CHAPTER 1

Q.1 Define Economics as has been defined by Adam Smith?

Ans: Adam Smith the forefather of the economics regarded Economics as a science which studies the process of production, consumption, distribution, and exchange of wealth. According to him: Economics inquiries into the factors those determine wealth of a country and its growth.

The definition of economics as a science of wealth caused a great deal of confusion and misunderstanding in seventeenth and eighteenth centuries. Actually, at that time religion and ethics had a strong hold.

Wealth and riches were looked upon as sordid and mean objects. Since science of Economics was defined as a science of wealth, therefore it was severely criticized by men of letters of the 19th century, like Ruskin, Carlyle and Mathew Arnold. Economics was taken as. “Bread and Butter Science”; as” the Gospel and Mammon”; as a “Science that teaches selfishness and love of money”; as a “dark and dismal science” ; as a “Pig science”. It was strongly alleged that economics has ignored the higher value of life.

Q.2 Write the main features of Marshall’s definition of Economics.

Ans: The material welfare definition given by Marshall has the following features.

Firstly, it is a study of ordinary persons living in a society. It does not study of isolated individuals.

Secondly, it studies only the economic aspect of human being and does not have any concern with any other aspect like religious, social and political. Strictly speaking, it relates to how the man earns his income and how he spends it.

Thirdly, it studies only material requisites of well-being or causes of material welfare.

Fourthly, it does not regard wealth as the be-all of economic activities. Wealth is sought only for promoting human welfare.

Q.3 What objectives have been raised Robbins on Marshall’s definition of Economics?

Ans: Robbins raised following objections on Marshall'

I. It has narrowed down the scope of Economics.

II. Relation sought between Economics and welfare is wrong approach

III. Welfare is a vague concept and cannot be quantitatively measured

IV. It is classificatory rather than analytical in character

V. It involves moral judgment:

According to Robbins,

Economics being a positive science is neutral as regards ends. It is not supposed to be its function to pass moral judgment and verdict; what is good and what is bad.

Q.4 What are merits of Marshall's definition?

Ans: MERITS OF MARSHALL'S DEFINITION

1. Marshall's definition clearly defines the scope of Economics.
2. It focuses only material activities of an ordinary man.
3. This definition clearly describes that Economics is a social science.It is neither a pure science nor an art too. It is just one the social sciences.
4. This definition is classificatory definition in the sense that it classifies the economic activities into two types as, material welfare and non-material welfare. Likewise, men are classified as ordinary and extra ordinary.

Q.5 What are short comings or drawbacks or demerits of Marshall's definition?

Ans: DEMERITS OF MARSHALL'S DEFINITION

Marshall's definition after 1932 has been criticized on the following grounds.

i. It restricted Economics to the study of man in the ordinary business of life

ii. It limits the scope of Economics

iii. Concept of material-welfare lacks clarity

iv. This definition is only a classificatory in nature. It does not scientifically explain the central problem of Economics is dealt with

v. It ignores positive science character:

vi. It is not concerned with practical way of life.

vii. It narrows down the field of economic activities.

Q.6 Define Economics as has been defined by Robbins? What are its main propositions?

<u>Ans:</u> <u>According to Robbins</u>,

“Economics is the science which studies human behaviour as a relationship between ends and scare means which have alternate uses”

This definition, in fact, is based on the following four basic propositions, i.e.

i. Human wants are unlimited
ii. Means are limited to fulfill them
iii. Wants are not equally important
iv. Means have alternative uses.

Q.7 What are merits of Robbin’s definition?

<u>Ans:</u> <u>MERITS OF ROBBIN’S DEFINITION</u>

Major merits of Robbin’s definition of Economics are of the following kinds.

i. Robbins gave Economics a status of positive science

ii. Robbins defined Economics in an analytical way. He based his definition on some solid reasons.

iii. Robbins’ definition clearly defines the scope of Economics.

iv. Robbins’ definition is universally applicable because it is concerned with limited resources and unlimited wants.

v. It identifies central problems of Economics

vi. It clarities the concept of human behavior.

Q.8 Is Economics merely a Positive Science or a Normative Science too?

<u>Ans:</u> <u>According to J.N Keynes,</u>

“A positive science may be defined as a body of systematized knowledge concerning what is: a normative science on the other hand, is a body of systematized knowledge relating to the criteria of what ought to be, and concerned with the ideal as distinguish from the actual. In other words, a positive science deals with things as they are. A normative science, contrary to it, deals with things, as they ought to be.”

<u>According to a great economist of today; Milton Friedman,</u>

”Positive Economics deals with how an economic problem is solved normative economics, on the contrary, deals with how an economic problem should be solved”

The economists of old English classical school believed only in the positive aspect of Economics. However the economists of Historical school of Germany held just contrary view. They firmly believed that Economics must be both a positive and normative science. According to them, all economic activities must be governed by ethical considerations. Same view is shared by the economists of our time.

Q.9 Is Economics merely a science an art too?

<u>Ans:</u> The term “Science” has been defined by Keynes as a systematized body of knowledge which traces the relationship between causes and effects. Applying this definition to Economics we find that it is that branch of knowledge wherein the various relevant facts have been systematically collected, classified and analyzed. From this view-point, Economics is a complete science because it makes use of scientific methods in its investigations and analyzed.

<u>According to J.N Keynes,</u>

“An art is a system of rules for the attainment of a given end. “Applying this definition of art, economics may be considered an art as well. There are several branches of economics which provide practical guidance in the solution of economic problems. It would therefore, be fair to say that Economics is both a science and an art simultaneously there is much truth what Cossa said.”

“Science requires art; art requires science, each being complementary to the other”

Q.10 What are characteristics of economic laws?

Ans: Economic laws are said to have the following characteristics.

Economic laws are said to be hypothetical or conditional or assumptions because they are based on the fulfillment or certain conditions

It is also said that economic laws are statements of economic tendencies. They are unavoidable and certain to happen only if some necessary conditions are fulfilled.

It is also said that economic laws are inexact and imprecise as compared to natural laws.

Q.11 How the economic laws are derived by Deductive Method?

Ans: According to Deductive Method, conclusions are derived from general truth through a process of reasoning. In Economics, facts, regarding to human nature, are taken to be granted and on their basis certain inferences are drawn in the form of economic laws. For example, it is a common thinking that men are entirely motivated by their self - interest in their life. Since Raza is a man, therefore, he is also motivated myself - interests.

Becon descried Deduction Method as a Descending Process in which we proceed from general to particular. The deduction method is also known as Analytical, Abstract or Priori Method.

Q.12 What are merits and demerits of Deductive Method?

Ans: **Merits:**

The deductive Method has the following merits.

1. Being analytical, it is simple, precise and logic-oriented.
2. It is nearer to reality.
3. It is a powerful method for deducting conclusions from certain facts.
4. The use of mathematics in deduction being exactness and clarity in economic analysis.
5. It helps in drawing inferences which are of universal validity.

Demerits:

Despite having some notable merits, this method is also not free some demerits of following nature.

1. It can prove its worth as a simple and precise method is also free from sometimes are valid.

2. This method is abstract to some great extent. IT, therefore, requires a great exercise of mind in drawing inferences form various premises.

3. Conclusions often derived from this method are not applicable universally. Professor Lerner, regarding this aspect, describe it as “Armchair Analysis”

Q.13 How economic laws are derived by the Inductive Method?

Ans: The inductive Method is the process of reasoning from particular facts to general principles. Becon describes it as “Ascending Process”, we collect facts, arrange them and then draw general conclusion.

The Induction Method is also known “Historical Method” and “Empirical Method”.

Under this method economic generalizations are derived on the basis of experience and observations. For this purpose, data are collected about a certain economic situation. It involves four stages:

i. Observation

ii. Formation of Hypothesis:

iii. Generalization

iv. Verification.

Q.14 What are the merits and demerits of Inductive Method?

Ans: Merits:

The main merits of this method are as follows:

i. Since it is based on facts and explains them as they actually are, therefore it is a realistic method.

ii. Since it discovers and proves general principles, it is therefore, helpful in future investigation.

iii. It makes use of statistical technique and analyzing a wide range of economic problems. It is, therefore, a more reliable method.

iv. Since the changing economic phenomenon can be analyzed on the basis of experiences, conclusions may be and remedial measures can be taken. Hence, it is a dynamic.

Demerits:

The main weaknesses of this method are of the following:

i. It is not only a time-consuming process but also a costly one.

ii. Case, conclusions are drawn from insufficient data the principles derived may be unreliable.

iii. The process of collection of data itself is very difficult task. The sources and methods employed in the collection of my data may different from analysis to analysis. The result, therefore, may differ even with the same problem.

Q.15 What is Microeconomics? What its scope of fields of study?

Ans: According to K.E Bolding,

“Microeconomics is concerned with specific economic units and a detailed consideration of behavior of these individual units. In microeconomics, we examine the trees, not the forest.

Microeconomics is useful in achieving a worm’s eye of very specific component of our economic system”

Scope of fields of study:

Microeconomics covers the following fields of study.

1. Price Theory:

In price Theory, two important economic factors –demand and supply are discussed

2. Theory of consumer Behaviour:

This theory deals with this main economic problem that how consumers can get maximum satisfaction from their limited spending.

3. Theory of Behaviour of Firms:

This theory guides various types of firms that how they can gain maximum profits thought their output inputs decisions.

4. Theory of Production:

This theory deals with three important laws of returns of laws of cost.

Q.16 Discuss the Importance of Microeconomics?

Ans: Microeconomics has many theoretical as well as practical advantages. Some of them are as under.

1. Guides to understanding the working of a free market economy
2. Guides to efficient employment of resources
3. Guides to understanding some of the problems of taxation
4. Guides to international executives
5. Guides to business executives
6. Guides to construction and use of models.

Q.17 What is Macroeconomics? What its scope or fields of study?

Ans: Macroeconomics deals with the behaviour or working of the whole economic system in totality or entirely. It is the satisfy of aggregates of averages covering the entire economy, such as a national income, national output, total employment, total investment, total consumption, total savings, aggregate supply, aggregates demand and general price level.

According to K.E Boulding:

"Macroeconomics deals not with individual quantities as such but with aggregates of these quantities, not with individual incomes but with the national income, not with individual prices level, not with individual outputs but with the national output."

Scope of Fields of Study:

i. It studies the theory of National Income and its various relevant concepts.

ii. It deals with three main determinants of National Income e.g. Consumption, Saving and Investment.

iii. It also studies different theories of consumption. Theory of Multiplier and theory of Acceleration are also studied.

iv. It also studies theories of inflation and deflation along with their causes and effects. It also covers the study of Quantity theory of Money.

v. It also studies functions of Monetary.

vi. It also focuses the scope of Fiscal Theory.

vii. It also studies various theories, approaches and models concerned with economic growth of a country.

Business world is exposed to many fluctuations; ups and downs. Macroeconomics also discusses them, Macroeconomics also studies those theories which explain how the international trade takes place and how the gain from international trade is divided.

Q.18 Distinguish between Microeconomics and Macroeconomics?

Ans:

MICROECONOMICS	**MACROECONOMICS**
Microeconomics is the study of small economic units	Macroeconomics deals with the economy as a whole or with its aggregates and averages
Such as particular firms, particular households, individual prices, wages, income, individual industries and particular commodities	such as national income, national output, price-level, international consumption and savings, investment and employment
microeconomic study the behavior of small components of an economy.	It examine the economy in it's entirely and totality
microeconomics is known as the Theory of Price	Macroeconomics is also called the Theory of Income, output and Employment

Q.19 Discuss importance and significance of Macroeconomics?

Ans: IMPORTANCE AND SIGNIFICANCE OF MACROECONOMICS

Following advantages signify the importance and significance of Macroeconomics.

i. It serves as a sound base for formulation of economic policies.

ii. It is helpful is understanding the working of an economic system

iii. It is helpful in formulation theories of economic development

iv. It is helpful in tacking the inflation and deflation situations

v. It is helpful in estimating an overall performance of the economy

vi. It is provide information about international economic affairs

vii. It is helpful in developing microeconomics theories.

CHAPTER # 2

Theory and Factors of Production

Q.1 Define production and name the factor of production?

Ans: PRODUCTION

The term production refers to those human which result in creation of goods and services to be used for satisfaction of wants. Such goods and services command a price and are used for satisfaction of wants. It means, production involves those human efforts which create utility in a good and add exchange value to it.

Factors of Production:

Factor of production are those element or agents or inputs which make production possible through their combined and co-operative action. They are: land, capital and organization or entrepreneurship. Modern economists call them productive services or more recently merely inputs.

Q.2 Describe the relative importance of the factors of production?

Ans: Relative Importance of Factors of Production:

Production of everything is the result of coordination of all the four factors of production. Due to this very fact, all the factors carry equal importance. In the process of production, it one of them is missing the other become ineffective. Presence of each on one is must to produce a thing. The owner of each factor claims to have greater importance compared to others. A capitalist awards the first place to capital; labourer to labour, landlord to land, while an enterprises does not lag behind in pushing forward his claim to be the superior one.

Classical economists view that among all the factors of production, since labour plays an active part and sets the whole productive machinery in operation, therefore, it is the most active factor of production compared to all other ones. Land is a passive material wealth. Capital also plays a passive role being a secondary factor of production. It is, in fact derived from land and labour, and therefore, has been termed as "Stored up labour". Whereas organization and enterprise are special forms of human activities.

Some economists are of the opinion, that there are only two factor of production; land and labour. Capital they say, it is appropriated from gifts of nature by human labour and is simply an instrument of production. Enterprise and organization are only special varieties of labour thus; land and labour are the primary factors of production while capital or organization and enterprise are only secondary.

Q.3 Define land. Explain importance of land as a factor of production?

<u>Ans:</u> L.M Fraser defines land as,

"Land stands for all natural resources which yield an income or which have exchange value. It represents those natural resources which are useful and scare, actually or potentially."

We may include in land besides its soil and fertility, and natural forces like heat, air, rainfall, and forest and mountains etc.

<u>Importance of Land as a factor of Production:</u>

Land is a basic factor of production; without land any kind of production is not possible. Howsoever, man may apply his efforts even with the aid of machinery and skill; he can produce nothing unless there is land to support his efforts. It is the land, out of which, we get a number of commodities which satisfy our wants.

Briefly, land is a basic factor of production; without is nothing can be produced even the survival of the man entirely depends upon it.

Q.4 Define efficiency of land and describe those factors on which efficiency to land depends?

<u>Ans:</u> Meaning of the efficiency of land:

By efficient of land is meant its ability and suitability for the purpose it is put to use. Efficiency of land is measured by its productivity in a certain process of production. Higher is the productivity, the more is the efficiency, and vice versa.

The efficiency of land depends upon the following three factors.

i. Internal or natural conditions:

Like the chemical nature of the soil, the climate and the sub-soil water are the most important.

ii. External or outside conditions:

These conditions refer to the location of land, availability of cheap and quick means of transportation and the way it is being used in production.

iii. Organizing ability of human resources:

The efficiency of land also depends upon the organizing ability of the human resources of the country.

Q.5 What is meant by labour? What are meanings of efficiency of labour?

Ans: Meaning of Labour:

In Economics, the term labour is used in a wider sense. It includes both physical and mental work undertaken for some monetary reward. According to S.E Thomas,

"Labour consists of all human efforts of body or a mind which are undertaken in the expectation of reward."

Meaning of Efficiency of Labour:

Efficiency of labour means the productive capacity or ability to work a labourer. In fact, it is the quality of a labourer to do more and better work or both during a given period of time compared to others. It is the qualitative aspect of the labourers. The more the labourers of a country have this quality, the more efficient they would be.

As a matter of fact, efficiency of labour is relative concept. When we say that Japanese workers are more efficient than Pakistani Workers, we compare the efficiency of the both.

Q.6 What are factors of efficiency of labour?

<u>Ans:</u> 1. **Personal Qualities**: They are included

i. Racial Qualities

ii. Hereditary or ancestral qualities

iii. Standard of living

iv. Individual qualities

v. Education and training

2. **Working conditions**: Such as

i. Factory environment

ii. Length of working hours

iii. Prospects and promotion

iv. Fair wages

v. Condition of machines

vi. Efficient management

3. **Social, religious and political conditions**: Such as

i. Social conditions

ii. Religious conditions

iii. Political conditions

Q.7 Define capital? What are functions of capital?

<u>Ans:</u> Meaning of Capital:

Capital has been defined as “Produced means of production”, i.e. man-made of production. His definition distinguishes capital from both land and labour because they are not the produced factors. They are, in fact, primary or original factors of production.

A precise definition of capital has been given by Prof. Richard t. Gill, According to him:

“A country’s capital is its stock of produced or man-made means of production, consisting of such items as building, factories, machinery, tools, equipment and inventories of goods ins stock.”

Functions of Capital:

Today, any sort of production without capital has become almost impossible. The main functions of capital are:

i. It increases productive efficiency of other factors of production.

ii. It helps in exploiting the resources.

iii. It helps in accelerating the rate of economic growth.

iv. It helps in attaining advantage of the division of labour.

v. It helps in facilitating exports.

vi. It helps in increasing quantity and improving quality.

vii. It helps in increasing mobility of human and material resources.

viii. IT helps in creating job opportunity.

ix. It makes large-scale production and greater degree of specialization possible.

Q.8 What is meant by Capital Formation? Describe the process of Capital Formation?

<u>Ans:</u> Meaning of Capital Formation:

Capital formation or accumulation is meant an addition to the stock or real capital goods in a country. The term stock of capital goods refers to all the produced means used for further production\, such as roads, railway, dams, barrages, canals, factories, machines, tools, instrument, seeds and fertilizers etc.

According to Prof. Nurkse:

"Capital formation is a process of diversion of a part of society's currently available resources tot eh purpose of increasing the stock of a capital goods so as to make possible an expansion of consumable output in the future."

The definition, stresses that saving is essential for capital formation.

Process of Capital Formation:

The process of capital formation involves following steps.

1. Increase in the volume formation involves following three steps
2. Mobilization of savings.
3. Investments of saving increasing real assets.

Q.9 Define Organization or Entrepreneurship. Describe different types of business organization?

<u>Ans:</u> **Meaning of the Organization:**

Organization is the fourth factor of production. It is the factor which brings together all other three factors of production-land, labour and capital and makes production possible. Due to its role in the process of production its user the organizer or enterpriser, is considered as one of the most important factors of production its user in modern times. Now-a days, the organizer of enterpriser is called an entrepreneur (a person who starts or organizes a commercial enterprise, especially the one involving financial risk). He is the main man who collects all the other chases raw-material, sells furnished goods and bears the risk of profit and loss. In these days, he is considered as the "Captain of industry".

Types of Business Organizations:

These are several of business organizations. They include.

i. Sole or Single or Individual Proprietorship

ii. Partnership

iii. Joint Stock Company

iv. Co-operative Societies

v. Public or State Enterprises

Q.12 What are merits or advantages of Sole Proprietorship?

<u>Ans:</u> Sole and individual proprietorship has the following merits.

i. Easy to start

ii. Easy to close

iii. Quick decision

iv. Need of small capital

v. Close contact with the customers

vi. Business secrets remain intact

vii. Free from labour disputes

viii. Gives personal incentive for hard work.

Q.13 What are demerits or disadvantages of Sole proprietorship?

<u>Ans:</u> Demerits or Disadvantages of Sole Proprietorship:

Sole or individual proprietorship is not free from some glare demerits. They may be of the following nature.

i. No scope of division of labour.

ii. No scope to reap the advantages of large-scale business.

iii. Disadvantage of Unlimited liability.

iv. Possibility of high cost of production.

v. Limited scope of using machines.

vi. Less credit worthiness.

vii. Uncertainty of continuity.

viii. Possibility to face economic crisis is very limited.

Q.14 What are merits or disadvantages of Partnership?

<u>Ans:</u> Merits or advantages of partnership have the following merits.

i. Easy to set up.

ii. Can secure more capital funds

iii. Large-scale production is possible

iv. Use of diverse talents

v. Promptness in decision-making.

vi. Check on hasty decisions.

vii. Personal interest and initiative.

viii. Availability of larger credit.

Q.15 Describe demerits or disadvantages of partnership?

<u>Ans:</u> Demerits or Disadvantages of Partnership:

Partnership has some demerits also. They may be of the following nature.

i. Lack of permanency

ii. Lack of mutual confidence

iii. Lack of liability

iv. Delay in decision

v. Un limited liability

vi. Difficult to close down

Q.16 How a Joint Stock Company is formed?

<u>Ans:</u> A joint stock company is formed according to the laws of the country. In Pakistan however, a joint stock company can be set up under Companies Ordinance 1984. There should be at least seven persons, known as promoters, prepare the plan of the company. After preparing plan, they submit an application to the Registrar of joint Stock Companies, seeking permission to set up such a company along with two documents, such as.

i. Memorandum of Association:

The Memorandum of Association consists the name, purpose, types of shares and amount of capital etc. of the company. It is the most important and fundamental document of the company. It is the charter that contains the basic facts about the company.

ii. Articles of Association:

The Articles of Association are the regulations or by-laws which govern the internal management of the company. They describe in detail powers and duties of directors and officers to be exercised by them in conducting different activities of business. They also give details of share-holders meeting, timing of meeting, and procedure of election of officers among share-holders.

These two documents are submitted to the Registrar of Joint Stock Companies. He grants permission to form such a company if the prescribed conditions according to law are fulfilled. After obtaining permission the company starts selling its shares and collects capital to establish the Joint stock Company.

Q.17 Describe merits or advantages of Joint Stock Company.

<u>Ans:</u> Merits of advantages of Joint Stock Company:

Following are the merits or main advantages of joint stock companies.

i. Mobilization of large resources

ii. Perpetual Existence

iii. Economics of large-scale production

iv. Limited liability

v. Specialized management

vi. Permanency

vii. Easy to collect capital

viii. Transfer of shares.

ix. Suitable for Large enterprise.

x. Champion of economic democracy. xi.

Q.18 What are demerits or disadvantages of joint stock companies?

<u>Ans:</u> Demerits or Disadvantages of Joint Stock Companies:

Joint stock companies are also not free from certain drawbacks of the following nature.

i. Drawback of separation is also not free from certain drawbacks of the following nature.

ii. Drawback of lack of interest of the shareholders.

iii. Exploitation of the majority of the shareholders.

iv. Drawback of limited liability.

v. Burden of heavy taxes.

vi. Encourage speculation

vii. Disadvantages of large-scale production

viii. Breeds corruption

ix. Labour disputes are common.

Q.19 What are the main functions of an Entrepreneur?

<u>Ans:</u> Main function of an Entrepreneur.

Main functions of an entrepreneur are as under.

i. He is the person who initiates a business enterprise by mobilizing and harnessing the necessary productive resources.\

ii. He takes the final responsibility of the business enterprise. Rask taking and uncertainty-bearing are his main responsibilities.

iii. He performs a role of an innovator because he is the person who search and discover economic opportunities, evaluate them, and marshal the financial resources necessary for the enterprise. He makes time-binding arrangements.

iv. He searches new discovers new economic information, translates new information into new markets, techniques and goods.

v. He provides leadership for the work groups.

Q.20 Explain Ricardian Theory of Rent.

Ans: Ricardian theory of Rent:

According to Ricardo,

i. Land rent is the payment of use of land only which is fixed in supply.

ii. It arises due to Original qualities of land which are indestructible.

iii. All the units of land are different in quality, fertility and location.

iv. The application of the amount of labour and capital etc. Gives different productivity. This difference in productivity or the surplus which arises on the superior units of land over the inferior ones is an economic rent.

v. Emergence of rent takes place in extensive cultivation.

vi. The rent is differential surplus enjoyed by a superior land over the inferior land.

Q.21 Differentiate between Nominal Wages and Real Wages.

Ans: Nominal Wages:

Nominal wages are those wages which paid or received in form of money only. These are also called money wages. They include only the payment made in cash.

Real Wages:

Real wages refers to the total amount of benefits and advantageous which a worker receives besides nominal wages in the form of different kinds of facilities in return to his rendered services. Real wages generally include money-wages and other facilities like free accommodation, uniform, free medical and educational facilities to the children, free electricity, telephone and gas etc. To estimate the standard of living of the labourer, these are real wages, which are taken into account.

JOIN

FOR

MORE!!!

CHAPTER # 3

Consumption or Theory of Consumer's Behaviour

Q.1 What is Consumption?

Ans: Meaning of Consumption:

Consumption, in ordinary sense, means eating or using up goods and services, but in Economics it has particular meaning. Consumption can, be defined as,

"All those human activities which are directly related to immediate satisfaction of wants are termed as consumption"

Contrarily, those human activities which are indirectly related to satisfaction of wants or which create means for obtaining satisfaction are termed as production. Since human wants are satisfied with wealth thus the act of applying wealth for getting satisfaction of wants is also termed as consumption.

Q.2 Describe the importance of consumption?

Ans: Importance of consumption can fairly be estimated from the following facts.

i. Consumption leads to production.

ii. Consumption determines economic welfare for the people.

iii. Consumption determines the level of employment.

iv. Consumption serves as a base for economic planning.

Q.3 What is utility? What are its characteristics?

Ans: Meaning of Utility:

Utility may be defined as the power of a product or service to satisfy a human want. A good or service may not be useful, even dangerous for the health, but if it satisfies an economics want, it possesses utility. For example, wine and cigarettes etc. are dangerous for health, but they are wanted by their users so they have utility. The persons who do not like them just considering them harmful or dangerous for health, there is no utility in these goods for them.

Characteristics of Utility:

The concept of utility has some certain characteristics. They may be of the following nature.

i. Different uses yield different utilities.

ii. Utility may change with change in ownership.

iii. Utility and a human desire go side by side.

iv. Utility mat change with the change in place.

v. Utility may change with time.

vi. Utility may change with the change in the form of articles.

vii. Utility may increase with the growth of knowledge.

Q.4 What is difference between Total Utility and Marginal Utility?

<u>Ans:</u> Total utility is the amount of utility derived from the consumption of all the units at the deposal of the consumer.

Marginal utility is the utility of an extra or additional unit. It is that point where the consumer uses more and more units of the same good at a particular time, the utility form successive units will be decreasing.

The satisfaction which a consumer derives from the consumption of the second units of good will definitely is less than the utility he would derive from the first unit. The utility from the third unit will be less than the second one, and from the fourth will be less than the third one, and so on.

Q.5 What are assumptions and exceptions of the Law of Diminishing Marginal Utility?

<u>Ans:</u> Assumptions or conditions of the law.

No doubt the law of diminishing marginal utility is a universal law. It, however, comes are under certain conditions or assumptions. They include:

i. All the units of the given good must be identical in quality and quantity.

ii. Taste, habit, custom, fashion, temperament and income of the consumer should remain unchanged.

iii. Units of the good should be consumed in succession at one particular period.

iv. The price of the good and its substitute must remain unchanged.

v. Units of the good must be suitable size.

Exceptions of law:

Following three factors are exempted from the law.

i. Rare objects or hobby goods

ii. Use of intoxicant, and

iii. Last of power, love of money and eagerness of showiness

Q.6 Describe the importance of the Law of Diminishing Marginal Utility?

Ans: The law of diminishing marginal utility is one of the fundamental laws of Economics. Its importance and significance lies in its application and uses in both economic theory and policy.

i. Base of some other important economic laws:

The law of demand, the law of equi-marginal utility and the Marshallian concept of consumer's surplus are based upon it.

ii. Helps in formulating fiscal policy:

In the modern welfare state the government is bound to redistribute income so as to increase the welfare of the people.

iii. It explains the value theory:

According to the value theory, the price of a good falls when its supply increases. It is so because with the increase in the stock of a good, its marginal utility falls.

iv. It encourages bringing variety in consumption and production.

v. It helps to explain paradox of value:

The concept of marginal utility has helped to explain paradox of value, also known as “Diamond- water paradox”.

Q.7 State the Law of Diminishing Marginal Utility.

<u>Ans:</u> The law of Diminishing Marginal Utility:

The law of diminishing marginal utility is a generalized statement of the behaviour of a consumer in relation to satisfaction of his wants. According to the law,

“The utility of a good to a consumer, while other things remain the same, decreases as the different units of that good are consumed in succession.”

Statement of the law:

Marshall, one of the greatest economists, has stated the law in the following words.

“The additional benefit which a person derives from an increase of his stock of anything diminishes with the increase in the stock that he already has.”

We may state this law in simple words as:

“The more we have a thing, the less is the utility that we get from the additional unit of it”

Q.8 What are the limitations of the Law of Equi-marginal Utility?

Ans: Generally, in practice the consumer's behaviour does not conform to this law due to a number of factors which constitute its limitations. They include:

i. Habitual behaviour of the consumers.

ii. Unawareness of other useful alternatives.

iii. Indivisibility of goods.

iv. Forcefulness of customs and conventions.

v. Fashion restrictions.

Q.9 What are equilibrium conditions or maximum satisfaction condition of a consumer?

Ans: A consumer can get maximum satisfaction when the marginal utility of each good is proportional to its price and the ratio of the prices of all goods is equal to the ratio to their marginal utilities.

The maximum satisfaction conditions of the consumer of his equilibrium condition may be stated in the following formula.

$$\frac{MUx}{Px} = \frac{MUy}{Py} = \ldots\ldots = \frac{MUn}{Pn}$$

CHAPTER # 4

Theory of Demand

Q.1 Differentiate between change in demand and change in quality demanded.

Ans: Change in demand represents the entire demand schedule or curve which shows the quantities of a good demanded at various prices. Quantity demanded, at the other hand, refers to that particular quantity which consumers by at a particular price.

Quantity demanded of good changes due to the changes in price of a good. When price of a good falls, its quantity demanded increases and when its price rises, its quantity demanded decreases. Change in demand occurs when due to the other factors than price a shift in change in prices of substitute goods, change in tastes and fashion etc.

Q.2 What are Assumptions or limitations of Law of demand?

Ans: Assumptions or Limitations:

The phrase “other things remaining the same” refers to certain assumptions on which the law of demand is based. They include:

i. Income of the consumers (buyers) must not change.

ii. Consumers’ tastes, choice & fashion must remain the same.

iii. Price of related goods must not change.

iv. Expectation regarding to a change in the price to certain commodity must not change.

v. Discovery of new cheaper & better related goods must not take place or expected to come in neat future.

vi. The quantity of population must not change.

Q.4 Why does Demand Curve slope downward or has a negative slope?

Ans: Demand curve slopes downward due to three main following reasons.

i. Income Effect:

When the price of a commodity falls, it enables a consumer to buy more quantity with the given income. Or, if he decides to buy the same amount of the commodity as before, some money will leave with him because he has to spend less on the commodity due to its lower price. This is called “Income effect” of the change in the price of the commodity.

ii. Substitute Effect:

When the price of a commodity falls, it become relatively cheaper than other commodities. This enables the consumer to substitute the commodity whose price has fallen for other commodities which have now become relatively dearer. As a result of this substitution-effect, the quantity demanded of the commodity, whose price has fallen, rises.

iii. Entry of new consumers:

When the price of a certain commodity falls, some new consumers, who were not able to buy it before, now become able to buy it on lower price. Hence new consumers enter the market and the quantity demanded goes up.

In fact, this negative slope indicates that a fall in price leads to an extension of demand, and a rise in price to a contraction of demand.

Q.5 Mention the Degrees of Elasticity of Demand.

Ans: Degrees of Elasticity of Demand. Following are the degrees of elasticity of demand.

i. Elastic demand.

ii. Highly Elastic Demand.

iii. Perfectly Elasticity Demand.

iv. Inelastic Demand.

v. Perfectly Inelastic Demand.

Q.6 Define Elasticity of Demand.

Ans: The term elasticity of demand signifies the change in demand for a good in response to a change in its price.

In the words of Stonier and Hugue.

"Elasticity of demand is a technical term used by the economists to describe the degree of responsiveness of the demand of commodity to a change in its price."

According to Michael Parkin,

"Elasticity of demand is a measure of the responsiveness of the quantity demanded of a good to a change in its price."

From these definitions we may define the elasticity of demand as the degree or the rate or the proportion of change of quantity demand for a good to a change in its price.

Q.7 How many kinds are there of Elasticity of Demand?

Ans: There are three kinds of demand for a good or a service. They are:

i. **Price Demand:** It concerns with price of a good or a service.

ii. **Income Demand**: It concerns with the income of a good or a service.

iii. **Cross Demand**: It concerns with the price of substitute goods.

Hence, Elasticity of demand can be classified into following three kinds

i. Price Elasticity of Demand.

ii. Income Elasticity of Demand.

iii. Cross Elasticity of Demand.

Q.8 How many kinds are there of Cross-Elasticity of Demand?

Ans: Cross elasticity of demand may be of two kinds.

i. Cross-elasticity of substitute:

When goods are substitutes, such as coffee and tea and butter and margarine etc. an increase in the price of one good will increase the quantity of demand of the other related good. The cross- elasticity of demand in case of substitute is positive.

ii. Cross-elasticity of complementary goods:

Complementary goods are those goods which are jointly demanded by a consumer, Tyre and tube car and patrol and pen and ink, for instance.

In case of complementary goods, when there is an increase in the price of one good (say Tyre), it leads to a decrease in the demand for the other good (say tube). In other words, in case of complementary goods, the cross-elasticity of demand is negative.

Q.9 What methods can be used to measure elasticity of demand?

Ans: To measure the price elasticity of demand of a good or a service, following three methods are used. It is to be noted; when elasticity of demand is referred either with price or without price it must be taken as price elasticity of demand only.

i. Total Outlay Method or Unity Method.

ii. Percentage Method, and

iii. Geometrical Method.

Q.10 What is theoretical importance of elasticity of demand concept?

Ans: The concept of elasticity of demand is very useful tool of economic analysis. Following facts verify it.

i. Helps in pricing decisions.

ii. Helps in price discrimination.

iii. Helps in measuring degree of monopoly power.

iv. Explains important relationship.

v. Helps in understanding different market forms.

vi. Explains incidence of taxes.

vii. A useful tool of Theory of Distribution.

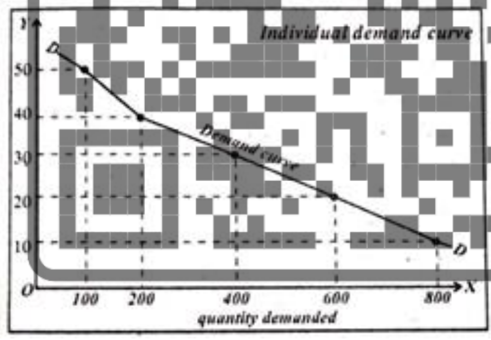
Q.11 What are factors which influence the elasticity of demand?

<u>Ans:</u> Suppose following schedule has been given to draw a demand curve on this given schedule, a demand curve has been drawn.

In diagram, X-axis is showing quantity demand at different prices, y-axis showing the different prices at which different prices at which different quantities of a good are demanded

Demand curve DD has been drawn by joining the point marked on the basis of price and demand relationship at different level of prices. We see demand curve is falling from left to right. It shows as price of a good increases, it demand contracts.

Price Per Kilo Sugar (Rs.)	Quantity Demanded Kilos
10	800
20	600
30	400
40	200
50	100



CHAPTER # 5

Theory of Supply

Q.1 What are meanings of supply?

Ans: Meaning of Supply:

The term supply, just like the term demand, is a relative term. IT is related to time, place and price. It is, therefore, defined as, "the quantity of a good which if offered for sale at a given price, at a certain place, in a particular period of time" Contrary to demand of a good if the price of a good increases quantity of supply expands, and vice versa.

Q.2 Differentiate between Stock and Supply?

Ans:

Stock is that total quantity of goods which the producers of sellers intend to sell at a particular reserve price in a specific period of time. Supply, is that part of the stock which is offered for sale at a price prevalent in the market. For example, suppose there is 1000 kilos of sugar available with the sellers in a certain locality today. The sellers intend to sell this total quantity at a reserve price of Rs.30.00 per kilo. But, on the other hand, the buyers are willing to buy it at a rate of Rs.25.00 per kilo. Now, if the sellers are ready to sell some quantity at this offered price, say 400 kilos, then un this case, 400 kilos of sugar will be considered supply and the remaining quantity (600 kilos) which has been held back for selling on a higher price than this one, will be considered stock.

Q.3 What is reserve price? What factors do influence the reserve price?

Ans: Reserve price is that price below which a seller refuses to sell any amount of his good. There are several factors which influence the reserve price of a seller. They include:

i. Nature of the goods

ii. Nature of the future cost

iii. Nature of the cost of storing

iv. Seller's liquidity preference i.e. , need for cash

Q.4 State the Law of Supply?

Ans: Statement of the Law:

The law of supply is stated in the following words.

"Other things remaining the same, if the price of a good rises its supply is expanded, and if the price its supply is contracted."

Q.5 Differentiate between increases and decreases of supply.

Ans: Increase and Decrease of Supply:

Increase and decrease in supply always takes place due to factors other than change in price, like change in fashion, the taste, weather and volume of population etc.

Supply is said to increase when, at the same price, more quantity is offered for sale by the sellers, or the same quantity is offered for sale at a lower price.

Supply is said to decrease when, at the same price, less quantity is offered for sale by the sellers, or the same quantity is offered at a higher price.

Q.6 Differentiate between expansion and contraction of supply?

Ans: Expansion and Contraction of Supply:

If the supply of a good changes simply because of the change in its price, it will either be an expansion or contraction of supply. In case of expansion of supply, more quantity is offered for sale at lower price.

Q.7 What are causes of changes in supply?

<u>Ans:</u> Causes of Change in Supply:

The increase or decrease in supply may take place on account of a number of causes. They include.

i. Production Technology

ii. Prices of Factors of Production

iii. Prices of other products.

iv. Objective of the firm.

Q.8 Describe the degrees of elasticity supply?

<u>Ans:</u> Degrees of Elasticity of Supply:

i. Elastic and Inelastic Supply:

When a small fall in price leads to a considerable contraction in supply or a small rise in price responds to a considerable expansion, supply is said to be elastic.

On the other hand, when a big fall in price leads to a very small contraction in supply or a big rise in price responds to a very small expansion, supply is said to be inelastic.

ii. Perfect inelastic or zero elastic supply:

When the quantity supplied of a good does not change at all in response to the change of its price, the elasticity of supply is said to be perfectly inelastic or zero elastic supply.

iii. Perfectly elastic or infinite elastic supply:

When at a given price, any quantity of a good is supplied, its supply will be said to be perfectly elastic or having an infinite elastic supply.

Q.9 Distinguish between Demand and Supply.

Ans: Demand and supply are two important forces which determine prices of goods and services by their interaction. Both exert quite opposite force on each other.

Demand and price act differently to each other. If price of a good or service goes up its quantity of demanded contracts, and if price goes down, quantity of demanded expands.

Supply force acts quite demand force regarding to price factor. In case, the price of a good or service goes up, its quantity of supply also rises, but if price goes down its quantity of supply also rises, but if price goes down its quantity of supply also decreases.

For determination the price of a good or service both the demand and supply forces has to act simultaneously. However, the intensity of degree of elasticity of one force plays decisive role in determining price.

Demand curve usually slopes downward from left to right. In other words, it has a negative slope, whereas, supply curve usually slopes upward from left to right; it has a positive slope.

CHAPTER # 6

Equilibrium of Demand & Supply and Price Determination

Q.1 What is an equilibrium price?

Ans: Equilibrium Price:

Demand and supply are the forces which act in the opposite direction regarding to price. When the price of a good falls, its quantity demanded increases but its quantity supplied decreases. Contrary to it, when price rises, its quantity demanded falls but quantity supplied goes up. Following a change in price, these two forces move into opposite direction to adjust each other. Ultimately, at a certain price they become equal to each other. Thus, the price at which the quantity demanded equals to quantity supplied is called equilibrium price. In other words, at an equilibrium price, the forces of demand and supply are balanced or tend to be equilibrium.

Q.2 How an equilibrium price is determined?

Ans: An equilibrium piece is determined by the interaction of demand and supply forces of the concerned goods. In fact, demand and supply forces are the function of price through they behave differently for the supply of goods. At higher price is less is demanded. Whereas supply reacts quite against it. Price comes to stay in the market at the point where both the demand and supply forces equate each other.

CHAPTER # 7

Scale of Production and laws of return

Q.1 What is large scale production?

Ans: Large scale production

When a firm uses huge machines, employs a large number of employees and invests a huge amount of capital, the scale of production is said to be the large one. The production units, which conduct large-scale production, are mostly the joint stock companies and public corporations. There can be seen division of labour and use of machines in their extreme use . The bigger cotton textile mills, chemical fertilizer plants, sugar factories, iron and steel mills and multinational pharmaceutical companies of Pakistan are included in the large-scale deductive units.

Q.2 What is small-scale production?

Ans: Small-scale production

When a firm operates by using less capital and small quantities of other factories of production, the scale of production is said to be the small one. The productive units which conduct small-scale production are such factories wherein small machines are used, division of labour is limitedly applied, and the number of employees is not big enough. In Pakistan, the firms or units which are engaged in the manufacturing of surgical instrument, sports goods electric fans, washing machines, ready-made garments, leather garments and hosiery goods etc. are being run on small scale production.

Q.3 Mention the factors that determine the scale of production.

Ans: Following are the factors that determine scale of Production.

1. Financial resources:

First of all financial resources of the entrepreneur decide what kind of scale of production he should prefer to attain. If large amount of capital is at his disposal, he will prefer to attain production at large-scale. Conversely, he will content to get small scale-production.

2. Available Production Technique:

Large-scale production will be preferred if available production is complicated. In case, production technique is simple and straight forward, the production will be preferable at small-scale.

3. Availability of Means of Communication and Transportation:

In case transport and communication facilities are easily, available, a large-scale production will be the choice of the entrepreneur, become raw-material will be easily available. Conversely, small-scale production will be considered most profitable.

4. Availability of the market:

If the market of the product is very vast, a large –scale production will be preferred. In opposite case, small –scale production will be preferable.

5. Entrepreneurial Competency:

Scale of production also depends upon the ability and capability of the entrepreneur. In case entrepreneur has full confidence and is an efficient in his work he will opt for large – scale production, provider other factors are also favourable. In other case, he has to content wills small-scale production.

Q.4 What are the disadvantages and demerits o large-scale production?

<u>Ans:</u> **Following types of disadvantages may be attributed to the large-scale production.**

i. Danger of under and over-production.

ii. Danger of Strike and lockout.

iii. Drawbacks of division of labour.

iv. Evils of advertisement and publicity.

v. Foreign markets dependency.

vi. Danger of Class-struggle.

vii. Danger of unequal distribution or wealth

viii. Ignorance towards individual tastes.

Q.5 What are advantages and merits of small-scale production.

<u>Ans:</u> Small-scale production may have following advantages.

i. Prompt decision and quick execution.

ii. Close supervision

iii. Direct relation between the workers and employers.

iv. Direct relation between the customers and the producer.

v. Ned of small capital

vi. Source of employment

vii. Free from large-scale production evils.

viii. Easily manageable.

ix. Suitable for particular goods.

Q.6 What are disadvantages of demerits of small-scale production?

<u>Ans:</u> The small-scale production has the following disadvantages.

i. Less scope for use of modern inputs.

ii. Wastage of by-products.

iii. Difficulty in facing bed times.

iv. Difficulty in getting cheap credit.

v. Lack of quality goods.

vi. Lack of research.

vii. Use of old techniques

viii. Difficulty in facing competition.

Q.7 What are internal and external economics?

<u>Ans:</u> Internal Economics:

Internal economies are, in fact, those advantages or benefits occur to a firm itself When it enlarges its scale of production or expands its volume of output.

The internal economies stake place within a firm as a result of its own expansion. They do not depend on the size and expansion of the industry. They occur simply due to the increase in the scale of production.

Types of kinds of Internal Economies:

They may be of the following type:

i. Technical economies.
ii. Managerial economies.
iii. Financial economies.
iv. Risk-bearing economies.
v. Economies of buying and selling.
vi. Economies of efficient use of capital equipment.
vii. Economies of research and experiments.
viii. Economies of using by-products.
ix. Economies of advertisement & salesmanship.
x. Economies of meeting bad days.

External Economies:

External economies are those advantages or benefits which arise to each member firm as a result of expansion of the industry as a whole. Expansion of industry may lead to newer and cheaper inputs like raw-materials, tools and machinery etc. Moreover, with the expansion of an industry, certain specialized firms come into being, which use waste products of large firms. Further, as industry flourishes, trade journal may appears which extend their services in the discover and diffusion of technical know-how.

Types of Kinds of External Economies:

External economies may be of following types.

i. Economies of concentration.

ii. Economies of information.

iii. Economies of specialization.

Q.8 State and briefly explain the law of Increasing Returns

<u>Ans:</u> Lack of Increasing Returns: Law of increasing returns describe the relationship between the successive increase in quantity of variable and fixed factors of production and the output obtained as the result of their combined working.

Statement of the Law:

Classical economists, including Professor Marshall, stated the law in the following words.

“An increase of labour and capital leads generally to improve organization, which increases the efficiency of labour and capital. Therefore, in those industries which are not engaged in raising raw produce, an increase of labour and capital generally gives a return increased more than in proportion.”

This definition contains two important points.

Firstly, the law of increasing returns sets in on account of the improved organization of a business enterprise.

Secondly, the law operates only in those industries which are not engaged in raising raw produce, In Other words, the law operates in manufacturing industries, and not in extractive industries (mining, fishing and forestry) or agriculture. Modern economists, however, have the different thinking.

Q.9 What are assumptions of the Law of Diminishing Returns? Why does law operate?

Ans: The law of diminishing returns is based on the following assumptions.

Firstly, techniques of production remain constant. In other words, no improvement takes place in the methods and techniques of production.

Secondly, all the units of variable factors are exactly similar to each other in quantity as well as in quality.

Thirdly, the proportion in which the various productive factors may combine should be variable. In case the proportion of combination between the factors is fixed, the law will not operate.

Fourthly, its operation is confined to short-run only, because in the long-run all productive services become variable.

Why does the law operate?

The operation of the law of diminishing returns can be attributed to the three main causes.

i. Improper combination of factors of production.

ii. Scarcity of factors of production.

Q.10 Why does the law of Diminishing Returns specially apply to agriculture?

Ans: Through the law of diminishing returns has a wide application but it specially applies to agriculture and other extractive industries like mining and fishing; where nature plays a dominant role with comparison to man. The reasoning is that, agriculture, being subjected to nature, is most sensitive to the application of this law, while industry, where man holds supremacy, is subjected to law of increasing returns.

Besides this main reason, there are also some other reasons which explain why the law of diminishing returns is mostly applicable to agriculture. They are:

i. The scope for the use of specialized machinery is very limited in agriculture. Thus benefits of large-scale production cannot be attained at the most.

ii. Agricultural activities are spread out over a wide range; therefore appropriate supervision cannot be effective.

iii. There are further limitations regarding to seasonal effects. In fact, agricultural operations are likely to be interrupted by dramatic changes or other natural calamities like floods, drought, locust attack and botanical diseases etc.

Q.11 How the application of the Law of diminishing returns can be checked?

Ans: Following counter-measure can help in checking the application of the law.

i. Most modern inputs like improved quality of seeds, chemical fertilizers and agricultural machinery

i.e. tractors, tube-wells, threshers, harvesters and levelers etc. must be extensively used.

ii. Extensive services must be made available to the farmers. Agricultural universities, colleges and other relevant departments should help the farmers. New inventions and innovations must be made practicable for the farmers.

iii. The extensive use of pesticides and insecticides should be encouraged to protect crops from various kinds of crop diseases and insects.

iv. Soil conservation and irrigation facilities should be made up through tube-wells facilities.

v. Water-logging and salinity must be checked and proper arrangement should also be done to reclaim the already affected land.

Q.12 Name all the three laws of returns and their reverse laws of costs?

OR

Name the law of Returns and Laws of Costs.

Ans: There are three laws of returns. They are

i. Law of increasing returns.

ii. Law of diminishing return, and

iii. Law of constant returns.

The reverse laws of returns are:

i. Law of decreasing cost.

ii. Law of increasing cost.

iii. Law of constant cost.

CHAPTER # 8

Product, Cost of production and Revenue Concepts

Q.1 What are Fixed Costs?

Ans: Fixed costs which are also called direct costs are those items of expenses of a business firm, which do not change with the volume of output. They remain constant as more or less output is produced. Such costs a firm has to incur even when it stops to produce anything temporarily. They include:

i. Rent of building and land.

ii. Interest of long-term debts,

iii. Salaries and wages of permanent staff.

iv. Payments of insurance.

Q.2 What are Variable Costs?

Ans: Variable costs are those items of expenses of a firm which change when the volume of output is changed.

When a larger output is produced, more raw-materials are required, more labour has to be hired, more fuel and electricity has to be used, and more transportation charges have to be paid. The variable costs are assumed to cease when output is zero. They are also called Indirect Costs. Variable costs include:

a) Wages,

b) Costs of Raw-material,

c) Cost of Transportation,

d) Costs of Fuel, power and electricity etc.

Q.3 What are Explicit Costs?

Ans: 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 include:

a) Wages and salaries,

b) Payment of raw-material,

c) Payment of hiring transportation facilities,

d) Charges of using fuel, electricity and water etc.

e) Payment of insurance,

f) Payment of taxes and duties,

g) Payment of hiring the services of advertising agencies,

h) Payment of interest on borrowed loans,

i) Payment of rent on hired building and machinery,

j) Payment of profit to firm’s share-holders in case of a corporate company.

Q.4 What are Implicit Costs?

Ans: 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 include:

a) Salary of the owner; working as a manager,

b) Interest of capital provided by the owner by his own source.

c) Rent or land provided by the owner of the firm,

d) Normal profit of the entrepreneur,

e) Depreciation charges of the machinery including obsolescent charges which the firm has as to face in case a fall occurs in the value of machinery due to introduction of new one.

Q.5 Distinguish between Short-run and Long-run time period?

Ans: Short-run is a period of time during which production can be increased or decreased only by changing the quantities of variable factors of production like labour, raw-materials and fuel etc., whereas fixed factor of production such as capital equipment, plant and land remain un-changed.

Long-run is a period of time long enough to vary all the factors of production. In long-ran not only the variable factors but also fixed can also be adjusted in response to the changes in demand for output.

Q.6 Distinguish between Variable Factors and Fixed of production?

Ans: There are some factors or inputs which can readily adjust with the changes in the output level. A firm can readily employ more workers, if it has to increase output. Likewise it can arrange and use more raw- materials, more chemicals without much delay, if the firm intends to expand production. Thus such factors which can be readily varied are called variable factors of production. Conversely, there are some factors, such as capital equipment, top management and building etc. which cannot be so readily varied. They require comparatively a long time to make variation in them. Thus, the factors which cannot be readily varied and require comparatively a long time to make required adjustment in them are called fixed factors of production.

Q.7 What is Marginal Cost? Explain it briefly.

Ans: Marginal cost is the addition to the total cost caused by production one more unit of output. In other words, it is additional cost of producing an additional unit of output. For instance, the production of 10 units of a product involves the total cost of production of Rs. 500. Now if the increase in production to 11 units raises the total cost to Re.540, the marginal cost of 11th unit of output will be Rs(540-500)=40. If output of product is raised to 12 units and total cost raises to Rs.530 , the marginal cost of the 12th unit of the product will be Rs.(530-500)=30, and so on for further units of output.

Q.8 Distinguish between Fixed Cost, Variable Costs and Total Costs?

Ans: Fixed costs: are the expenditure spent on the fixed factors of production, such as capital equipment, plant and factory building etc. They remain fixed in the short-run and cannot be changed. They are independent of output in the short-run. They do not vary with output in the short-run. Even if no output is produced in the long-run, the firm has to bear them. However, in the long-run even fixed costs are changed due to installation of new plant, construction of a bigger factory building.

Variable Costs: Variable costs are such expenditure which is incurred by the firms on the building of variable factors such as labour, raw-material etc. Variable costs vary with the level of output in the short- run. However, variable costs can be zero if a firm decides not to produce any output. Wages paid to workers prices for the raw0materials purchased by the firm are included in variable costs.

Total Costs: Total cost are the sum of variable costs and fixed costs incurred for the production,

E.g. TC = TVC + TFC.

Q.9 Explain the relationship between marginal cost (MC) and average variable cost. (AVC)?

Ans:

i. When marginal cost (MC) is less than average variable cost (AVC), average variable cost decreases.

ii. When marginal cost is equal to average variable cost, average variable cost remains constant.

iii. When marginal cost is greater than average variable cost, average variable cost increases.

Q.10 Describe the relative importance of the factors of production.

Ans: Relative Importance of Factors of Production: Production of everything is the result of coordination of all the four factors of production. Due to this very fact, all the factors carry equal importance. In the process of production. If one of them is missing the other become ineffective. Presence of each one is must to produce a thing. The owner of each factor claims to have greater importance compared to others. A capitalist awards the first place of capital; labourer to labour, landlord to land, while an enterprises does not lag behind in pushing forward has claims to be the superior one.

Classical economists were of the view that among all the factors of production, since labour plays an active part and sets that whole productive machinery in operation, therefore, it is the most active factor of production compared to all other ones. Land is a passive factor because it merely obeys man. It is only indispensable when we have to produce material wealth. Capital also plays a passive role being a secondary factor of the production. It is, in fact derived from land and labour, and therefore, has been termed as “stored up labour”. Whereas organization and enterprise are special forms of human activities.

Some economists are the opinion, that there are only two factor of production; land and labour. Capital, they say, is appropriated from gifts of nature by human labour and is simply an instrument of production. Enterprise and organization are only special varieties of labour thus, land and labour are the primary factors of production while capital and organization and enterprise are only secondary.

Q.11 Differentiate between Fixed costs and Variable Costs?

Ans: Fixed Costs: Fixed costs are those money expenses of a firm which do not change with change in volume of output. They are independent to output. Even if the firm closes down its production for sometimes, those costs have to be borne buy it.

Fixed costs are also known as overhead costs. They include charges such as maintenance cost, property tax, interest on the capital invested, contractual rent, insurance fee, minimum expenses regarding salaries and wages of permanent staff etc.

CHAPTER # 9

Equilibrium of the firm & Industry under perfect Competition

Q.1 What is a perfect competition?

Ans: Perfect competition is a business situation in the market wherein there is a large number of firms included in an industry, produce identical products. Factors of production are perfectly mobile. Firms can freely enter or exit the industry. They are quite independent in their decision-making. Government does not interfere in market activities.

Q.2 Describe the salient features of perfect competition?

Ans: Following are necessary conditions of perfect competition.

1. A large number of sellers
2. Homogeneous products are being traded.
3. Factors of production are perfectly mobile.
4. Entry and exit are free.
5. Buyers and sellers have perfect awareness about the market conditions.
6. Government's interference is not there.
7. Free firm any short of collusion.

Q.3 Define the nature of the demand curve of a firm working under perfect competition?

Ans: In perfect competition, an individual firm produces a product which is quite identical to the product being produced by all the other firms. Besides, the firm is too small to exert any influence on the prevailing market price of that product. Hence, each perfectly competitive firm is a price-taker instead price-maker. It has to accept a price of its product that is determined by market forces which are beyond its control.

The graphical expression of the demand curve for a price – taker firm is a horizontal straight line drawn at the going market price. In other words, in a perfect competition, an individual firm has to face a perfectly elastic demand curve at given price.

Q.4 What is the meaning of a firm's equilibrium?

Ans: Meaning of a firm' equilibrium: A firm is said to be equilibrium when it has no incentive either to expand or to contract its level of output. A firm will not like to change its certain level of output if it is earning total profits at the maximum at that level. It will prefer to expand its level of output only if it can increase its total profits by doing so. Likewise, it will prefer to contract its level of output only if it can help in avoiding losses. Therefore, a firm is said to be in equilibrium when it is earning maximum money profits or in case of losses, it is incurring minimum losses.

Q.5 How a firm can attain equilibrium in the long-run?

Ans: The long-run equilibrium of a firm under perfect competition refers to the situation where free and full adjustment in the scale of production as well as the number of firms can take place according to the changed condition, since in the long-run all the costs become variable and none remains fixed, therefore, the long-run average cost (LAC) and long-run marginal cost (LMC) curves are relevant for making output decision. However, it is the long-run average cost (LAC) which plays a determining important role.

Under perfect competition, a firm in the long-run will be in equilibrium (earning normal profit) at the level of output where its long-run marginal cost (LMC) equates marginal revenue (MR) and, at the same time, average revenue (AR) equates long-run average cost (LAC). In other words, it must qualify the following condition.

LMC = MR = MR = LAC

Q.6 How short-run equilibrium of an industry takes place under perfect competition?

Ans: Following are two conditions for the short-run equilibrium of the industry working under perfect competition must be maintained.

Firstly, the long-run demand for and supply of the product of the industry must be equal.

Second, all the firms including in the industry should be in equilibrium whether making profits or having losses.

Q.7 How long-run equilibrium of an industry takes place under perfect competition?

Ans: The industry attains equilibrium in the long-run when all firms are in equilibrium and further there in neither a tendency for the new firms to make entry into the industry, nor for the exiting firm to leave it. Besides, the equality of long-run supply of and demand for the industry's product must be maintained. However for attaining equilibrium in the long-run the industry has to maintain following three conditions.

Firstly, the long-run supply of and demand for the product of the industry must be equal. Second, all the firms including the industry should be in equilibrium.

Third, there should be no tendency for the new firms to enter the industry or for the existing firms to leave it.

Q.8 Explain the Characteristics of perfect competition?

Ans: Following are the main characteristics of perfect competition.

a) A large number of sellers and buyers exist

b) Homogeneous products are being traded.

c) Factors of production are perfectly mobile.

d) Entry of new firms and exist of old firms are free.

e) Buyers and sellers have perfect awareness about the market conditions

f) Government interference in not there.

g) Free from ant sort of collusion.

CHAPTER # 10

Equilibrium of the firm and industry under Monopoly

Q.1 What is monopoly? State the key features of monopoly.

Ans: Monopoly refers so that market situation where there is only one seller or producer who has some kind of power control over the supply of a particular product which has no close substitute. The cross-elasticity of demand of the monopolist's product is zero, e.g.; the monopolist has no rivals at all.

A monopolist firm may be characterized by the following main features.

1. Consisting of single firm industry.
2. Price-maker capacity.
3. No close substitute available.
4. Block entry for any other firm.
5. Discriminatory price is possible.

Q.2 What are merits or advantages of monopoly?

Ans: Following merits or advantages may be expected from monopoly.

1. Benefits of internal and external economies can be fully reaped.
2. Leads to growth of investment.
3. Benefited stability may take place.
4. Price stability may take place.
5. Suitable for public welfare.

Q.3 What are demerits or disadvantages of monopoly?

Ans: Monopoly has many demerits or disadvantages of the following nature.

1. Causes to hinder economic development.
2. Leads to inequality of income distribution.
3. Discourages new energetic entrepreneurs.
4. Consumer's tastes and choices are disregarded.
5. Innovations are not inducted willingly.

Q.4 Distinguish between Perfect competition and Monopoly.

Ans: Following features distinguish between them to each other.

1. Contrary to prefer competition, in monopoly there is only one seller against a large number of buyers.
2. A perfect competitive firm can earn only normal profits, whereas a monopolist firm can earn super normal profit even in the long-run.
3. Both attain equilibrium at different behaviour of their cost of production.
4. A monopolist firm contrarily to a perfect competitive firm, can discriminate prices of his product.
5. A monopolist, contrarily to a perfect competitive firm, can fix price at a higher point than MC.
6. Price is higher and output smaller under monopoly compared to perfect competition.
7. Under monopoly, possibility of public welfare is not there, whereas under perfect competition such possibility is quite possible.
8. Contrary to perfect competition, under monopoly, new firms cannot freely enter the industry or the old ones can leave it they suffer due to many barriers.

CHAPTER # 11

The Theory of Distribution or Factor Pricing

Q.1 On what assumptions, the Theory of Marginal Productivity is based?

Ans: Assumptions: The theory of marginal productivity is based on following assumptions.

1. All the units of a factor are identical
2. Factors can be substituted
3. Factors have perfect mobility
4. Application of law of diminishing returns comes into action.
5. Perfect competition exists

Q.2 On what ground the Theory of Marginal Productivity has been rejected?

Ans: The theory has been rejected on the following several grounds.

1. Based on unrealistic assumptions.
2. Factors are not perfect substitute.
3. Concept of application of law of diminishing returns is also wrong,
4. One sided theory.
5. A static theory.
6. Mainly applicable in the long-run

Q.3 Define Marginal Productivity Theory.

Ans: The Marginal Productivity Theory states that the share as reward or price of each factor of production, in a perfect competitive market, in the long-run, tends to be equal to its marginal productivity. By marginal productivity of a factor of production is meant the addition made to the total production by the employment of marginal unit, i.e. the unit which the employer just thinks worthwhile to employ. If the reward or price is paid at the rate lower than the marginal productivity, then it will not be preferable to move to the factor to continue in the that industry, so the producer will replace this factory by another, whose marginal productivity is higher r whose cost is relatively low. Thus, the reward of each factor of production would tend to be equal to its marginal productivity. If it is higher, then the producer will replace it by another factor, if it is less, then the factor would leave the industry and move to another place.

The lost unit of a factor production, which an employer just thinks it worthwhile to employ is called the marginal unit and the addition made by it to the total production is called marginal productivity or marginal productivity.

CHAPTER # 12

National Income and its measurement

Q.1 Define National income?

Ans: The term national income has been defined differently by the different writers. In the words of Professor Marshall,

“The labour and capital of a country, acting on its natural resources, produce annually a certain net aggregate of all kinds of goods and services. This is the national income of that country.”

Another recipient of the Nobel Prize Professor Simon Kuznet has defined national income as,

‘”The net output value of commodities and services, flowing during a year from the country’s productive system in the hands of ultimate consumers”

We may simplify define these definitions as the total net market-value of all the final goods produced and that of the services rendered in a country during a certain year is the national income of the concerned country.

Q.2 Explain the concept of GDP.

Ans: Gross Domestic Product of GDP is that total market-value of final goods and services which are produced within the country during a specific period usually a year. What is produced or earned outside the country by a country’s workers, being the part of that country where they work, is not included in GDP of that country to which they belong. Hence, the remittances (earning from overseas workers) are excluded from GDP they are included in Gross Domestic Production of that country where they work. In other words, GDP does not include net factor income from aboard. It is only included in GNP.

GDP = GNP – Income From aboard

Q.3 Explain the concept of GNP.

Ans: Gross National Product is the total market-value of final goods and services a national or a Country produces during a certain year. The remittances sent by the nationals working aboard are also included in GNP of that country which they belong. The depreciation allowance, replacement charges of capital goods, the wear and tear cost of capital goods are also included in GNP. They are deducted when Net National Product (NNP) is computed. Besides, net factor income from aboard (value of exports – value of imports) and net difference of inflow and outflow of capital outflow is also included in GNP. Since the non-productive transaction like pensions, old-age benefits and bonuses do not from the part of the GNP, they are not included in GNP. Economists generally use expenditure method to calculate GNP.

Q.4 Distinguish between Gross National Product and Net National Product.

Ans: Gross National product (GNP) is the total market – value of final goods and services a nation or a country produces during a certain year. The remittances sent the nationals during a certain year. The remittances sent the national working aboard are also included in the GNP of that country which they belong. The depreciation allowances, replacement charges of capital goods, the wear and tear cost of capital goods are also included in GNP. They are dedicated when the Net National Product (NNP) is computed. Besides, net factor income from aboard and net difference of inflow and outflow of capital is also included in GNP.

Net National Product (NNP) is the total net market – value of final goods and services a national or a country produces during a certain year. In other words, it is the GNP minus the value of depreciation allowances of capital goods. In the process of production of GNP during a year, we have to use various capital goods like equipment, machinery, instruments, tools and buildings etc. These capital goods are subjected to wear and tear being used, so their value goes on decline. Thus while computing NNP, a certain percentage of value has to be deducted. Therefore, NNP is also called National Income at Market prices. Briefly, we can define NNP as.

NNP = GNP – depreciation of capital allowances.

Q.5 Explain the concept of Net national Product at Market Prices.

Ans: Net National Product – NNP is the total net market-value of final goods and services a nation or country products during a year. In other words, it is the GNP minus the value of depreciation allowances of capital goods. Since in the process of production of GNP during a year, we have to use various capital goods like equipment, machinery, instruments, tools and building etc., these capital goods are subjected to wear and tear being used. So their value goes on decline. Thus, while computing NNP, a certain percentage of value has to be deducted. Therefore NNP is also called national Income at market price.

Briefly, we can define NNP as;

NNP or NIMP = GNP – depreciation of capital allowances

Q.6 Explain the concept of National Income at Factor Cost.

Ans: National income is the total sum of all the income payments received by the factors of production-land, labour, capital and organization. It can also be derived by net national Product (NNP) in the following manner.

NI of NIFC = NNP –Indirect taxes + Subsidies

It is, in fact, the national income at factor cost for which the term national income is frequently used.

Q.7 What is difference between national Income at Factor Cost and National Income at market Prices?

Ans: The difference between national Income (NI) or National Income at factor cost and net National Product (NNP) or national Income at market prices arise form imposition of direct taxes and provision of subsidies. These two elements cause market prices of output to be different from the factor income resulting from it. Therefore, national income or national income at factor cost is equal to national product minus indirect taxes plus subsidies.

Q.8 Differentiate between Personal Income (PI) and Disposable Personal Income.

Ans: Personal Income –PI: Personal Income is that total sum of all incomes which are actually received by all individuals or households during a certain year. In fact, whole of the national income earned by the individuals is not divided among them. Several deductions have to be made to arrive at personal income. Some income which earned by the individuals such as social security contributions, corporate income taxes and undistributed corporate profits, are not actually received by individuals. Conversely, some income which is received by them, like transfer payments (old-age pensions, unemployment allowances, relief payments, subsidies and interest payment on the public debt) are not actually earned by the individuals. So, while estimating personal income, these kinds of income which are earned but not received are deducted and those incomes area added which are received but not currently earned. Therefore

PI – NI – social Security contribution – Corporate Income taxes- undistributed corporate profits + Transfer payments.

Disposable Personal income –DPI

After a part of personal income is paid to government in the form of direct taxes like income tax and property tax etc. what is remained with is termed as disposable personal income. DPI can either be consumed or saved.

Therefore PDI = consumption + saving

Q.9 How the National Income of country is measured under Total Product or Total Output Method?

Ans: Under this method, national of a country is computed from the production or output side. In other words, this method involves measurement of the national income of a country on the basis of market prices of the produce.

According to this method, the economy is divided into different sectors; such as agriculture, manufacturing, mining, commerce, transport and communication etc. Then the gross product is sought out by adding up net values of all the production that has taken place in various sectors over the year. The net value of production of all the sectors plus net income from aboard (exports-imports or net difference of balance of payments) will give the gross national product. By subtracting the total amount of depreciation of capital from the gross national product will give national income.

Q.10 How the National Income of a country is measured under Income Method?

Ans: The Income Method of national income measurement is also known as factor payment of factor cost approach. The method is used to calculate national income of a country from its distribution side.

According to this method, national income is measured by summing up incomes of all individuals of a country. Since individuals earn their incomes either through rendering their own services of through the services of their factors of production, i.e. land and capital, therefore, under this method, national income can be calculated by adding up rent of land, wages and salaries of employees, interests on capital and profits of entrepreneurs.

Besides this, undistributed profits of the joint stock companies and income of self-employed persons are also taken into account.

Q.11 How the national of a country is measured under Expenditure Method?

Ans: This method is used to calculate national income by adding up all the expenditure made on goods and services during a year. Since income can be spent on either consumer's goods or investment goods, therefore, national income can be calculated by swimming up all the consumption expenditure and investment expenditure made by all the individuals as well as the government during a year.

Concisely, under expenditure method, the national income of a country can be measured by adding up the following five flows.

Q.12 Mention the difficulties in the measurement of National Income.

Ans: Following are the difficulties which frequently come in the way of measurement of National Income.

1. Since National Income of a country is measured in money, whereas money itself is not a reliable source of measurement because it is subject to many frequent changes.

2. Exact and adequate dates are not available about the different sectors of the economy.

3. Double accounting problem cannot be avoided.

4. The real value working of non-monetized sector cannot be adequately assessed.

5. International transactions also create a number of problems,

6. Non-monetary transactions are not taken seriously, therefore, national income cannot exactly be assessed.

CHAPTER # 13

Money , its Function and Value

Q.1 Define money?

Ans: To give a precise definition of money it is not an easy task because so far various definitions have been put forward by different writers:

The most acceptable definition has been given by D.H Robertson. According to him,

“Money is everything which is widely accepted in payment of goods or in discharge of other kinds of business obligations”

According to Robertson’s definition, the thing which is termed as money should qualify the condition of general acceptability.

Professor Crowther offered the best definition of money which nearly includes all the functions of money. “Money is anything that is generally acceptable as a means of exchange and at the same time acts as a measure and store of value”

Q.2 What the difficulties of Barter system?

Ans: In the barter system direct exchange of goods people have to face a large number of difficulties of the following nature.

1. Difficulties of lack of double coincidence.
2. Difficulties of common measure of value.
3. Difficulties of lack of divisibility of goods.
4. Difficulties of lack of store of value.
5. Difficulties of deferred payment.

6. Difficulties of transfer of wealth from one place to another.

7. Difficulties of revenue collection by the government.

Q.3 How money has removed various difficulties of barter system?

Ans: The money has removed various difficulties of barter system in the following ways.

1. Multiple use of money.
2. Unit of account.
3. Liquidity.
4. Portability.
5. Establishment of financial institutions.
6. Creation of credit or bank money.
7. Working of market mechanism.
8. An all-round process of economic development.

Q.4 Explain importance of money?

Ans: The real importance and significance of money lies in the following facts.

i. It is helpful to producers in production.

ii. It is helpful to consumers in consumption.

iii. It is helpful in distributing.

iv. It is helpful in expanding trade and commerce activities.

v. It is helpful to saving and investment.

vi. It is helpful to fiscal management.

vii. It is helpful to social reforms and social progress.

viii. It is helpful in attaining political progress.

ix. It acts as index of growth.

Q.5 Write down the function of money?

<u>Ans:</u> The main functions performed by the money are as under.

i. It acts as medium of exchange.

ii. It acts as common measure or yardstick of value.

iii. It acts a standard of deferred payments.

iv. It acts as a store of value.

v. It acts as a transfer of value.

vi. It acts as an important instrument of economic policy.

vii. It acts as a tool of monetary management.

viii. It acts as an instrument of saving and investment.

ix. In influences the levels of income and consumption.

x. It acts to facilitate the economic growth.

Q.6 What are main characteristics as good money?

<u>Ans:</u> Good money should have the following essentials qualities.

i. General Acceptability having intrinsic value and should enjoy legal support.

ii. Stability of Value.

iii. Portability.

iv. Cognizability.

v. Divisibility.

vi. Durability.

vii. Homogeneity.

viii. Malleability.

ix. Storability.

Q.7 What are advantages of Paper Money?

Ans: Paper money has the following advantages.

i. Most economical.

ii. Most convenient.

iii. Highly portable.

iv. Easy in counting.

v. Quality of elasticity is there.

vi. Easy to recognize.

vii. Useful to Government.

viii. Helpful to Banks.

ix. Helpful for industrial and commercial development.

x. Possessor of almost all the qualities of good money.

Q.8 What are disadvantages of Paper Money?

Ans: Following are the disadvantages of paper money.

1. Unstable Value: paper money does not possess stable value as compared to metallic money. It is so because the intrinsic worth of the paper money is almost zero. Its value is determined by its demand and supply sides which are balanced rarely. Its value fluctuates rapidly.

2. Danger of Inflation: Possibility of over-issue is always there if and when the government is in financial trouble. Once this course is adopted, comeback because very difficult.

3. Danger of Inflation: Over-issue of paper money may also cause inflation which brings various kinds of evils with it. Of them, rapid rise in prices cause to fall the external value of the currency and rate of exchange, fall in exports and rise in imports, which in turn, may deteriorate balance of payments etc.

Q.9 What is Value of Money?

Ans: By value of money is meant purchasing power of money. Goods and services are purchased with the help of money. The phrase value of money is a relative concept. It expresses the relationship between a unit of money and the goods and services which can be purchased with it. When the price rises, the value of money falls and vice versa. The value of money, is of two types: the internal value of money and the external value of money.

Q.10 What is Inflation?

Ans: In ordinary language, Inflation means a process of sustained rise in prices. A situation is said inflationary when either the prices of goods and services or the supply of money are rising.

In the words of Friedman,

“Inflation is always and everywhere a monetary phenomenon and can be produced only by a more rapid increase in the quantity of money than output.”

But majority of the economists do not agree that money supply alone is the real cause of inflation. Harry,

W. Johnson, F.S Broon and Edward Shapiro share the view that:

“Inflation is a situation where in a persistent and appreciable rise in the general level of prices take place.”

Q.11 Give the various Assumption of Quantity Theory of Money.

Ans: Assumption of Quantity theory of Money.

Professor Fisher assumes that:

In the short-run T (transaction to be performed by money remain constant, and V (velocity of metallic money and V’ (velocity of credit money also remain constant)

Besides, the proportion of M’ (metallic money and M(credit money also remain constant.

Hence, P (price level) or value or money varies directly with M (credit money) In other words, value of money varies inversely with money of quantity of money in circulation.

Q.12 highlights the effects of changes in the value of money on different section of the society.

Ans: When changes take place in value of money, usually inflation emerged, Inflation affects different sectors of a society differently.

1. Debtors and creditors are differently affected; debtors gain but creditors have to undergo losses.

2. Salaried class has to suffer a loss when inflation is there.

3. During inflation, wage-earners can earn or suffer a loss. It depends however at the rate at which wages are adjusted to the rate of inflation.

4. Fixed income group have to suffer during inflation.

5. Investors or share – holders gain during inflation but suffer losses during deflation.

6. Businessmen gain during period of inflation.

7. Agriculturists, who are landlords, have to suffer a loss during inflation because they have to content with fixed rents.

Q.13 State the Quantity Theory of Money.

Ans: Quantity Theory of Money: Quantity Theory of Money asserts that the value of money depends largely on the quantity of money. If the quantity of money is increased, without corresponding increase in volume of production, the value of money will decrease and vice-versa.

“Other things remaining the same, value of money falls in proportion to increase in quantity of money in circulation.”

It means, if the quantity of money is increased by 50%, whereas other remains unchanged, the value of money will fall by 50% and vice-versa. Thus, the quantity of money and its value are inversely related.

Q.14 State the causes of inflation.

Ans: Following are the causes of inflation.

1. Effect of increase in money supply without corresponding increase in output.
2. Impact of increase in disposable income.
3. Impact of expansion of credit.
4. Impact of deficit financing policy.
5. Impact of black money spending.
6. Impact of repayment of public sector.
7. Effect of expansion of private sector.
8. Impact of increase public expenditure.

Q.15 Highlight the impact of inflation on consumer.

Ans: Impact of inflation on consumer:

Due to inflation, first of all, food prices star rising rapidly, particularly in a developing country. Rise in food prices is then followed by the rise in the prices of other consumer goods. This happens because a greater part of the increase in demand generated by the investment expenditure is spent on food products which cannot be sufficiently increased in the short – run. Food products take sufficient time to be got ready – at least six months are required to get ready a food crop. So, inflation proves to be very difficult to face with for consumers.

The income elasticity of demand for food is very high because the majority of the consumers are under – nourished. Thus, inflation leads to a sharp rise in demand for food grains which causes to increase in food prices.

Some agricultural products are raw – materials for industries, increase in their prices causes to directly increase the cost of production of industrial goods.

CHAPTER # 14 –

Public Finance

Q.1 What is public finance?

Ans: Public finance deals with the revenue – expenditure activities of government. It studies the ways and means by which government income is secured through taxation, borrowing and other sources. It also deals with the principles and problems relating to the government expenditure and her expenditure policies.

Q.2 What is subject-matter of public finance?

Ans: The subject-matter of public finance consists of

1. Public Revenue: This part includes the study of the methods of raising public revenues and the principles of taxation.

2. Public Expenditure: This part concerns with the study of the principles and the effect of public expenditure.

3. Public Debt: The part deals with the study of the causes and methods of public loans and public debt management.

4. Financial Administration: The part explains how the financial machinery is organized and financial administration is dealt with.

Q.3 What are similarities between public and private finance?

Ans:

1. Both kind of finance are based on "Principle of Rationality". A sane individual tries to maximize his personal benefits through his expenditure. Similarly, a responsible government tries to maximize social benefits through public expenditure.

2. Both kind of finance are also based on the common objective of satisfaction of human wants. An individual uses his resources to satisfy his personal wants but the government aims at to satisfy social wants.

3. The ultimate end of the both is to balance their respective income and expenditure.

4. Both are concerned with the problems of economic choice i.e. both try to satisfy unlimited wants limited resources.

Q.4 What are dissimilarities between public and private finance?

Ans: The dissimilarities between the two kinds of finance are of the following nature.

1. Different approaches between the two kinds to finance are of the following nature.
2. Different period of time.
3. Different of nature of resources.
4. Difference of secrecy.
5. Different nature of budget.
6. Different objective of expenditure.
7. Different outlook for the future.

Q.5 What are sources of public revenue?

Ans: There are two main sources of public revenue.

1. Tax Revenue: The revenue, which is managed through various taxes is known as tax revenue. A tax is a compulsory contribution imposed by the government. It is, in fact, a legal as well as a personal obligation of a tax-payer to pay his due taxes regularly.Taxes are main sources of public revenue. They affect consumption, production and distribution.

2. Non-tax revenue: The revenue which is collected through administration, commercial enterprises, grants and gifts etc. is known as non-tax revenue.

Q.6 What is tax?

Ans: Almost all the economists seem to agree on this point that a tax is a compulsory payment by a tax-payer to the government without expectation of any direct return or benefit.

Professor Dalton; a well-known writer on Public Finance, expresses his opinion about a tax as,

“A tax is a compulsory contribution imposed by a public authority irrespective of the exact amount of service rendered to the tax-payer in return and not imposed as a penalty for any legal offence.”

Q.7 What are important characteristics of a tax?

Ans: A tax possesses the following main characteristics.

i. A tax is a compulsory payment imposed by the state. It is paid indirectly to the state. A government collects it on behalf of the state as is agent.

ii. A tax-payer cannot claim in return benefits against the taxes paid. There is no relation between the services rendered to a tax-payer and the amount of tax paid by him.

iii. A tax is a payment made for meeting the expenses in the common interest of all the citizens.

iv. A tax is a personal obligation. A tax-payer has to pay it. He should not try to evade it.

Q.8 Describe main characteristics of a tax?

Ans: A tax possesses the following main characteristics.

1. Administrative Revenue: They include fees, fines and penalties, special assessment, forfeiture and escheat.

i. Fees.

ii. Fines and Penalties.

iii. Special assessment.

iv. Forfeitures.

v. Escheat. vi.

2. Gifts and Grants: Gifts are generally voluntary contributions. They are given to the state by patriotic persons of the country. They, however, do not play any important role in modern revenue system.

3. Revenue from Public Enterprises: The income earned by public enterprises also included in government has to run a number of commercial enterprises with the aim to provide social benefits to the people. In Pakistan Steel Milles, PIA, WAPDA, KESC and other commercial enterprises are being run by the state.

Q.9 Explain the cannon of taxation given by Adam Smith.

Ans: According to Adam Smith, a good taxation system is that one which contains the four following cannons or principles.

1. Canon of Equality or Equity: The cannon of equality suggests that the burden of taxation must be distributed equally or equality regarding to the ability of the tax payers. Adam Smith argued taxes should be proportional to income; i.e.; everybody should pay the tax according to his ability to pay.

2. Canon of Certainty: The tax payer should be well-informed about i) the time of payment, ii) the amount to be paid and, iii) the method payment of the tax.

3. Canon of Convenience: The canon of Convenience suggests that the sum, time and manner of payment of a tax should not only be certain but it must also be convenient to the taxpayer.

4. Canon of Economy: The canon of Economy suggests that there should not be made unnecessary expenditure while collecting and administering taxes.

Q.10 Distinguish between Direct tax and Indirect tax.

Ans: A direct tax is one whose impact and incidence are on the same person. It cannot be shifted to someone else. Income tax is a good example of a direct tax, because the person from whom it is collected has to bear its burden.

On the other hand, indirect tax is that one, whose impact is on one person but the incidence on the other. Sales tax is a good example of an indirect tax, because it is collected initially from sellers of goods but they do not pay it from their own pockets. They add the tax to the selling prices of the goods and recover from the buyers of the goods.

Q.11 What are merits or advantages of direct taxes?

Ans: Direct taxes have to the following good qualities in them.

i. Justify Principle of Equity.

ii. Justify the Canon of Economy.

iii. Justify Canon of Elasticity.

iv. Justify the Canon of Certainty.

v. Justify the distributive justice.

vi. Create civic consciousness.

vii. Help in sealing leakage.

viii. Help in avoiding adverse effect of direct taxes.

Q.12 What are demerits or disadvantages of direct taxes?

Ans: The following are the main disadvantages taxes.

i. Encourage large-scale evasion.

ii. Unpopular and painful.

iii. Arbitrary.

iv. Inconvenience.

v. Create non-civic consciousness among non-tax payers.

vi. Non-reliable source of revenue in a poor country.

Q.13 What are merits or advantages of indirect taxes?

Ans: Following are the merits of indirect taxes.

i. Convenient to pay.

ii. Difficult to be evaded.

iii. Revenue productive.

iv. Effective in securing rational allocation of scare resources.

v. Maintain the purpose of social value.

vi. Raise civic sense.

vii. Prove to be more productive.

Q.14 What are demerits of disadvantages of indirect taxes?

Ans: Following are the main disadvantages of indirect taxes.

i. They are inequitable.

ii. They are uneconomical.

iii. Discourage honesty.

iv. Harmful to the customers.

Q.15 What are essential of a good taxation system?

Ans: All the economists agree that a good tax system must contain certain following essentials.

1. It should maintain fundamental principles of taxation.
2. It should be balanced combination.
3. It should be an absorber of all the canons.
4. It should ensure maximum social advantage.
5. It must be efficient from the administrative point of view.
6. It should be an efficient instrument for the reduction of economic inequalities.
7. It should be an effective tool of economic stability.
8. It should be an effective instrument of economic growth.
9. It should be socially advantageous.
10. It should ensure the optimum allocation of the productive resources.

Q.16 Distinguish between a Proportional Tax and a Progressive Tax

Ans: A proportional tax is one in which the same rate or same percentage of the tax is charged whatever be the size of taxable income on which it is levied. The rate of tax remains the same with a change in income.

All the tax-payers have to pay, say 5% of their income as tax.

A progressive tax on the other hand, is one in which, the rate or the percentage of tax increases as the taxable income increases. The principle of progressive tax is "higher the income, higher the tax rate."

Q.17 Distinguish between a Proportional tax and a Progressive Tax.

Ans: Indirect taxes may be either specific or ad valorem. A specific tax is levied on a good according to its weight. An ad valorem tax, on the other hand, is levied according to its value. In other words, a specific tax is levied on per unit of a good, whatever is price is. The amount of specific tax varies in accordance with the volume of output or sales of the good. On the other hand, ad valorem tax is levied on a good according to its value; it varies with the total value of output or sales of the good.

Q.18 Distinguish between Impact and Incidence of a Tax.

Ans:

1. The impact refers to the initial burden of a tax. Incidence refers to the final burden of a tax.

2. Impact of a tax can be shifted, the incidence of a tax cannot be shifted.

3. Impact is felt by the tax-payer at the time of imposition of the tax. Incidence is felt at the time of settlement of the tax.

4. The impact of a tax is felt by the person from whom the tax is collected. The incidence is felt by the person who actually bears the burden of the tax.

Q.19 What are two main types of public expenditure?

Ans: There are two following main types of public expenditure.

1. Productive Expenditure: The public expenditure, which directly or indirectly help in developing natural or human resources of the country or lead to increase national prosperity by increasing national wealth, are said to be productive expenditure.

2. Unproductive Expenditure: The public expenditure which does not result in any increase of national income or does not help in attaining any social benefit, are said to be unproductive, expenditure. War expenditure, expenditure made on defense, payment of interest on loans, salaries, pensions, public administration, maintaining the situation of law and order in the country, are considered unproductive expenditure. These expenditures are also called current expenditure.

Q.20 What is public dept?

Ans: Generally, the term "Public Debt" is referred to loans raised by a government within the country or outside the country. Just like individuals, the governments also have to borrow when their expenditure tends to exceed their revenue.

Philips E. Taylor; an authority on Public Finance, has described these three feature of public debt.

1. Public debt arises in the form of borrowing by the treasury or the state exchequer; central bank or state bank of the country.

2. The government has to borrow when there is a budget deficit public expenditure exceeds the revenue.

3. The government has to pay not only the principle amount but the interest also.

Q.21 What is a budget? What are its types?

Ans: A budget is an annual statement of income and expenditure of a government. According to Taylor, "The budget is the master financial plan of a government. It brings together estimates of anticipated

revenues and proposed expenditures for the budged period and from these estimates the activities to be undertaken and the means of their financing can be inferred."

Types of Budget: There are three types of budget. They are:

1. Balanced Budget: If the budget balance is zero; total estimated revenue and total proposed expenditure are equal, the government has a balanced budget.

According to Dr. Dalton, "The common conception of a balanced budget is that, over a period of time, revenue does not exceed or at least fall short of expenditure."

2. Surplus Budget: If the total estimated revenue of the budget is greater than total proposed expenditure the government has a surplus budget.

3. Deficit Budget: If the total estimated revenue of the budget is greater than total proposed expenditure the government has a deficit budget.

Q.22 What are main parts of a budget?

Ans: A budget, it may be a balanced or a surplus or a deficit, consists of following two parts:

1. Revenue Budget: This part of the budget consists of tax-revenues, non-tax revenues and other revenues and the expenditure to be met from these revenue receipts.

2. Capital Budget: This part of the budget shows capital receipts and development payments of the government. The main form of capital receipts are loans raised from the public, borrowing from central bank through the sale of treasury bonds are bills, and loans received from foreign countries. Capital expenditure consists of that expenditure suggested to spend on roads, railways, ports, water, gas, electricity, irrigation projects and long-term projects etc.

Q.23 Distinguish between private Finance and Public Finance.

Ans: The basic principles of public finance and private finance are the same. There are, however, some different between them.

1. They have different approach of adjustment of income to expenditure.
2. They concern with different period of time.
3. The nature of resources is different.
4. They have different nature of secrecy.
5. They have different nature of budget.
6. They have different pattern of expenditure.
7. Their objective of expenditure may be different.

8. Both have different outlook for the future.

9. Both are based on common objective of satisfaction of human wants

10. Both are based on common objective of satisfaction of human wants.

11. Both try to satisfy unlimited wants with limited resources.

Q.24 Difference between a Tax and Zakat.

Ans: Zakat is not a kind of a tax. It is absolutely different from a tax. Following points distinguish Zakat from a tax.

1. Zakat is liable on the accumulated wealth of Sahib-i-Nisab Muslims, which they are bound to pay every year to the poor and the needy for their financial support. Contrarily, tax is imposed on the income and wealth of the people by the government. It is also paid to the government for the general welfare of the people.

2. The payment of Zakat is a religious duty which is performed only by the Sahib-I-Nisab Muslims. Payment of a tax, on the other hand, is a national responsibility, which is performed by all the citizens of a country.

3. The zakat rate has been fixed at 2.5% forever on certain amount of accumulated wealth for full year.

4. The objective of the Zakat is to meet the needs of the needy. Tax revenue, on the other hand, can be used to meet the development or non-development expenditure of the government.

5. Zakat is a religious obligation. It is liable to be paid by the Sahib-e-Nisab Muslims. On the other hand, tax is legal responsibility. IT is paid under the order of government.

6. Zakat is paid only once a year; in or after the month of Rajab. A tax, on the other hand, is paid in the form of excise duty and sales tax every day and again and again because it is included in prices of the goods.

7. A taxi s paid almost by all the rich and the poor of a country because they have to pay excise duty or sales tax on buying the consumer goods. As opposed to it, zakat is paid only by the Sahib-I- Nisab Muslims and the government paid is received the poor and the needy.

8. The rate of Zakat is a proportional for all Sahib-I-Nisab Muslims. It Is 2 2% on all type of accumulated wealth for all income groups. A tax, on the other hand, be in the form of an income tax is progressive in a nature because its rate increases with the increase of income.

9. Purpose of Zakat is to discourage the concentration of wealth in the hands few. For this purpose it is levied on savings and hoard of gold and silver. On the other hand, there are no taxes on savings and gold ornaments.

CHAPTER # 15

Business or trade Cycle

Q.1 Define a trade cycle.

Ans: In words of Keynes,

“A trade cycle is composed of periods of good trade characteristics by rising prices and low employment percentages, altering with periods of bad trade characterized by falling prices and high unemployment percentages.”

According to Professor Gordon.

“Business cycles consist of recurring alternation of expansion and contraction in aggregate economic activities, the altering movements in each direction being reinforcing and prevailing virtually in all parts of the economy”

Q.2 What are salient features of trade cycles?

Ans: Salient features of trade cycles are as under:

1. A trade cycle is formed by two contrary forces of expansion follow each other. This flow from expansion to contraction and contraction to expansion is wave-like in its course.
2. The forces of expansion and contraction take place periodically at fairly regular intervals.
3. They are always crisis-ridden, weather it is a boom or depression.
4. None cycle is exactly similar to any other one.
5. Prices and production usually rise or fall together.
6. Profits fluctuate by a much larger percentage than other type of income.
7. They have an all-embracing nature.
8. They mostly occur in organized money economies.
9. The swings from upward to downward are faster their swings from downward.

Q.3 Name the different phases of a Trade Cycle and describe any one of them.

Ans: A typical business cycle contains four different phases or stages. They are boom or prosperity, depression or Contraction, Recessio0n and phase of Recovery or Revival.

Phase of Boom or Prosperity: In this phase, the phase of recover or revival gets momentum. The revival of investment in one industry induces the revival of another. Optimism grows and spreads far and wide. The income of businessmen takes a forward jump, while wages, interest and other costs lag behind.

Attracting by the rising profits the businessmen and industrialists further enhance their capital investment. Prices rise sky-high. The tempo of boom touches new heights. Business confidence researches to its peak point. This situation paves the way to full employment. This phase is also known as prosperity phase.

Q.4 Describe the main features of Depression phase?

Ans: Features of Depression Phase: This is the period of mass suffering because during depression economic activities turn extremely far below the normal Price level becomes low. Sharp reduction in output, mass unemployment, falling prices, falling profits, low wages and contraction of credit become salient features of the economy. All sorts of construction activities come to almost complete stand still. Some industries are compelled to close down their production. All sections of the economy have to share some suffer more than others. Business community is the worst sufferer.

Q.5 Describe the main features of phase of Boom?

Ans: Main Features of Phase of Boom: In this phase, optimism grows and spreads far and wide. The income of businessmen takes a forward jump, while wages, interest and other costs lag behind. Attracting by the rising profits the businessmen and industrialist further enhance their capital investment. Prices rise sky- high. The tempo of boom touches new heights. Business confidence reaches to its peak point.

Q.6 Describe the main features of phase of Recession?

<u>Ans:</u> Main features of Phase of Recession: In due course of time, boom phase emerges into recession. The over-optimism gives way to over-pessimism involving a feeling to hesitation, doubt and fear. Credit is contracted and business expansion is stopped. Investment ceases and unemployment expands. Prices decline sharply and businessmen confidence is badly shaken Construction activities slacken and unemployment spreads all over the economy.

Q.7 Describe the main features of phase Recovery?

<u>Ans:</u> Main features of Phase Recovery: An atmosphere of optimism gets start. This leads to further improvement in business activities. Industrial production begins to increase slowly and gradually. The volume of employment also begins to increase steadily. Consequently, production and prices of goods and services begin to show an upward trend. Banks and other financial institutions begin to advance loans and credit to industries which lead to increase the velocity of circulation of money. The process or revival has its commutative effects.

CHAPTER # 16

International or Foreign Trade

Q.1 What are different between domestic and international trade?

Ans: Following area the different aspects of both kinds of trade.

1. Difference of mobility aspects of both kinds of trade.
2. Difference of currencies.
3. Restrictions on trade imposed by different countries.
4. Difference on natural resources.
5. Difference of geographical and climatic conditions.
6. Difference of markets.
7. Problem of balance of payments.

Q.2 What are advantages of international trade?

Ans: Following types of advantages may be gained from international trade.

1. International trade can help a country to get those goods which does not produce it.
2. With the help of international trade, deficiency in domestic production can be met by imports from other countries.
3. Certain countries enjoy relative advantages in the production of some particular goods of raw- material.
4. International trade also helps the under-developed countries to industrialize their economies.
5. International trade also helps in interchanging of goods from one country to another which results in interchanging of ideas too.
6. International trade makes people realize the dependency of one country on other.
7. International trade also helps in increasing total production of different kinds of products of the world.

8. It also helps in increasing employment opportunities.

Q.3 What are disadvantages of International trade?

Ans: International trade causes some disadvantages.

1. International trade is based on competition which usually leads to ruin with cost factor to domestic industries of a developing country.

2. International trade makes some countries dependable upon even for the essential goods o raw- material to be used for manufacture of consumer goods or capital goods. This is not always gods.

3. Some countries exploit their raw-materials for exports.

4. In some cases, the international trade may involve political domination of one country over another.

Q.4 What are terms of trade?

Ans: The rate at which country's goods are exchanged against the gods of other countries is referred to as the Terms of Trade. The terms of trade, in fact, implies the international values of goods. These values depend upon the prices of exports and imports of a country. When the prices of exports of a country are higher as compared to those of its imports. In such a situation, terms of trade are said to be favorable for the country as it's here of gain from the trade will be relatively larger and vice versa.

Q.5 What are causes of disequilibrium in the balance of payments?

Ans: There are a number of factors, which jointly constitute disequilibrium in the balance of payments of a country.

1. Natural factor endowment.

2. Trade cycles pressure within the country.

3. Inflationary pressure within the country.

4. Large scale capital movements.

5. Political instability.

6. Other causes.

Q.6 What measures can be adopted to correct disequilibrium in the balance of payments?

<u>Ans:</u> In order to correct the disequilibrium in the balance of payments a number of measure are needed to be adopted. Some of them are of the following nature.

1. Exports must be promoted and Imports restricted.
2. Devaluation of the home currency may be opted.
3. Policy of deflation or reducing prices must be followed with appropriate measures.
4. Exchange control must be maintained vigoursely.

Q.7 Differentiate between Balance of Trade and Balance of Payment.

<u>Ans:</u> Balance of Trade vs. Balance of Payments: The balance of trade of a country indicates its trade transactions with the rest of world during a certain year. It takes into account only the aggregate value of visible exports and imports. The visible or tangible exports and imports are those tangible items which are actually recorded at the ports. They are in form of goods only; values of services are not included in balance of trade. It is included in balance of trade is said to be favorable to the country. Contrarily, if the money value of imports is greater than the money value of visible exports, the balance of trade is said to be unfavorable for the country.

The balance of payments gives a comprehensive picture of a country. It includes besides the total value of visible exports and imports, also includes various types of invisible exports and imports and non- commodity items. The invisible items are those which are not recorded at the ports. These items are the services rendered by shipping, insurance and banking companies, debt repayment of interest, expenditure done by tourists and pilgrims, payment of dividends on capital invested by foreigner investors. Thus, balance of payments is a wider and more comprehensive concept than the balance of trade. Balance of trade is a part of balance of payments.