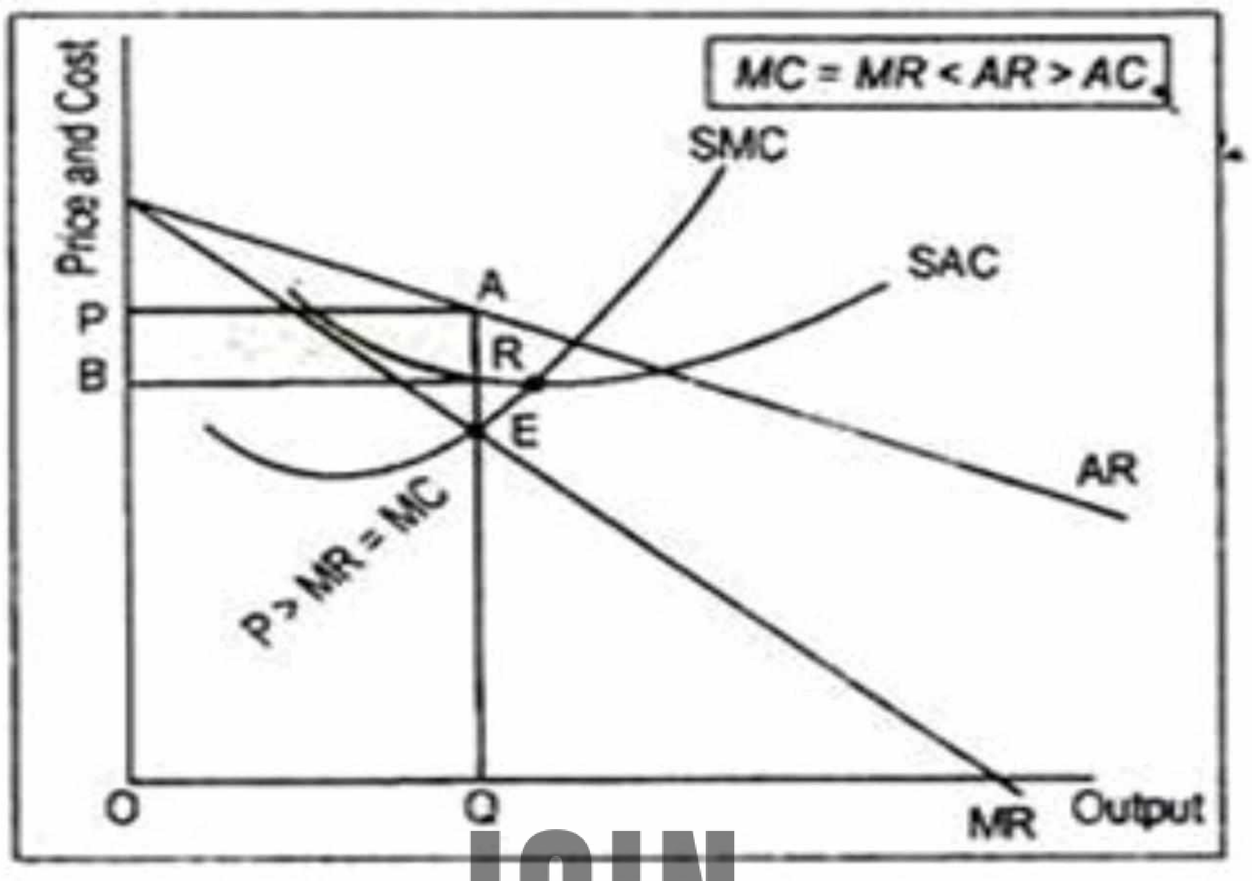

Fig. 5.15: Short Run Equilibrium
[Supernormal Profit: BRAP rectangle]

A firm, in the short run, may earn only normal profit if MC = MR < AR = AC occurs. A loss may result in the short run if MC = MR < AR < AC happens

(b)Long Run Equilibrium:

In the long run, monopolistic competition comes closer to perfect competition because the freedom of entry and exit allows firms to enjoy only normal profit.Whenever some firms earn pure profit in the long run some other firms may be attracted to join this product group, thereby shifting the demand curve or AR curve downward and to the left. Thus, entry of new firms would cause decline in market share by reducing the demand for its product.Consequently, excess profit will be reduced to zero. Further, if the existing firm experiences losses then the exit of firms will bring about an opposite effect and the process will continue until normal profit is earned driving excess profit to zero. Seeing losses for a long time, losing firms may be induced to leave the product group thereby eliminating losses. Thus all firms in the long run earn only normal profit.Long run equilibrium is achieved at point E where LMC equals MR (Fig. 5.16). The equilibrium output thus determined is OQ_M. At this output, AR equals AC. The firm gets normal profit by selling OQ_M output at the price OP_M. Note that a monopolistically competitive firm always operates somewhere to the left of the minimum point of its AC curve.

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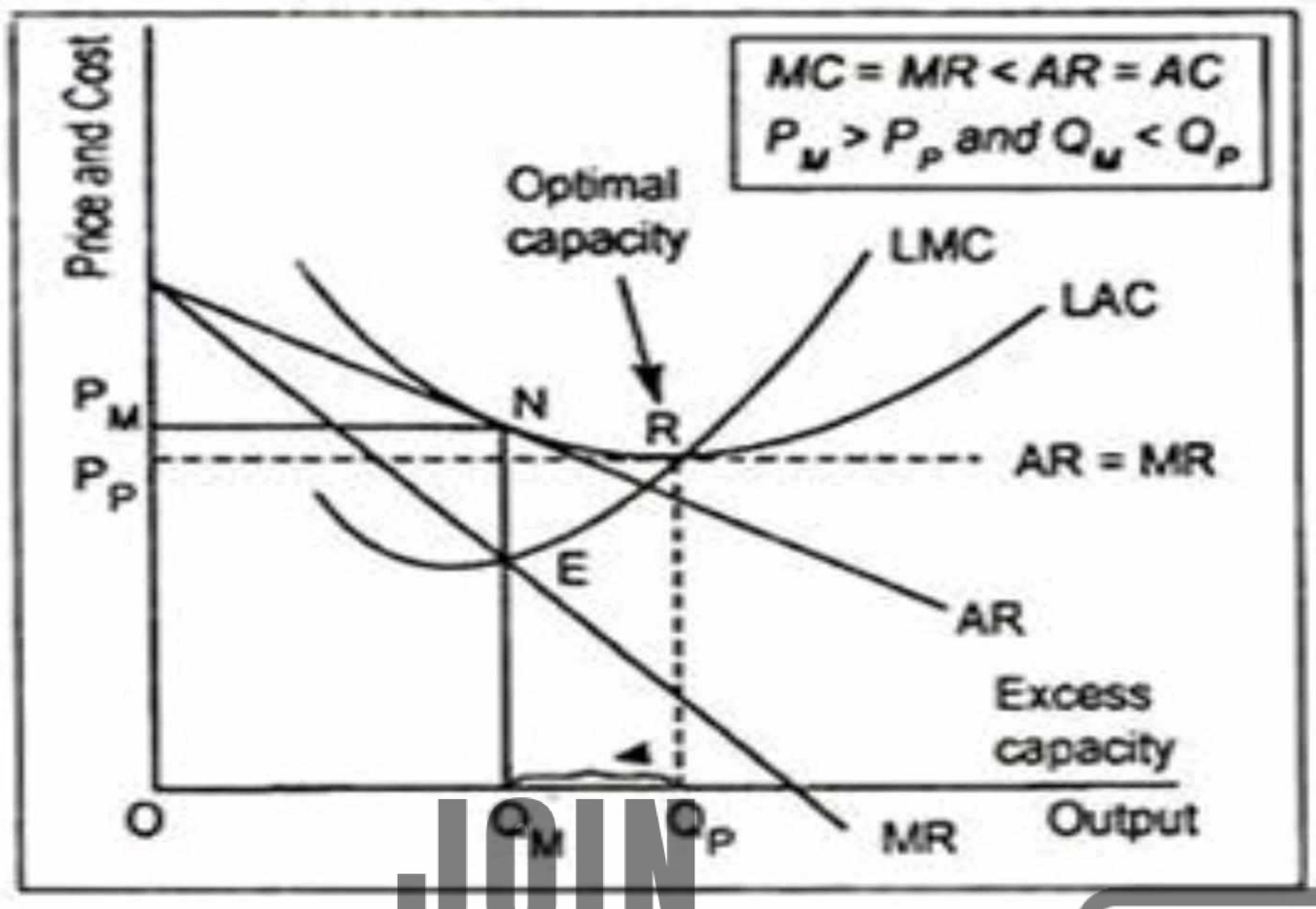

Fig. 5.16: Long Run Equilibrium : Normal Profit

In other words, as the demand curve is not perfectly elastic, or, as the demand curve is negative sloping, the AR curve becomes tangent to the left of the lowest point of the AC curve (say, point N). Each firm thus produces at a cost higher than the minimum and gets only normal profit.

Under perfect competition, long run equilibrium is achieved at that point where MC = MR = AR = AC. Because of the perfectly elastic AR curve, a tangency occurs between AR and AC at the latter's lowest point. In Fig. 5.16 the dotted AR = MR curve is the demand curve faced by a competitive firm.

Equilibrium is attained at point R where LMC = MR = AR = lowest point of LAC. The competitive output thus determined is OQP which will be sold at the price OPP. So, we can conclude that monopolistically competitive output (OPM) is less than the perfectly competitive output (OQP), and monopolistically competitive price (OPM) is larger than competitive price (OPP).

Thus, the difference in output — QMQP— measures excess capacity or unused capacity faced by monopolistically competitive firms. Production at a higher cost implies wastage of resources or underutilization of resources.Since production takes place at the lowest point of AC curve under perfect competition, there does not occur any wastage of resources. Hence a perfectly competitive market is

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'efficient' in the sense that resources are allocated efficiently. Society gets larger output and consumers get output at a low price. Thus, as perfect competition maximizes social welfare, it is an ideal market.But as the monopolistically competitive firm operates to the left of the minimum point of its AC curve, this market is considered as an 'inefficient' one. As a result, social welfare is not maximized under monopolistic competition since society gets lower output compared to perfectly competitive output and buyers buy the differentiated products at a high price.

Dominick Salvatore argues:

"Excess capacity permits more firms to exit (i.e., it leads to overcrowding) in monopolis-tically competitive markets as compared with perfect competition. Consumers, however, seem to prefer that firms selling some services operate with same unused capacity (i.e., they are willing to pay a slightly higher price…) so as to avoid waiting in long lines."

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CHAPTER 10. THEORY OF DISTRIBUTION OF FACTOR PRICING.

LIST OF TOPICS

1- Introduction to Theory of Factor Pricing or Theory of Distribution
2-Marginal Productivity Theory (Neo-Classical Version)
3-Firm's Equilibrium in the Factor Market Under Perfect Competition
4-Modern Theory of Factor Pricing Under Perfect Competition

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TOPIC 1 Introduction to Theory of Factor Pricing or Theory of Distribution

Q.no-1 Define theory of Factor pricing? (short question of exams)

Definition and Explanation of Theory of Factor Pricing:

The theory of distribution or the theory of factor pricing deals with the determination of the share prices of four factors of production, viz., land, labor, capital and organization.

Four Factors of Production, in Economics:
(i) The share of land, is named as Rent.
(ii) The share of labor as Wages.
(iii) The share of capital as Interest.
(iv) The share of organization as Profit.

The four factors of production in cooperation with one another produce annually a net aggregate of commodities, material and non-material. This we name as national income. The national income is to be shared among the four factors of production which have contributed to this production. In the theory of

distribution, we are chiefly concerned wrath the principles according to which the price of each factor of production is determined and distributed.

In the words of Chapman:

"The Economics of distribution or the pricing of factors accounts for the sharing of the wealth produced by a community among the agents or the owners of the agents which have been active in its production".

Distribution is Functional and not Personal. I would like to make it clear that the pricing of factor of production discussed here is functional and not personal. By this we mean that when the reward of each factor is distributed, it is not paid to an individual but to the agents or factors of production. The individual may represent in his person as landlord (if he used his own land), the labor (if he works himself), the capitalist (if he has contributed his capital) and. the entrepreneur (if be organizes the business). The price of land, labor, capital and organization which is termed as rent, wages, interest and profit is in fact their functional income. They are the costs from the point of view of the firm but income from the point of view of factors of production.

Why a Separate Theory of Factor Pricing?

It is often pointed out that the price of a factor of production is determined, like the price of a commodity, by the equilibrium of forces of demand and supply, If the demand of the particular factor rises, other things remaining the same, its price goes up and vice versa. The other economists who differ with this view are of the opinion that the theory of value is not applicable in its entirety to the pricing of factor of production. They believe that on the side of demand there is similarity between the two, because the value of a particular commodity and the price of a factor of production are governed by marginal utility and marginal productivity respectively. But on the side of supply, much difference exists between them. On the side of supply, the price of a particular commodity is determined by its marginal cost of production. But in ease of labor or an acre of land or a unit capital, it is not possible to ascertain exactly its costs of production. The other dissimilarity between the two is that the supply of a factor of production cannot be readily adjusted as we can do in the case of a commodity. For example, if the demand of a particular type of labor increases or the rent of land rises-up, it will not be possible to increase their supply immediately.

In the words of Marshall:
"Free human beings are not brought up to their work on the same principle of a machine, a house of a slave. If they were, there would he very little difference between the distribution and the exchange side of value".
Thus, we come to the conclusion that though the value of the commodities and the prices of the factors of production are determined by demand and supply yet, due to some differences of the factors of production on the side of supply, there is a need for a separate theory of distribution.

Topic 2 Marginal Productivity Theory (Neo-Classical Version)

Q.no-1 Define and explain marginal productivity theory? (short and long both question of exams)

The marginal productively theory is an attempt to explain the determination of the rewards of various factors of production in a competitive market. The marginal productivity theory of resource demand was the work of many writers, it was widely discussed by many economists like J.B. Clark, Walras, Barone, Ricardo, Marshall. It was improved, amended and modified later on. The final version of the theory as stated by Neo Classical economists is given below.

Definition and Meaning:
By marginal productively theory of a factor is meant the value of the marginal physical product of the factor. It is worked out by multiplying the price of the output per unit by units of output.
Formula:

$$\mathbf{VMP = MP \times P}$$

Value of Marginal Product (VMP) = Marginal Physical Product x Price
The marginal productivity theory contends that in a competitive market, the price or reward of each factor of production tends to be equal to its marginal productivity.

Explanation:

The demand for various factors of production is a derived demand. The resources do not usually directly satisfy consumer wants. They are demanded because these help in producing goods and service's. An entrepreneur while hiring a factor of production calculates the contribution which it makes to total production and the amount which has to be paid to it in a competitive market. An individual firm cannot influence the price of the factor of production. It has to take the ruling price in the market as given. The firm can employ as many number of factors units as it wishes at the ruling price of the factor.

It has been observed that as a firm hires increasing amounts of a variable factor to a combination of fixed amounts of other factors, the marginal productivity increases up to a certain stage of production and then it begins to decline. The buyers of a factor of production while deciding whether one more unit of factor should be employed or not, compares the net addition which it makes to total revenue and the cost which has to be incurred on engaging it. If the marginal revenue product of a factor is greater than its marginal cost, the entrepreneur will employ that unit because it earns more than what he has to spend on employing the additional unit.

As he employs more and more units of factor of production, the marginal revenue productivity increases up to a certain limit and then it begins to decrease. On the other hand, marginal cost decreases as production is expanded. After a certain point, when business becomes difficult to manage, marginal cost begins to increase. When both marginal revenue productivity of a factor and its marginal cost are equal, (MRP = MC) the entrepreneur stops giving further employment to a factor of production.

The last variable unit which an employer just thinks it worthwhile employing is called the marginal unit and the addition made to the total production by the employment of the marginal unit is called marginal productivity or marginal revenue productivity. The entrepreneur will pay the remuneration to each factor of production according to its marginal revenue productivity.

The marginal productivity theory is explained with the help of a schedule:

Demand for a Factory or Resource (Daily):

Units of Resource (Labor) (1)	Total Product Meters	Marginal Productivity MP	Product Price ($) P	Total Revenue	Marginal Revenue (Product) (6)

	(2)	(3)	(4)	(5)	
1	8	8	10	80	80
2	15	7	10	150	78
3	20	5	10	200	50
4	23	3	10	230	30
5	25	2	10	250	20
6	26	1	10	260	10
7	26.5	5	10	265	5

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Assumptions:

The theory of marginal productivity is based on the following assumptions:

(i) Factor identical

(ii) Factors can be substituted

(iii) Perfect mobility of factors

(iv) Application of law of diminishing return

(V) Perfect competition

Topic 3 Firm's Equilibrium in the Factor Market Under Perfect Competition

Q.NO-1 Describe firm equilibrium in the factor of market under perfect competition? (short and long both question of exams)

Definition and Explanation:

In a perfectly competitive market, an individual firm cannot influence the market price of a factor by increasing or decreasing its demand. So it has to hire units of a factor at its prevailing price in the market. Same is the case with the supplier of a factor. As the supplier of a factor sells an insignificant quantity of the total supply, it is therefore not in a position to alter the market price of a factor by its own individual action. The individual buyers and sellers of a factor take the market price of a factor as given and adjust the quantity of a factor in the light of market factor price. The buyers and sellers of a factor are therefore called price takers.

Since a firm in a perfect competitive factor market is a price taker, so the marginal product of the factor (MP) and the average product (AP) are the same and their curves coincide. They are a horizontal straight time and parallel to the X-axis.

Equilibrium of the Firm:

When a factor of product is to be hired by a firm, it compares the marginal revenue productivity of the factor (MRP) with that of its marginal cost (MC). So long as the MRP of the factor is greater than its MC. (MRP > MC), a firm will continue hiring the units of a factor (because the factor adds more to its total revenue than to its total cost). When the marginal revenue productivity of a factor is equal to the marginal cost of the factor, the firm will be in equilibrium and its profits maximized MRP = MC.

If the output is increased by hiring additional units of the factor, then the MRP < MC, and firm incurs loss.

Formula For Firm's Equilibrium:

Marginal Revenue Productivity of Labor = Marginal Cost of Labor

The equilibrium of the firm in the factor market is explained with the help of a diagram.

Diagram:

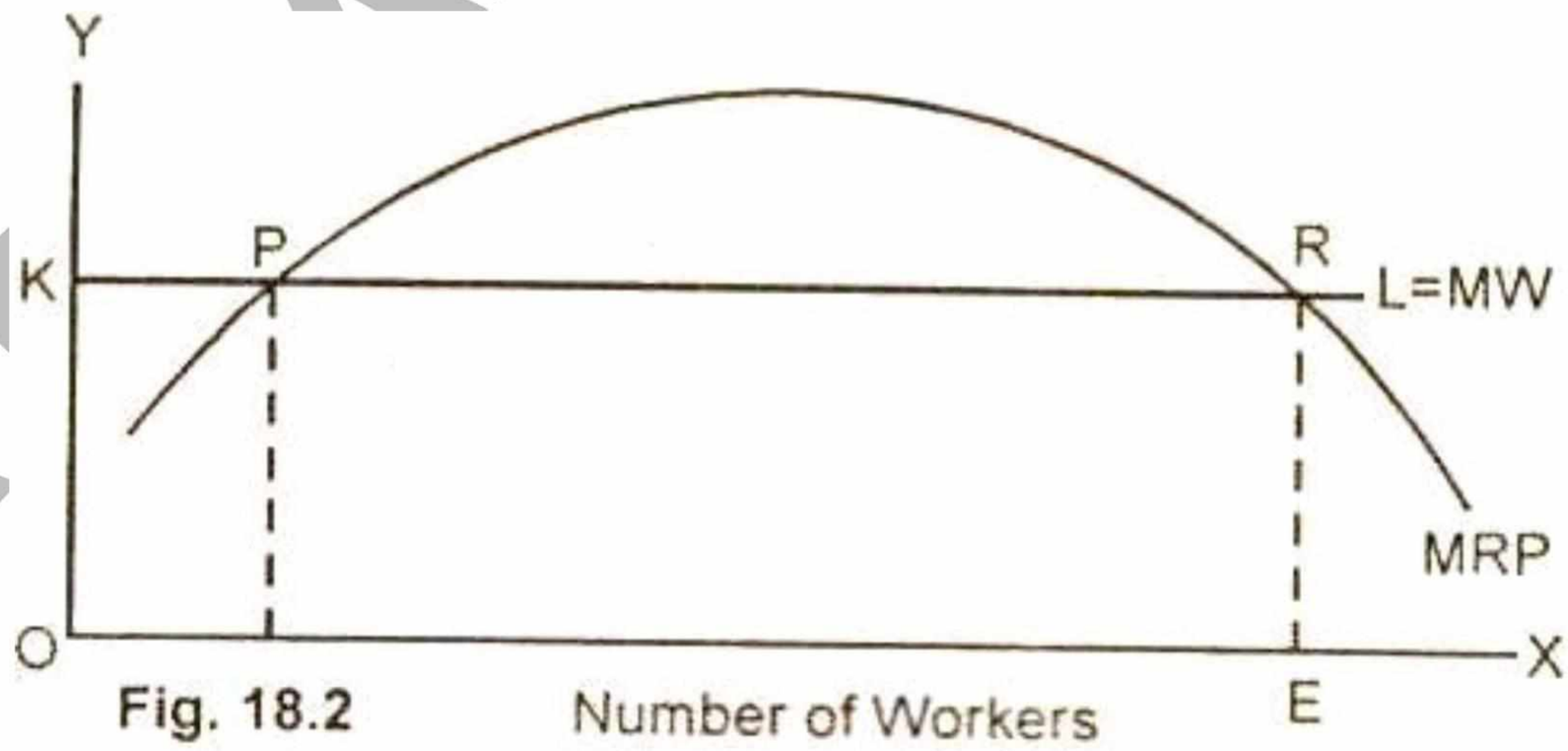

Fig. 18.2

In figure (18.2), we assume that labor is the only variable factor in the factor market. KL straight line represents the marginal wags rate. All the firms in the

factor market can hire any number of workers at the ruling wage of OK. The marginal revenue product curve of labor cuts the wage line KL at two points P and R. The firm is not in equilibrium at point P because by the employment of increasing number of workers, the marginal revenue product rises higher than the marginal cost or the marginal wage OK. At point R, the marginal revenue productivity of the labor is equal to its marginal cost When the firm employs OE number of workers, it is in equilibrium because at point R marginal revenue product of the variable factor is equal to marginal cost of that factor. In case a firm decides to engage more than OE workers, the marginal cost of the workers {marginal wage) will exceed its marginal revenue productivity. The firm with there not be, in equilibrium.

Summing up we can say that a firm in the labor market is in equilibrium when:

(i) Marginal revenue productivity of labor = Marginal cost of labor.
(ii) Marginal revenue productivity curve of labor cuts the marginal cost curve {marginal wage) from above.

Topic 4 Modern Theory of Factor Pricing Under Perfect Competition

Q.no-1 Describe modern theory of factor pricing under perfect competition? (short and long both questions of exams)

Definition and Explanation:

The modern economist discard the marginal productivity theory on the ground that it completely ignores the supply side of a factor of production. Moreover, it simply states as to how many units of a factor of production will be employed at different prices but it does not explain the real issue, i.e., the determination of the price of the factor of production. They, therefore, use the tools of demand and supply in solving the problem of determination of factor prices. Just as the price of a commodity in the market, they say, is determined by matching of demand and supply, similarly the price of an agent of production is determined by their forces of demand and supply in the factor market. The demand for and supply of a factor in a resource market under conditions of perfect competition is new explained in brief.

Demand For a Factor of Production:

The demand for factors is a derived demand. They are not demanded for their own sake but their services are required for the production of other goods and services which the consumers need. For instance, labor is hired because it helps in the production of the commodities. Similarly, land is not desired for itself. It is demanded for the things which It grows or for the construction of a factory or shop, etc., on it.

The demand for a factor of production, like the price of commodity, is a function of price. How much a factor of production will be demanded in the market depends upon two parameters:

(1) the magnitude of demand and (2) the elasticity of demand for that factor.

(1) <u>The Magnitude of Demand:</u>

(i) If a factor of production is very important in the process of production of a particular commodity or commodities, it will have a higher demand in the factor market.

(ii) If the demand for final product is expected to be high, then the demand for all the factors which produce the product will go up.

iii) If a factor of production has close substitutes, then its demand will not rise even if the demand for final product in which it is used increase. The reason is that the employers of factors of production would prefer to engage a substitute which is available in the market at an attractive price.

(2) <u>Elasticity of Demand for Factors:</u>

By elasticity of demand for factors is meant the degree of responsiveness of demand for the various factors to changes in their prices. The main propositions on which the elasticity of demand for the factors of production depends are as fellows:

(i) If the price of a factor of production forms a very small proportion in the total costs of a product, then its demand will be inelastic. If cost forms a greater proportion of the total cost, then its demand will be elastic.

(ii) The demand for a factor of production also depends upon the elasticity of demand for a commodity in which it is used. If the demand for a commodity is fairly elastic, then the demand for factors which go to make the product will also be elastic and *vice versa*.

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(iii) If a factor of production is easily substitutable in the market, then its demand will be fairly elastic. In case, it is indispensable, the demand will be inelastic.

Market Demand Curve for a Factor of Production:

We have stated earlier that the demand curve for a factor is the marginal revenue productivity curve of a firm. If we add up laterally individual demand curves of all the firms, we get market demand curve for a factor. This is illustrated with the help of the curve.

Diagram/Curve:

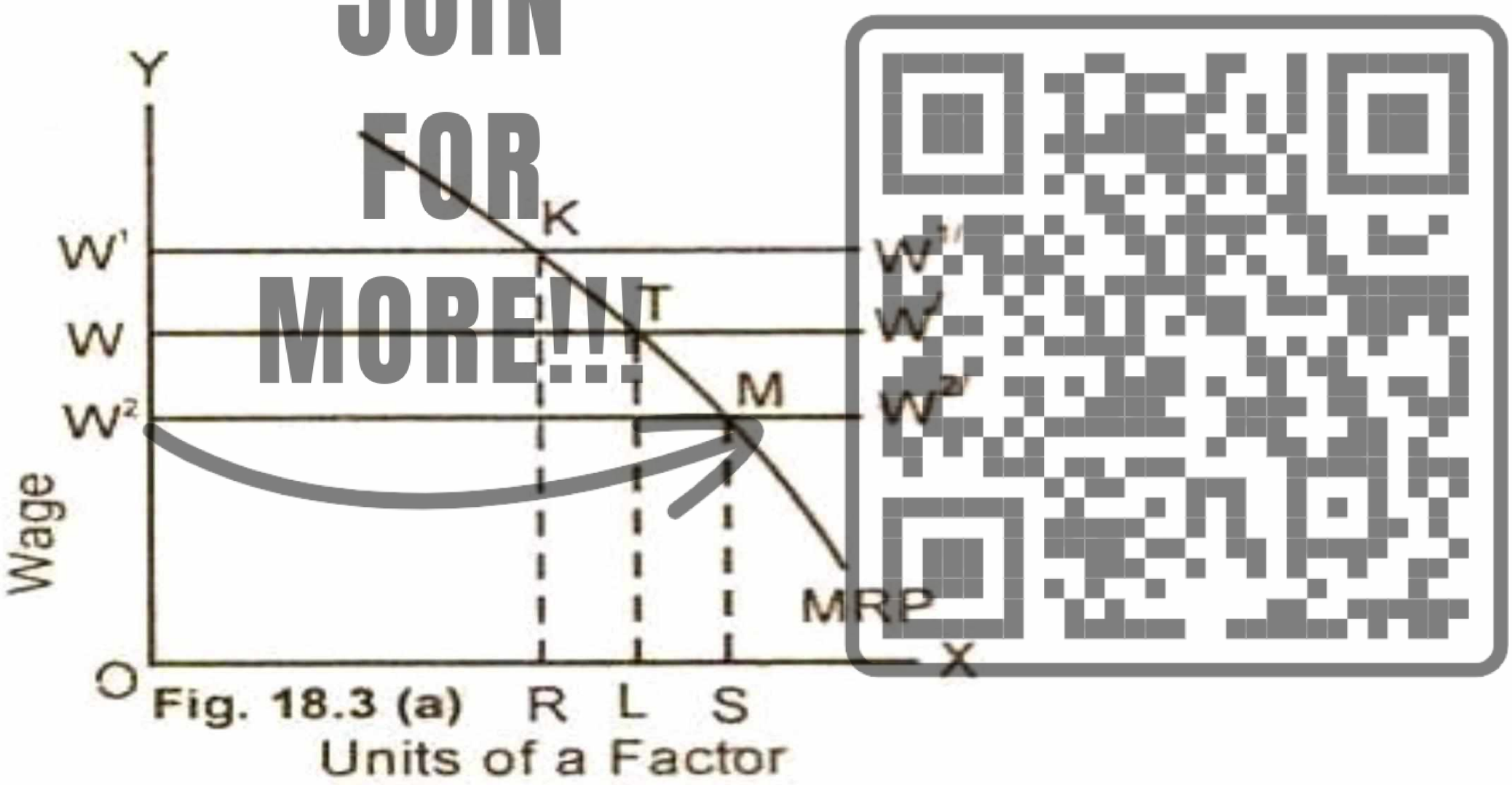

Fig. 18.3 (a)

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MACRO ECONOMICS

CHAPTER11. NATIONAL INCOME AND ITS MEASUREMENT

LIST OF TOPICS

1- What is National Income.
2- Defination of National Income.
3- Various concept of National Income.
4- Methods of measurement of National Income.
5- Difficulties of measurement of National Income In an under developing countries like Pakistan.
6-Significance and importance of national income Measurement.

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Topic 1: What is NATIONAL INCOME

Q.no-1 what is National income? Or what is the meaning of national income? (short question of exams)

What is NATIONAL INCOME

National income is the total value a country's final output of all new goods and services produced in one year. Understanding how national income is created is the starting point for macroeconomics.

Topic 2: Defination of NATIONAL INCOME

Q.no-1 Define national income? Or Give the Definition of national income? (short question of exams)

Defination:

"The total net value of all goods and services produced within a nation over a spe cified periodof time, representing the sum of wages, profits, rents, interest, and p ension payments to residents of the nation."

Topic 3: Various Concept Of NATIONAL INCOME

Q.no-1 Give the name of various concepts of National Income? (short question of exams)
Or
Describe the various concepts of National Income in detail? (long question of exams)

Various Concept Of NATIONAL INCOME

There are various concepts of National Income. The main concepts of NI are: GDP, GNP, NNP, NI, PI, DI, and PCI. These different concepts explain about the phenomenon of economic activities of the various sectors of the various sectors of economy.

(A) Gross Domestic Product (GDP)

The most important concept of national income is Gross Domestic Product. Gross domestic product is the money value of all final goods and services produced within the domestic territory of a country during a year.

Algebraic expression under product method is,

$$\boxed{GDP=(PxQ)}$$

where,
GDP= Gross Domestic Product
P=Price of goods and service
Q=Quantity of goods and service
denotes the summation of all values.

GDP includes the following types of final goods and services.They are:

1. Consumer goods and services.

2. Gross private domestic investment in capital goods.
3. Government expenditure.
4. Exports and imports.

(B) Gross National Product (GNP)

Gross National Product is the total market value of all final goods and services produced annually in a country plus net factor income from abroad. Thus, GNP is the total measure of the flow of goods and services at market value resulting from current production during a year in a country including net factor income from abroad. The GNP can be expressed as the following equation:

GNP=GDP+NFIA (Net Factor Income from Abroad)

Hence, GNP includes the following:

1. Consumer goods and services.
2. Gross private domestic investment in capital goods.
3. Government expenditure.
4. Net exports (exports-imports).
5. Net factor income from abroad.

(C) Net National Product (NNP)

Net National Product is the market value of all final goods and services after allowing for depreciation. It is also called National Income at market price. When charges for depreciation are deducted from the gross national product, we get it. Thus,

NNP=GNP-Depreciation

(D) National Income (NI)

National Income is also known as National Income at factor cost. National income at factor cost means the sum of all incomes earned by resources suppliers for their contribution of land, labor, capital and organizational ability which go into the years net production. Hence, the sum of the income received by factors of production in the form of rent,

wages, interest and profit is called National Income. Symbolically,

NI=NNP+Subsidies-Interest Taxes
or,GNP-Depreciation+Subsidies-Indirect Taxes

(E) Personal Income (PI)

Personal Income is the total money income received by individuals and households of a country from all possible sources before direct taxes. Therefore, personal income can be expressed as follows:

PI=NI-Corporate Income Taxes-Undistributed Corporate Profits-Social Security Contribution+Transfer Payments

(F) Disposable Income (DI)

The income left after the payment of direct taxes from personal income is called Disposable Income. Disposable income means actual income which can be spent on consumption by individuals and families. Thus, it can be expressed as:

DI=PI-Direct Taxes

From consumption approach,

DI=Consumption Expenditure+Savings

(G) Per Capital Income (PCI)

Per Capital Income of a country is derived by dividing the national income of the country by the total population of a country. Thus,

PCI=Total National Income/Total National Population

Topic 4: Methods of measurement of National Income.

Q.no-1 Give the name of methods of measurement of national income?(short question of exams)
Or
Explain in detail different methods of measurement of National Income? (long question of exams)

Methods of measurement of National Income.

There are four methods of measuring national income. Which method is to be used depends on the availability of data in a country and the purpose in hand.

(1) Product Method:

According to this method, the total value of final goods and services produced in a country during a year is calculated at market prices. To find out the GNP, the data of all productive activities, such as agricultural products, wood received from forests, minerals received from mines, commodities produced by industries, the contributions to production made by transport, communications, insurance companies, lawyers, doctors, teachers, etc. are collected and assessed at market prices. Only the final goods and services are included and the intermediary goods and services are left out.

(2) Income Method:

According to this method, the net income payments received by all citizens of a country in a particular year are added up, i.e., net incomes that accrue to all factors of production by way of net rents, net wages, net interest and net profits are all added together but incomes received in the form of transfer payments are not included in it. The data pertaining to income are obtained from different sources, for instance, from income tax department in respect of high income groups and in case of workers from their wage bills.

(3) Expenditure Method:

According to this method, the total expenditure incurred by the society in a particular year is added together and includes personal consumption expenditure, net domestic investment, government expenditure on goods and services, and net foreign investment. This concept is based on the assumption that national income equals national expenditure.

(4) Value Added Method:

Another method of measuring national income is the value added by industries. The difference between the value of material outputs and inputs at each stage of production is the value added. If all such differences are added up for all industries in the economy, we arrive at the gross domestic product.

Topic 5: Difficulties of measurement of National Income In an under developing countries like Pakistan.

Q.no-1 What is the major difficulties of measurement of National income? In an under developing countries like Pakistan? (long question of exams)

Difficulties of measurement of National Income In an under developing countries like Pakistan.

According to **Kuznets,** the measurement of national income is a complicated problem and is best with the following difficulties:

(i) Non-availability of statistical material: Some persons like electricians, plumbers, etc., do some job in their spare time and receive income. The state finds it very difficult to know the exact amount received from such services. This income which, should have been added to the national income is not recorded due to {be lack of full information of statistics material.

(ii) The danger of double counting: While computing the national income, there is always the danger of double or multiple counting. If care is not taken in estimating the income, the cost of the commodity is likely to be counted twice or thrice and national income will be overestimated.

(iii) Non-marketed services: In estimating the national income, only those services are included for which the payment is made. The unpaid services, or non-marketed services are excluded from the national income.

(iv) Difficulty in assessing the depreciation allowance: The deduction of depreciation allowances, accidental damages, repair, and replacement charges from the national income is not an easy task. It' requires high degree of judgment to assess the depreciation allowance and other charges.

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(v) Housing: A person lives in a rented house. He pays $5000 per month to the landlord. The income of the landlord is recorded in the national income. Let us suppose that the tenant purchases the same house from the landlord. Now the income of the owner occupant has increased by $5000. Is it not justifiable to include this income in the national income? Should or should not this income be recorded in the national income is still a controversial question.

(vi) Transfer earnings: While measuring the national income, it should be seen that transfer payments should not become a part of national income. The payments made as relief allowance, pensions, etc. do not contribute towards current production. So they should be excluded from national income.

(vii) Self-consumed production: In developing countries, a significant part of the output is not exchanged for money in the market. It is either consumed directly by producers or bartered for other goods This unorganized and non-monetized sector makes calculation of national income difficult.

(viii) Price level changes: National income is measured in money terms. The measuring rod of-money itself does not remain stable. This means that national income can change without any change in output.

Problems of Measurement is Under Developed Countries like Pakistan:

The national income in under-developed countries like Pakistan cannot be accurately measured due to the following reasons:

(i) Self-consumed-bartered consumption: Some of the transactions of agricultural goods in the villages are done without the use of money. The statisticians, therefore, cannot measure the exact amount of the transactions for inclusion in the national income.

(ii) No systematic accounts maintained: Most of the producers do not keep any record of the sale of the products in the market. This makes the task of national income still more complicated.

(iii) No occupational classification: There is no occupational specialization in the under-developed countries. People receive income by working in various

capacities. One person sometimes works as carpenter and at another time as mason. The statisticians cannot accurately measure the income of such persons.

(iv) Unreliable data: The statisticians themselves do not feel the importance of figures which they collect They also do not take much pains for getting the reliable data. The figures of national Income are, therefore, not up-to-date in the under-developed countries.

Topic 6: Significance and importance of national income Measurement.

Q.no-1 Explain the major significance and importance of National income measurement? (long question of exams)

The significance of national income estimates will be clear from the following discussion:

(a) A comprehensive summary of the economic activity:
(b) Assessment of the relative importance and progress of the different sectors:
(c) Indispensable to government for framing policies and programmes:
(d) The pivot of economic planning:
(e) Input-output analysis:
(f) Measurement of inflationary and deflationary gaps:
(g) Social accounting and the framing of the budget:
(h) Measuring the rate of growth and the per capita income:
(i) Comparison of living conditions:

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CHAPTER12. MONEY AND ITS FUNCTION AND VALUE

LIST OF TOPICS

1- What is Money.
2- Defination of money.
3- Evaluation of money.
4- Barter system or direct exchange of Goods.
5- Significance and importance of money.
6- Function of Money.
   (a) Primary function.
   (b) Secondary function.
7- Characteristics of a good money.
8- Kinds or forms of money
   A-Matellic Money.
   B-Paper Money.
   C-Bank Money.
9- Quantity theory of Money.
10- Inflation its meaning and different forms.

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Topic 1: What is Money?

Q.no-1 what is Money? (short question of exams)

What is Money?

Money is primarily a medium of exchange or means of exchange. It is a way for a person to trade what he has for what he wants. Ideal money has three critical characteristics: it acts as a medium of exchange; it is an economic good; and it is a means of economic calculation.

Topic 2: Defination of Money.

Q.no-1 Define Money? (short question of exams)

Defination of Money.

Money is any good that is widely used and accepted in transactions involving the transfer of goods and services from one person to another. Economists differentiate among three different types of money: **commodity money, fiat money**, and **bank money.** Commodity money is a good whose value serves as the value of money. Gold coins are an example of commodity money. In most countries, commodity money has been replaced with fiat money. Fiat money is a good, the value of which is less than the value it represents as money.

Topic 3: Evaluation of money.

Q.no-1 Describe evaluation of money? (long question of exams)

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Evaluation of money.

Some of the major stages through which money has evolved are as follows:
(i) Commodity Money (ii) Metallic Money (iii) Paper Money (iv) Credit Money (v) Plastic Money.

Money has evolved through different stages according to the time, place and circumstances.

(i) Commodity Money:

In the earliest period of human civilization, any commodity that was generally demanded and chosen by common consent was used as money.
Goods like furs, skins, salt, rice, wheat, utensils, weapons etc. were commonly used as money. Such exchange of goods for goods was known as 'Barter Exchange'.

(ii) Metallic Money:

With progress of human civilization, commodity money changed into metallic money. Metals like gold, silver, copper, etc. were used as they could be easily handled and their quantity can be easily ascertained. It was the main form of money throughout the major portion of recorded history.

(iii) Paper Money:

It was found inconvenient as well as dangerous to carry gold and silver coins from place to place. So, invention of paper money marked a very important stage in the development of money. Paper money is regulated and controlled by

Central bank of the country (RBI in India). At present, a very large part of money consists mainly of currency notes or paper money issued by the central bank.

(iv) Credit Money*:*
Emergence of credit money took place almost side by side with that of paper money. People keep a part of their cash as deposits with banks, which they can withdraw at their convenience through cheques. The cheque (known as credit money or bank money), itself, is not money, but it performs the same functions as money.

(v) Plastic Money:
The latest type of money is plastic money in the form of Credit cards and Debit cards. They aim at removing the need for carrying cash to make transactions.

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<u>Topic 4</u>: <u>Barter system or direct exchange of Goods</u>.

Q.no-1 Explain the concepts of Barter system or Direct exchange of Goods? (long question of exams)

<u>Barter system or direct exchange of Goods</u>.
Direct exchange of goods against goods without use of money is called barter system of exchange. Alternatively, economic exchanges without the medium of money are referred to as barter exchanges. An economy based on barter exchange (i.e., exchange of goods for goods) is called C.C. Economy, i.e., commodity for commodity exchange economy. In such an economy, a person gives his surplus good and gets in return the good he needs.For example, when a weaver gives cloth to the farmer in return for getting wheat from the farmer, this is called barter exchange. Similarly the farmer can get other goods of his requirement like shoes, cow, plough, spade, etc. by giving his surplus wheat (or rice or maize). Thus, the system of barter exchange fulfills to some extent the requirements of both the parties involved in exchange.However, as the transactions increased, inconveniences and difficulties of barter exchange also increased involving rising trading costs. Trading costs are costs of engaging in

trade. Its two components are search cost and disutility of waiting.Remember, search cost is the high cost of searching suitable persons to exchange goods and disutility of waiting refers to time period spent on searching the required person. This ultimately led to evolution of money as medium of exchange. Following are some of the drawbacks or inconveniences of barter.

Topic 5: Significance and importance of money.

Q.no-1 Explain the Significance and importance of money? (long question of exams)

Significance and importance of money.

Money is an essential and basic necessity in a modern economy. In the beginning of human existence, human needs were so simple that they could be satisfied by barter system , i.e., exchange of goods for goods. In barter system, an individual produces some goods in greater quantity than what he could consume and then exchanges the extra units with another individual for something he needed in return. Barter system suffered from lack of double coincidence of wants, lack of common measure of value, difficulty in stored of extra goods and indivisibility of goods. The main advantage of using money is that it decomposes a single barter transaction into two separate transaction of Sale and Purchase. People can hold their wealth in the form of money as a generalised purchasing power which can be utilised to buy goods and services as and when they desire. Money s a pivot around which the whole economy revolves. It alone has the power to buy things directly in the market. It does not require to be spent. All economic system-Capitalist, Socialist and Maixed-need money.

1. Money may not produce anything, but without it, nothing can be produced.
2. With the help of money, consumers make payment for goods and services.
3. With the help of money, producers can but raw material, plant and machinery. They can settle their debts and pay corporate taxes.
4. Money has contributed to economic growth all over the world because it has removed trade barriers.
5. With the help of money, government realises all taxes, fees, fines, penalties and other sources of public revenue.

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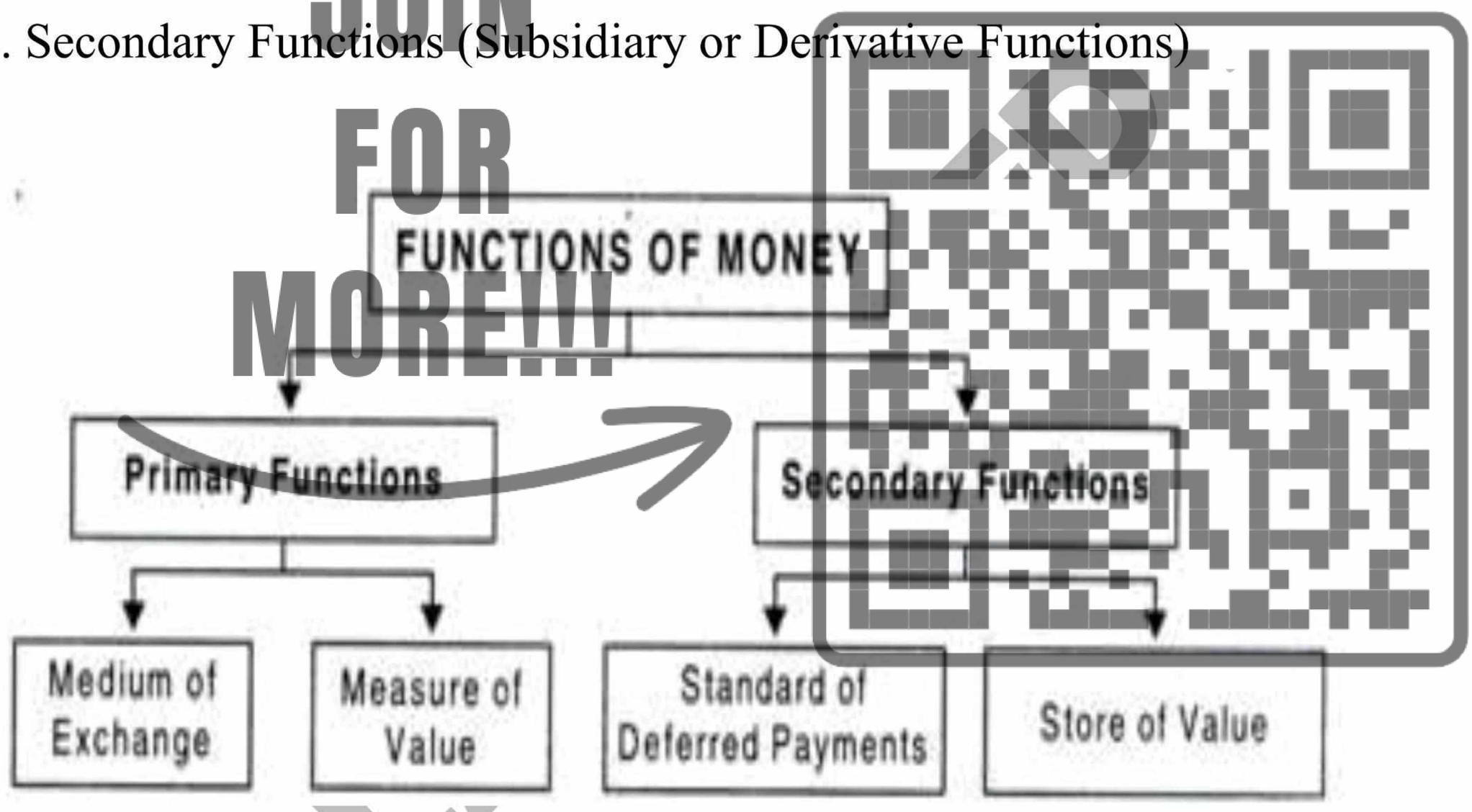
Topic 6: Function of Money.

Q.no-1 what are the main function of money? (short question of exams)
Or
Q.no-1 Describe the main function of money? (long question of exams)

There are 2 function of Money.

1. Primary Functions (Main or Basic Functions)

2. Secondary Functions (Subsidiary or Derivative Functions)



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1. Primary Functions:
Primary Functions include the most important functions of money, which it must perform in every country,
These are:

(i) Medium of Exchange:
Money, as a medium of exchange, means that it can be used to make payments for all transactions of goods and services. It is the most essential function of

money. Money has the quality of general acceptability So, all exchanges take place in terms of money.

(ii) Measure of Value (Unit of Value):

Money as measure of value means that money works as a common denomination, in which values of all goods and services are expressed.

1. By reducing the value of all goods and services to a single unit (i.e. price), it becomes very easy to find out the exchange ratios between them and comparing their prices.
2. This function facilitates maintenance of business accounts, which would be otherwise impossible.

2. Secondary Functions:

These refer to those functions of money which are supplementary to the primary functions. These functions are derived from primary functions and, therefore, they are also known as 'Derivative Functions'.

The major secondary functions are:

(i) Standard of Deferred Payments:

Money as a standard of deferred payments means that money acts as a 'standard' for payments, which are to be made in future. Every day, millions of transactions take place in which payments are not made immediately. Money encourages such transactions and helps in capital formation and economic development of the economy.

This function of money is significant because:

1. Money as a standard of deferred payments has simplified the borrowing and lending operations.
2. It has led to the creation of financial institutions.

(ii) Store of Value (Asset Function of Money):

Money as a store of value means that money can be used to transfer purchasing power from present to future. Money is a way to store wealth. Although wealth can be stored in other forms also, but money is the most economical and convenient way. It provides security to individuals to meet contingencies, unpredictable emergencies and to pay future debts. Under barter system, it was difficult to use goods as a store of wealth due to perishable nature of some goods and high cost of storage.

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Topic 7: Characteristics of a good money.

Q.no-1 what is the characteristics of Good money? (short question of exams)

Characteristics of good Money is material should be economical. The cost of printing currency notes a minting of coins must be low. The material of money must be easily available at reasonable prices.

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Characteristics of good Money are determined by the following points:

1-General acceptance
2-Portable
3-Durable:
4-Divisibility:
5-Store-ability
6-Durability
7-Recognizable
8-Economically
9-Conclusion

Topic 8: Kinds or forms of money.

Q.no-1 what is kinds or forms of money? (short question of exams)

Kinds or forms of money.

A Metallic Money.

Discovery of precious metals and the the spread of civilisation and trade relations by land and sea, led metalic money to take place of commodity money. Gold and silver were the metals mostly used to form metallic money. Because of their scarcity, usefulness and attractiveness, gold and silver were regarded as natural

money. They were choosen because of their convenience, storability, high value density and easy portability.

B Paper Money.

The Chinese used one-fool square pieces of deer skin as money and later became the first people to use paper money. One of the reasons for issue of paper currency was shortage of copper for making coins. Europe learnt of paper money two hundred years later than Marcopolo visited China. Initially, the merchants used to carry paper receipts against metallic money due to the safety problem of carrying costlier metals like gold and silver from one place to another. With the passage of time, the scarcity of metals resulted in the introduction of convertible paper currency by the state authorities; paper money was convertible into metals.

C Bank Money.

Another stage in the evolution of money in the modern world is the use of the credit money or bank money. Credit money or bank money was used due to the development of banking institutions and their credit creation activities. Credit money (cheques) are issued against demand deposits. In fact, it is not money; it only performs the functions of money. Credit money, therefore is regarded as near-money.

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Topic 9: Quantity theory of Money.

Q.no-1 Explain and "Define quantity theory of money"? (short and long both question of exams)

Quantity theory of Money.

The quantity theory of money is a theory about the demand for money in an economy. The most common version, sometimes called the "neo-quantity theory" or Fisherian theory, suggests there a mechanical and fixed proportional

relationship between changes in the money supply and the general price level. This popular, albeit controversial, formulation of the quantity theory of money is based upon an equation by American economist Irving Fisher.

BREAKING DOWN 'Quantity Theory Of Money'

The Fisher equation is calculated as:

$$M \times V = P \times T$$

Where:

M represents the money supply.

V represents the velocity of money.

P represents the average price level.

T represents the volume of transactions in the economy.

Generally speaking, the quantity theory of money assumes that increases in the quantity of money tend to create inflation, and vice versa. For example, if the Federal Reserve or European Central Bank doubled the supply of money in the economy, the long-run prices in the economy would tend to increase dramatically.

Economists disagree about how quickly and how proportionately prices adjust after a change in the quantity of money. The classical treatment in most economic textbooks is based on the Fisher Equation, but competing theories exist.

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Topic 10: Inflation its meaning and different forms.

Q.no-1 Define Inflation? (short question of exams)
Q.no-1 What is meaning of Inflation? (short question of exams)

Q.no-1 Define inflation and Explain the different forms of Inflation? (long question of exams)

1. Meaning of Inflation:

Inflation is often defined in terms of its supposed causes. Inflation exists when money supply exceeds available goods and services. Or inflation is attributed to budget deficit financing. A deficit budget may be financed by the additional money creation. But the situation of monetary expansion or budget deficit may not cause price level to rise. Hence the difficulty of defining 'inflation'.Inflation may be defined as 'a sustained upward trend in the general level of prices' and not the price of only one or two goods. G. Ackley defined inflation as 'a persistent and appreciable rise in the general level or average of prices'. In other words, inflation is a state of rising prices, but not high prices.

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2. Types of Inflation:

As the nature of inflation is not uniform in an economy for all the time, it is wise to distinguish between different types of inflation. Such analysis is useful to study the distributional and other effects of inflation as well as to recommend anti-inflationary policies.

Thus, one may observe different types of inflation in the contemporary society:

A. On the Basis of Causes:

(i) Currency inflation:
(ii) Credit inflation:
(iii) Deficit-induced inflation:
(iv) Demand-pull inflation:
(v) Cost-push inflation:

B. On the Basis of Speed or Intensity:

(i) Creeping or Mild Inflation:
(ii) Walking Inflation:
(iii) Galloping and Hyperinflation:
(iv) Government's Reaction to Inflation:

3. Causes of Inflation:

Inflation is mainly caused by excess demand/ or decline in aggregate supply or output. Former leads to a rightward shift of the aggregate demand curve while the latter causes aggregate supply curve to shift leftward. Former is called demand-pull inflation (DPI), and the latter is called cost-push inflation (CPI). Before describing the factors, that lead to a rise in aggregate demand and a decline in aggregate supply, we like to explain "demand-pull" and "cost-push" theories of inflation.

Effects of Inflation:

People's desires are inconsistent. When they act as buyers they want prices of goods and services to remain stable but as sellers they expect the prices of goods and services should go up. Such a happy outcome may arise for some individuals; "but, when this happens, others will be getting the worst of both worlds."

One can study the effects of unanticipated inflation under two broad headings:

(a) Effect on distribution of income and wealth; and

(b) Effect on economic growth.

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CHAPTER13. PUBLIC FINANCE

LIST OF TOPICS

1 -What is Public Finance.
2 -Difference between Public finance and Private finance.
3 -Public Revenue.
4 -Non tax Revenue.
5 -Tax Revenue.
6 -What is Tax?
7 -Canons or Principle of a good taxation system.
8 -Direct and Indirect tax.
9 -Budget.
10 -Zakat.
11 -Difference between tax and zakat.

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Topic 1: What is Public Finance.

Q.no-1 what is public finance? (short question of exams)

What is Public Finance

Public finance is the study of the role of the government in the economy. It is the branch of economics which assesses the government revenue and government expenditure of the **public** authorities and the adjustment of one or the other to achieve desirable effects and avoid undesirable ones.

Topic 2: Difference between public finance and private Finance.

Q.no-1 Difference between public finance and private finance? (short question of exams)

Difference between public finance and private Finance.

Meanings:

public finance is a branch of economics that deals with the expenses and revenues from government to government in the economy.

The long-term financing is revenue and expenditure. If you have a link to the private sector, private financing is needed. On the other hand, if it related to the

public sector, ie, the public finances.

Private Finance:
Deal to income and expenditure by the private sector.

Public Finance:
This revenue and expenditure of the Government Sector (public sector)

Public finance Vs Private finance

1. Time period: The public finances in a period of several years together, while private financing to do with the financial daily, weekly, monthly, etc.

2. Assets Vs expenditure: In public finance, income from fees as follows. In addition, the cost of private financing in line with sales.

3. Arrears financing: Budget deficit, government. can create new tickets issued. In addition, the private sector has no authority to issue new tickets.

4. Nature of budget: In the public sector's budget deficit is important. In the private sector, the budget surplus is large.

5. Compulsory loans: The government can borrow to bind to other financial institutions to their cost, while the private sector can not be met.

6. Secrecy: State budget is not a secret, but Govt. published their budgets for television, radio, etc. On the other hand, the household, to keep the secret.

7. Nature of projects: In public finance, the government must complete the long-term projects. In addition, the private sector has a short project is completed.

8. Nature of changes: Public Finance shows significant changes, while the private sector has to do with minor modifications.

9. Accounting document: The state budget is a written document that the budget sector is a written document.

10. Analysis system: Govt. Revenue and expenditure is regularly monitored by an audit system. On the other hand, there is no system of private financing.

11. Adopted assistance: In the public finances, the Government may rely on foreign aid, but private financing, there is no way of outside help.

12. Absolute or aberrant antecedent of income: Public Finance, source of income is indirect, while the tax is a source of private funding, that address income.

13. Above-mentioned sanction: Public Finance, Government. have the prior approval of his cabinet, etc. National Assembly, Senate, while in private funding, without prior permission is required from any authority.

14. Future planning: In public finance, there are no long-term planning, while private funding is nothing planned.

15. Use of banking resources: In public finance, the main goal for the welfare of the population, used as in private funding, the resources for maximum personal satisfaction.

Topic 3: Public Revenue.

Q.no-1 what is public revenue? (short question of exams)

Public Revenue

The income of the government through all sources is called **public**income or **public revenue**. According to Dalton, however, the term "**Public** Income" has two senses — wide and narrow. In its wider sense it includes all the incomes or receipts which a **public** authority may secure during any period of time.

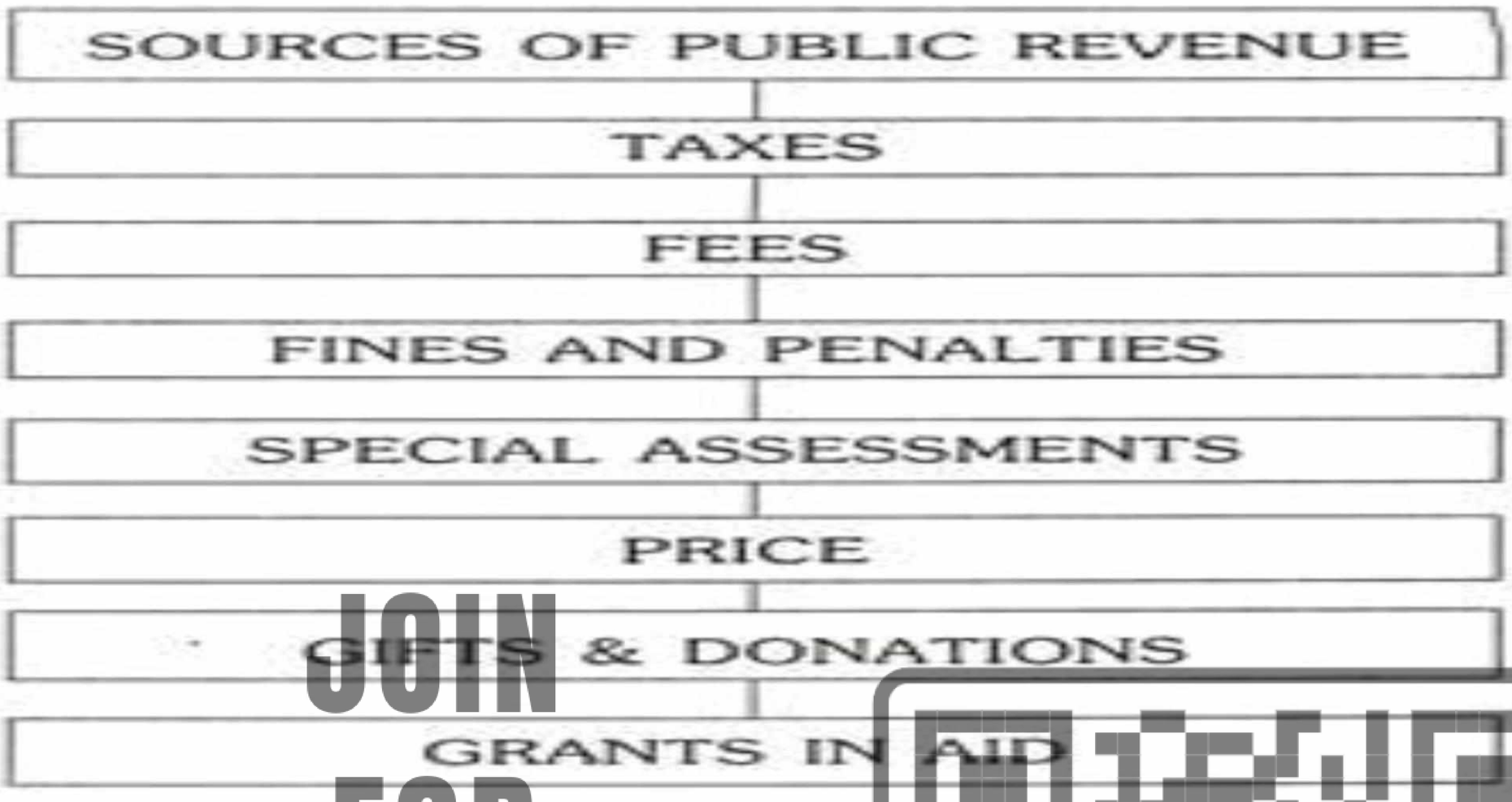

Chart I

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Topic 4: Non Tax Revenue.

Q.no-1 what is Non tax revenue? (short question of exams)

Definition of 'Non-tax Revenue':

Non-Tax Revenue is the recurring income earned by the government from sources other than **taxes**. This is largely the **revenue** expenditure of the government, although it also includes capital expenditure.

Topic 5: Tax Revenue.

Q.no-1 what is Tax Revenue? (short question of exams)

Tax revenue: a key concept in Economics. Money earned by the State thanks to taxation. It is the main **income** for the state, funding public expenditure and other items, tangibly expressing the common efforts of the community.

Topic 6: What is Tax.

Q.no-1 what is tax? (short question of exams)

A fee charged ("levied") by a government on a product, income, or activity.
If **tax** is levied directly on personal or corporate income, then it is a direct **tax**.
If **tax** is levied on the price of a good or service, then it is called an indirect **tax**.
The purpose of taxation is to finance government expenditure.
Tax is the major source of Government revenue. In the medieval times, no proper attention was given to the tax by the economists. They believed that the Government should collect minimum revenue from tax. As tax affects every section of the society in one way or the other, it should be levied very carefully with a view to avoid unnecessary hardships to those who have no capacity to pay. The Government should follow the canons of taxation propounded by various economists for efficient economic administration.

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Topic 7: Canons or Principle of a good taxation system

Q.no-1 Explain the canons or principle of a good taxation system? (long question of exams)

Among 9 canons of taxation discussed, **Adam Smith** propounded the following first four canons of taxation.

Canons or Principle of a good taxation system

(1) Canon of Equity. It implies that tax should be Levied on citizens on the basis of equality. The sacrifice of all citizens must be equal. In the words of Adam Smith "**The subjects of every state ought to contribute towards the support of the Government, as nearly as possible, in proportion to their respective abilities, that is, in proportion to their revenue which they respectively enjoy under the protection of the State**".

(2) Canon of Certainty: This canon of taxation suggests that the tax which an individual has to pay, should be certain and not arbitrary. It should be certain to the lax payer how much tax he has to pay, to whom and by what time the tax is to be paid.
(3) Canon of Convenience or Ease: According to this canon of taxation, every tax should be levied in such a manner and at such a time that it affords to the

maximum of convenience to the tax payer. According to Adam Smith, a good taxation policy must be convenient for the tax payer. The reason is that the tax payer for goes his purchasing power and makes a sacrifice at the time of payment of tax hence the Government should see that the tax payer suffers no inconvenience.
For example, in an agricultural country, tax should be collected only after the harvesting has been done.

(4) <u>Canon of Economy</u>.
In the words of Adam Smith-"Every tax ought to be contrived as both to take out and keep out of pockets of the people as little as possible over and above what it brings, into the public treasury of the State"
Besides the above four canons of taxation suggested by Adam Smith, some other economists have also propounded certain other canons of taxation. The important among them are-

(5) <u>Canon of Productivity</u>. The theory was expounded by Prof. Bastable. According to this canon of taxation, the tax should be of such a nature as to yield sufficient income to the Government to run the administration efficiently and to work for the welfare of the people. Tax yield is important and every finance minister considers the yield before proposing any new tax.
(6) <u>Canon or Elasticity</u>. The tax system of the Government should be elastic so that tax burden may be increased or reduced from time to time as and when tile demand for revenue changes. The tax system should have a capacity to respond quickly to the changes in demand for revenue.

7) <u>Canon of Simplicity</u>. According to this canon of taxation, the tax should not be complicated in its nature. It should be so simple that tax payer can understand its complications without the help of any expert. It would safeguard the tax payer against the exploitation of tax authorities and experts
(8) <u>Canon of Diversity</u>. The cannon requires that there should be a number of taxes of different varieties so that every class of citizen may be called upon to pay something towards the national exchequer. The yield from a number of taxes is more dependable than from anyone. The reason being that a person can manipulate to avoid single tax.
(9) <u>Canon of Desirability or Expediency</u>. A tax should be expedient or desirable so that the Government may defend itself against the public criticism,

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by advocating its expediency. A tax without any expedient cause will face severe criticism from the tax payers. An unjust tax will always face sharp unwillingness on the part of the tax payers to pay and they will try to evade them, Every new tax must have a justification to create a feeling of acceptance in the mind of the tax-payers.

Topic 8: Direct and Indirect Tax.

Q.no-1 Differentiate between Direct tax and Indirect tax system? (short question of exams)

A. Direct Tax

1. Direct tax is paid directly by an individual or organization to an imposing entity like government
2. Direct Taxes are based on the ability-to-pay principle, which means that if you earn more, your rate of tax is also more.
3. The purpose of Direct Tax is to redistribute the wealth of a nation (taking from rich, thus making them poorer)
4. Direct taxes cannot be passed on to a different person or entity;
5. The individual or organization upon which the tax is levied is responsible for the fulfillment of the full tax payment.
6. It is considered to be progressive tax since you taxe depending upon the ability of the taxpayer to pay

B: Indirect Tax

1. An indirect tax is a tax that is shifted from one taxpayer to another i.e. collected by one person but actually born by another person
2. An indirect tax is levied on goods or services, which increases the price of a good or services
3. The tax is actually paid by the end consumer, by way of a higher retail price.
4. Indirect taxes are levied equally upon all taxpayers irrespective of their income.
5. Indirect taxes are passed on, as the price of the tax is compensated for by simply increasing the overall price of the good or service.

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6. It is considered to be a regressive tax since all taxpayers whether rich of poor have to bear the same burden.

Topic 9: Budget.

Q.no-1 what is Budget? Give the definition of budget? (short question of exams)

Budget.

A budget is a description of a financial plan. It is a list of estimates of revenues to and expenditures by an agent for a stated period of time. Normally a budget describes a period in the future, not the past.

Topic 10: Zakat.

Q.no-1 Define Zakat? (short question of exams)

Zakat

A term used in Islamic finance to refer to the obligation that an individual has to donate a certain proportion of wealth each year to charitable causes. Zakat is a mandatory process for Muslims in order to physically and spiritually purify their yearly earnings that are over and above what is required to provide the essential needs of a person or family.

There are comprehensive descriptions in religious texts describing minimum amounts of zakat with regards to farm produce, cattle, business activities, paper currency and precious metals such as gold and silver.

The most common level of zakat on wealth from cash, equities and gold is 2.5% of the total value.

Topic 11: Difference between TAX and ZAKAT.

Q.no-1 Differentiate between Zakat and Tax? (short question of exams)

DIFFERENCE BETWEEN ZAKAT & TAX

Zakat is absolutely different from tax which is imposed by the Govt. the main differences are as under

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1. Payment:
The payment of Zakat is a religious duty whereas the payment of tax is a national duty.

2. Imposition:
Zakat is imposed only on the muslim members of the society whereas tax is imposed on all the citizens in proportion to their ability to pay.

3. Compulsion:
Zakat is a compulsory payment which is not remitted by anyone whereas tax though compulsory payment, yet is remittable by the Govt.

4. Rates:
In case of Zakat, the rates of Zakat payment are fixed by the Holy Quran and cannot be changed by anyone whereas, in case of tax, the rates can be changed by the govt. from time to time.

5. Collection:
Zakat can be paid individually whereas tax is collected only by the Govt.

6. Utilization:
The beneficiaries of Zakat have been clearly pointed out in the holy Quran and Zakat can not be spent by the govt. on other than beneficiaries anywhere.

7. Nisab:
Nisab of Zakat is fixed by the holy Quran wheras taxable income varies from time to time.

8. Period:
Zakat is payable after the completion of one year whereas it is nto necessary for tax. Its period may be less or more than one year.

9. Sources:

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Zakat is imposed on all types of goods even animals , gold and silver etc. held by the individual , whereas tax is imposed only on the income earned by various sources.

10. Objectives:

The objective of the payment of Zakat is the pleasure of Almighty Allah through financial assistance of the poor and needy whereas the objective of tax is to meet the development and non development expenditures of the society , as a whole.

11. Purification:

Zakat purifies the wealth , whereas tax does not serve this purpose.

12. Variability:

Zakat is non variable whereas the tax is usually progressive.

13. Feeling:

Zakat creates the feelings of being a member of muslim society irrespective to regional limits whereas tax creates the feelings of being a member of just single society. Thus Zakat creates universal feelings while tax creates native feelings.

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CHAPTER14. BUSINESS OR TRADE CYCLE

LIST OF TOPICS

1-What is a Trade Cycle.
2- Phases of Trade Cycle.

Topic 1: What is trade Cycle?

Q.no-1 what is Trade cycle? (short question of exams)

What is trade Cycle?

According to Keynes,

"A trade cycle is composed of periods of Good Trade, characterized by rising prices and low unemployment percentages, shifting with periods of bad trade characterized by falling prices and high unemployment percentages."

Topic 2: Phases of trade cycle.

Q.no-1 what are the different Phases of Trade Cycle? Describe in details? (short and long both question of exams)

Phases of trade cycle.

A full trade cycle has got four phases: (i) Recovery, (ii) Boom, (iii) Recession, and (iv) depression. The upward phase of a trade cycle or prosperity is divided into two stages—recovery and boom, and the downward phase of a trade cycle is also divided into two stages—recession and depression.

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FIG. 2 : PHASES OF TRADE CYCLE

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CHAPTER15. INTERNATIONAL TRADE

LIST OF TOPICS

1 -Difference between domestic trade and international trade.
2 -Difference between balance of trade and balance of payment.

Topic 1: Difference between domestic trade and international trade.

Q.no-1 Differentiate between Domestic trade and International trade? (short question of exams)

The following are the major differences between domestic trade and international trade:-

1.Mobility in Factor Of Production Domestic Trade: Free to move around factors of production like land, labor, capital and labor capital and entrepreneurship from one state to another within the same country International Trade: Quite restricted
2.Movement Of Goods Domestic trade: easier to move goods without much restrictions. Maybe need to pay sales tax,etc International Trade: Restricted due to complicated custom procedures and trade barriers like tariff, quotas or embargo
3.Usage of different currencies Domestic trade: same type of currency used International trade: different countries used different currencies
4.Broader markets

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Domestic trade: limited market due to limits in population, etc International trade: Broader markets
5.Language And Cultural Barriers Domestic trade: speak same language and practice same culture International trade: Communication challenges due to language and cultural barriers

Topic 2: Difference between balance of trade and balance of payment.

Q.no-1 Differentiate between Balance of Trade and Balance of payment? (short question of exams)

The differences between balance of trade (BOT) and balance of payment (BOP) are as follows:

Balance of Trade (BOT)

1. It records only merchandise (i.e., goods) transactions.
2. It does not record transactions of capital nature.
3. It is a part of current account of BOP.
4. It may be favourable, unfavourable or in equilibrium.
5. Defect in BOT cannot be met by BOP
6. It is not true indicator of economic relations or economic prosperity of a country.

Balance of Payment (BOP)

1. It records transactions relating to both goods and services.
2. It records transactions of capital nature.
3. It includes balance of trade, balance of services, balance of unilateral transfers and balance of capital transactions.
4. It always remains in balance in the sense that receipt side is always made to be equal to payment side.
6. Defect in BOP can be met through BOT.
7. It is true indicator of economic performance of an economy.