PART - A

I.   choose the correct answer   **10x1 = 10**

1. Subjective
2. Marginal Product
3. Monopolistic competition
4. Economic agent
5. Macro economics
6. Medium of exchange
7. Encourages investment
8. Excise duty
9. Gold standard
10. All of the above

II.   Fill in the blanks. By choosing correct answer from the bracket   **5x1 = 5**

11. Average revenue
12. Final
13. RBI
14. Not consumed
15. April 1st to March 31st

III.   Match the following   **5x1 = 5**

16.

a)	Service of teacher	ii) Skill
b)	Normal Profit	iv) Zero Profit
c)	Market equilibrium	v) QD=QS
d)	Balance of Trade	iii) Trade in Goods
e)	Managed Floating	i) Dirty Floating

PART-B

IV.   Answer any NINE of the following questions in four sentences each   **9x2 = 18**

17. Budget line

• It is locus of different combinations of the two goods which the consumer Consumes and whose price exactly Equals his income.

• It is also known as Price line.

Budget Set

• It is a collection of all bundles available to a consumer at the existing price at his given level of income.

• It is also known as opportunity s

18. What do you mean by inferior goods? Give example.

Ans: The inferior goods are those goods for which the demand increases with the fall in income of consumer and vice-versa. That is, there will be a negative relationship between income of consumer and demand for inferior goods. Here the income of consumer and demand move in opposite directions.

Example:

19. What is monotonic preference?

Ans: A consumer's preferences are said to monotonic if and only if between any two bundles, the consumer prefers the bundle which has more of at least one of the goods and no less of the other good as compared to the other bundle.

For instance, the consumer, between any bundles say (x_1, x_2) and (y_1, y_2), if (x_1, x_2) has more of at least one of the goods and no less of the other good compared to (y_1, y_2) then the consumer prefers (x_1, x_2) to (y_1, y_2). This is called monotonic preferences.

Here the consumer will not remain indifferent between two combinations of commodities when he has an opportunity to have more quantity in one combination than the other.

20. Mention two different approaches which explain consumer behaviour.

Ans: The two approaches which explain consumer behaviour are:

a) Cardinal Utility Analysis – Law of Diminishing Marginal Utility

b) Ordinal Utility Analysis – Indifference Curve analysis

21. Mention the two determinants of firms supply curve

1) Technological changes   2) Input price

22. Define equilibrium price and quantity.

Ans: Equilibrium price is the price at which equilibrium is reached in the market.

The equilibrium quantity is defined as the quantity which is bought and sold at equilibrium price.

Therefore price and quantity will be at equilibrium when

$Q_d(p*) = q_s(p*)$

$p*$ denotes the equilibrium price and $Q_d(p*)$ and $q_s(p*)$ denote the market demand and market supply respectively.

23. Write the features of monopoly.

Ans:

• Existence of single seller or firm.

• No close substitutes.

• Barriers on entry of new firms.

• Firm is a Price maker and buyers are price takers.

• Uniform price or price discrimination.

• No difference between firm and industry.

24. State the meaning of average revenue and marginal revenue

Average revenue: Total revenue per unit of production

AR = TR/Q

Marginal revenue: increase in total revenue for a unit

Increase in the firms output.

$\Delta TR/\Delta Q$

25. What are the four factors of production? Mention their rewards.

Ans: The four factors of production are Land, Labour, Capital and Organisation. The rewards of these factors of production are as follows:

• Land gets Rent

• Labour gets wages

• Capital gets Interest.

• Organisation gets profit.

26. Distinguish between stock and flow. Give example.

Ans:

Stock

➢ It is that quantity of economic variable which is measured at a particular point of time.

➢ Example capital, inventory, wealth, foreign exchange reserves etc.

Flow

➢ It refers to that quantity of economic Variable measured over a period of time.

➢ Example net investment, salary, National Income etc.

27. Give the meaning of CRR and SLR.

Ans: **The Cash Reserve Ratio (CRR):** is a certain percentage of bank deposits which a Commercial bank is required to keep as cash reserves with itself.

The Statutory Liquidity Ratio (SLR): refers to the ratio of deposits which the commercial banks have to maintain a certain percentage of their total deposits and time deposits with themselves in the form of liquid assets, as per the directions of RBI.

28. Give the meaning of paradox of thrift.

Ans: As people become thriftier, they end up saving less or same as before in aggregate, known as Paradox of thrift. In other words, If all the people of the economy increase the proportion of income they save, total value of savings in the economy will not increase – it will either decrease or remain unchanged. This result is known as the Paradox of Thrift.

29. Who are free riders? Why are they called so?

Ans: If some users do not pay and it is difficult and sometimes impossible to collect fees for the public good, such non paying users are known as free riders. They are called so because, consumers will not voluntarily pay for what they can get for free and for which there is no exclusive title (ownership) to the property being enjoyed.

30. What is foreign exchange rate?

Ans: Foreign exchange rate is the price of one currency in terms of another currency. It links the currencies of different countries and enables comparison of international costs and prices.

For example, if we need to pay Rs.68 for 1 dollar, then the exchange rate is Rs.68 per dollar.

PART- C

V.   Answer any SEVEN as the following questions in twelve sentences each.   7x4 = 28

31. Write a short on market economy.

Ans: A market economy also known as capitalistic economy is that economy in which the economic decisions are undertaken on the basis of market mechanism by the private entrepreneurs. It functions on demand and supply conditions. In USA, Japan, Australia, UK and other countries we can see Market Economic systems. In market economy, private individuals own the factors of production. Here, the profit is the main goal of business. There is least intervention of Government. Price mechanism plays a major role in market economy. It is a balancing wheel of the market mechanism. Prices coordinate decisions of the producers and consumers. The price is determined by demand and supply in the market. No individual organization or Government is responsible for the production and distribution or pricing of goods. All depend on market mechanism. Regarding basic problems of an economy, the problem of what to produce is solved on the basis of demand and profit. The producers produce those products which bring more income. The problem - how the goods are to be produced is determined by the competition among different entrepreneurs. The select least cost combination of technology so that they can get more returns with less cost. In market economy, the problem

of whom to produce is decided on the basis of purchasing power of consumers. The producers produce commodities to the rich as they can afford to pay more but poorer sections of the society are neglected. In Market economy, profits and losses play a predominant role in growth and development of every producer.

32. **Explain the long run costs.**

Ans: In the long run, all inputs are variable. There are no fixed costs, The total cost and the total variable cost coincide in the long run. There are two types of long run costs. They are as follows:

a) **Long Run Average Cost (LRAC)**: The long run average cost is the cost per unit of output produced. It is obtained by dividing the Total Cost by the output produced. It can be calculated as follows:

$LRAC = TC/q$

Where TC is Total cost and 'q' is quantity of output produced.

b) **Long Run Marginal Cost:** The long run marginal cost is the change in total cost per unit of change in output. When output changes in discrete units, then, if we increase production from q_1-1 to q_1 units of output, the marginal cost of producing q_{1th} unit will be measured as follows:

$LRMC = $ (TC at q_1 units) $-$ (TC at q_1-1 units) or $LRMC = TC_n - TC_{n-1}$

33. Write a short note on profit maximization of a firm under the following conditions

a) **P=MC**   b) **MC must be none decreasing at q_0**

Ans:

A firm always wishes to maximize its profit. The firm would like to identify the quantity q_0, the firm's profits are less than at q_0. For profits to be maximum, the following conditions must hold at q_0.

a) **The price P must equal MC (P = MC):** Profit is the difference between Total Revenue and Total Cost. Both total revenue and total cost increase as output increases. As long as the change in total revenue is greater than the change in total cost, profits will continue to increase.

The change in total revenue per unit increase in output is the marginal revenue and the change in total cost per unit increase in output is the marginal cost. Therefore, we can conclude that as long as marginal revenue is greater than marginal cost, profits are increasing and as long as marginal revenue is less than marginal cost, profits will fall. It follows that for profits to be maximum, marginal revenue should be equal to marginal cost. For the perfectly competitive firm, we have established that the MR=P. So the firm's profit maximizing output becomes the level of output at which P=MC.

b) **Marginal cost must be non-decreasing at q_0:** It means that the marginal cost curve cannot slope downwards at the profit maximizing output level. This can be explained with the help of diagram:
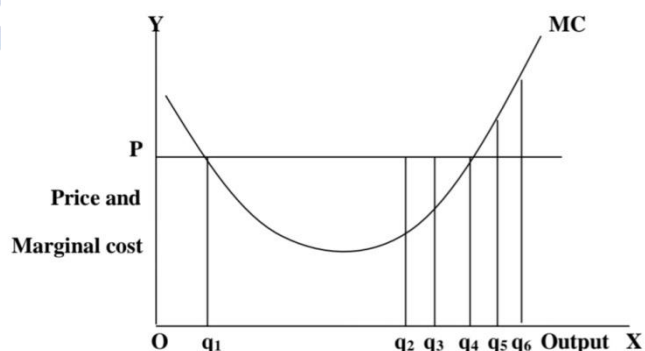
In the above diagram, at output levels q_1 and q_4 the market price is equal to the marginal cost. However, at the output level q_1 the marginal cost curve is downward sloping. The q_1 is not profit maximizing output level. If we observe all output levels left to the q_1 the market price is lower than the marginal cost. But the firm's profit at an output level slightly smaller than q_1 exceeds that corresponding to the output level q_1. Therefore, q_1 cannot be a profit maximizing output level.

34. **Explain the role of the Government (State) and household sector in both developed and developing countries.**

Ans:

Role of Government: In both the developed and developing countries, apart from capitalist sector, there is the institution of State. The role of the state includes framing laws, enforcing them and delivering justice. The State here refers to the Government which performs various developmental functions for the society as whole. It undertakes production, apart from imposing taxes and spending money on building public infrastructure, running schools, providing health services etc. These economic functions of the state have to be taken into account when we want to describe the economy of the country.

Role of Household sector: By household we mean a single individual who takes decisions relating to her own consumption or a group of individuals for whom the decisions relating to consumption are jointly determined. Households consist of people. These people work in firms as workers and earn wages. They are the ones who work in government departments and earn salaries or they are the owners of firms and earn profits. Therefore, the market in which the firms sell their products could not have been functioning without the demand coming from the households. Further, they also earn rent by leasing land or earn interest by lending capital.

34. **Write a note on externalities.**

Ans: An externality is a cost or benefit conferred upon second or third parties as a result of acts of individual production and consumption. But the cost or benefit of an externality cannot be measured in money terms because it is not included in market activities. In other words, Externalities refer to the benefits or harms a firm or an individual causes to another for which they are not paid or penalized. They do not have any market in which they can be bought and sold. There are two types of externalities viz.,
• Positive Externalities and
• Negative Externalities.
For example, let us imagine that there is chemical fertilizer industry. It produces the chemical fertilizers required for agriculture. The output of the industry is taken for counting GDP of an economy. This is positive externality. While carrying out the production the chemical fertilizer industry may also be polluting the nearby river. This may cause harm to the people who use the water of the river. Hence their health will be affected. Pollution also may kill fish and other organisms of the river. As a result, the fishermen of the river may lose their livelihood. Such harmful effects that the industry is inflicting on others, for which it will not bear any cost are called negative externalities.

35. **Illustrate unplanned accumulation and decumulation with an example**

Ans: Change in inventories may be planned or unplanned. In case of unexpected fall in sales, the firm will have unsold stock of goods which it had not anticipated. Hence there will be unplanned accumulation of inventories. If there is unexpected increase in the sales there will be unplanned decumulation of inventories. This can be explained with the help of following illustration: Suppose a firm produces T Shirts. It starts the production year with an inventory of

200 T Shirts. During the coming year it expects to sell 2000 T shirts. Hence, it produces 2000 T shirts, expecting to keep an inventory of 200 T Shirts at the end of the year. However, during the year, the sales of T Shirts became low unexpectedly. The firm is able to sell only 1200 T Shirts. This means that the firm is left with 800 unsold T Shirts. The firm ends the production year with 800 + 200=1000 T shirts. The unexpected increase of inventories by 800 T shirts is an example for unplanned accumulation of inventories. On the other hand, if the sales had been more than 2000 we would have unplanned decumulation of inventories. For instance, if the sales had been 2100, then not only the production of 2000 T shirts will be sold, the firm will have to sell 100 T shirts out of the inventory. This 100 (T shirts) unexpected reduction in inventories is an example of unexpected decumulation of inventories.

36. Briefly explain the functions of RBI.
Ans: The main functions of RBI are as follows:

a) Printing and issuing currency notes-It has complete authority of printing and issuing currency notes in the country. RBI issues all denominations of currency notes (Rs.2, Rs.10, Rs.20, Rs.50, Rs.100, Rs.500 and Rs.2000) except one rupee note, which is issued by finance ministry, Government of India. The minimum reserve system of note issue was followed by RBI after 1956.

b) Lender of last resort: RBI provides financial assistance to commercial banks
like giving credit, discounting bills, giving advances, etc during their financial crisis and helps the banks as a lender of last resort.

c) Controls credit creation activities of commercial banks-The credit provided by all commercial banks is controlled by RBI. RBI implements both Quantitative and qualitative techniques to control the credit generated by commercial banks. The quantitative measures to control credit are Bank rate policy, Open market operations, Repo and Reverse Repo rates, Cash reserve ratio and Statutory liquidity ratio.

d) Controls money market- RBI is the leader of money market. All the activities and components of money market like commercial banks and financial institutions are controlled and directed by RBI.

37. Briefly explain consumption function.
Ans: The consumers demand can be expressed by the equation $C = \hat{C} + cY$, where $\hat{C}$ is autonomous expenditure and c is the marginal propensity to consume. The consumption function can be shown as follows:
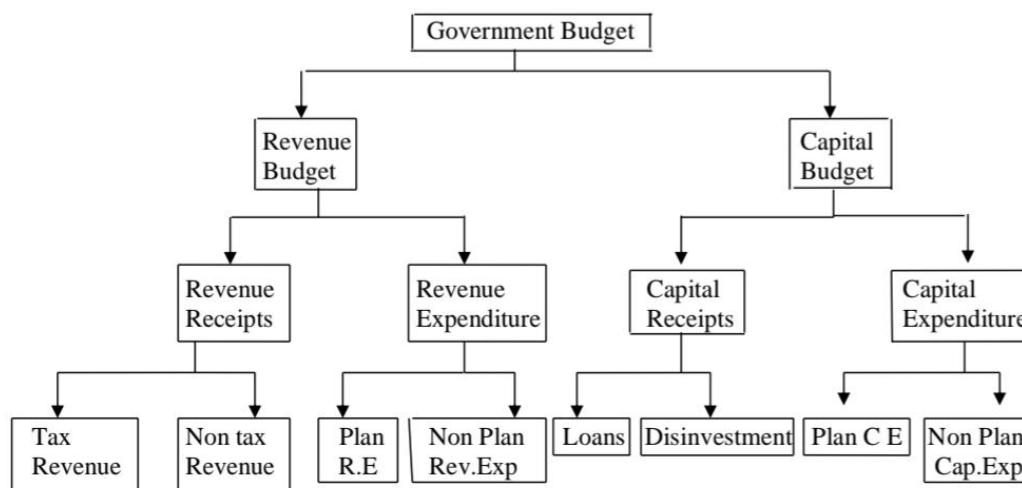
The consumption function can be graphically expressed as follows:
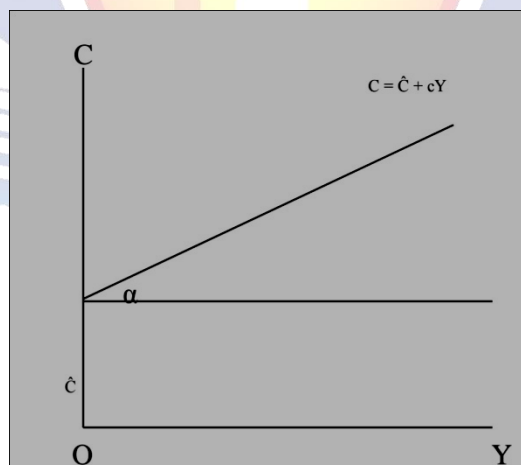
In the above diagram $\hat{C}$ is the intercept of the consumption. 'c' is slope of consumption function equals α.

38. Write the chart of the Government budget.

Ans: The chart of Government Budget is represented as follows:

```
                          ┌──────────────────┐
                          │ Government Budget │
                          └──────────────────┘
                    ┌───────────┴────────────┐
              ┌──────────┐              ┌──────────┐
              │ Revenue  │              │ Capital  │
              │ Budget   │              │ Budget   │
              └──────────┘              └──────────┘
           ┌──────┴──────┐          ┌──────┴──────┐
     ┌──────────┐ ┌──────────────┐ ┌──────────┐ ┌──────────────┐
     │ Revenue  │ │ Revenue      │ │ Capital  │ │ Capital      │
     │ Receipts │ │ Expenditure  │ │ Receipts │ │ Expenditure  │
     └──────────┘ └──────────────┘ └──────────┘ └──────────────┘
      ┌────┴────┐   ┌────┴────┐    ┌────┴────┐   ┌────┴────┐
  ┌───────┐┌────────┐┌──────┐┌──────────┐┌─────┐┌──────────────┐┌─────────┐┌──────────┐
  │ Tax   ││Non tax ││ Plan ││ Non Plan ││Loans││ Disinvestment││Plan C E ││Non Plan  │
  │Revenue││Revenue ││ R.E  ││ Rev.Exp  │└─────┘└──────────────┘└─────────┘│Cap.Exp   │
  └───────┘└────────┘└──────┘└──────────┘                                   └──────────┘
```

39. Does public debt impose a burden? Explain.

Ans: There are two interlinked aspects of perspectives on the appropriate amount of Government Debt. One is whether government debt is a burden and the other is the issue of financing the debt. The burden of debt can be discussed by keeping in mind that what is true for an individual debt may not be true for the government's debt. Unlike any one individual, the government can raise resources through taxation and other means. The government, by borrowing, transfers the burden of reduced consumption on future generations. This is because it borrows by issuing indemnity bonds to the people living at present but may decide to pay off the bonds 10 years later by raising taxes. The tax may be levied on the young population that has just entered the work force, whose disposable income will go down and hence consumption. Thus, national savings would fall. Further, government borrowing from the people reduces the savings available to the private sector. Therefore, to the extent of the reduction in capital formation and growth, debt acts as a burden on future generations. Traditionally, it has been argued that when a government reduces taxation and runs a budget deficit, consumers respond to their after-tax income by spending more. It is possible that these people are short sighted and do not understand the implications of budget deficits. They may not realize that at some point in the future the government will have to raise taxes to pay off the debt and accumulated interest. It has been often argued that debt does not matter because we owe it to ourselves. This is because although there is a transfer of resources between generations, purchasing power remains within the nation. However, any debt received from foreign sources involves burden since we need to export goods abroad to make interest payments.

40. Write a note on balance of trade.

Ans: Balance of trade is the difference between the value of exports and value of imports of goods of a country in a given period of time. Export of goods is entered as a credit item in balance of trade. Import of goods is entered as a debit item in balance of trade. It is also called as Trade balance. Balance of trade is said to be in balance when exports of goods are equal to the imports of goods i.e., balanced balance of trade. Surplus balance of trade arises if country's exports of goods are more than its imports. Deficit balance of trade arises if a country's imports

of goods are more than its exports. Balance of trade is narrow concept and it may not show the international economic position of an economy. It gives partial picture of international transactions and it is less reliable. It does not include net invisibles i.e., the difference between the value of exports and value of imports of invisibles (services) of a country in a given period of time.

PART-D

VI.   Answer any FOUR of the following questions in twenty sentences each.   **4x6 = 24**

41. Explain the features of Indifference curves with the help of diagrams.

Ans: The main features of Indifference curves are as follows:

a) **Indifference curve slopes downwards from left to right:** An indifference curve slopes downwards from left to right because, the consumer in order to have more of one product, he has to forego some units of other product. This can be explained with the help of diagram.
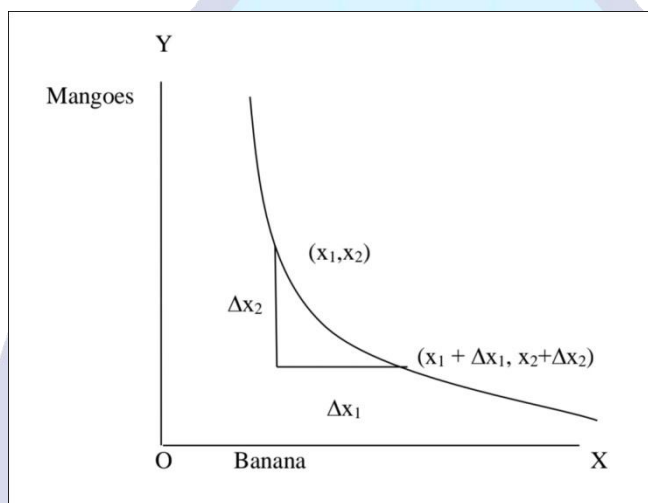
Thus, according to above diagram, as long as the consumer is on the same indifference curve, an increase in bananas must be compensated by a fall in quantity of mangoes. That means, an increase in the amount of bananas along the indifference curve is associated with a decrease in the amount of mangoes.

b) **Higher indifference curve gives greater level of utility:** As long as marginal utility of a commodity is positive, a consumer always prefers more of that commodity to increase his level of satisfaction. This can be explained with the help of table and a diagram:

Combination	Banana	Mango
A	1	10
B	2	10
C	3	10
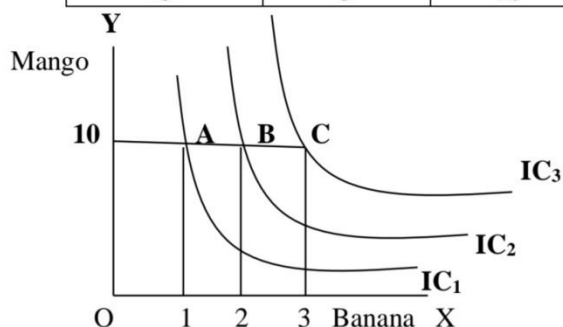
Let us consider the different combinations of two goods bananas and mangoes A, B and C in the above table and diagram. All the three combinations consist of same quantity of mangoes but different quantities of bananas. As combination B has more bananas than A, B will provide the consumer higher level of satisfaction than A. Therefore, B will lie on higher indifference curve. Similarly,C has more bananas than B and therefore C will provide higher level of satisfaction than B and also lie on higher indifference curve than B.Thus higher indifference curves give greater level of utility.

c) **Two indifference curves never intersect each other:** If the two indifference curves intersect each other, they will give conflicting results. This can be explained with the help of diagram.
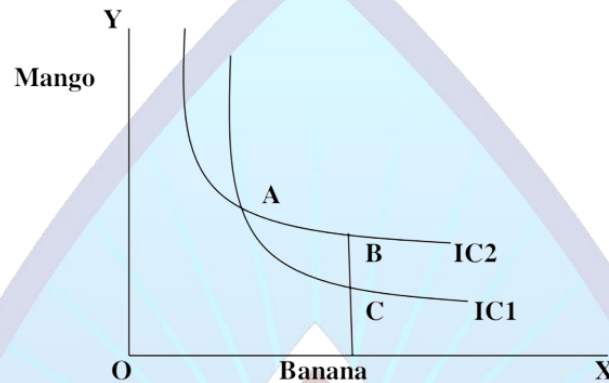

In the above diagram the two indifference curves have intersected with each other. As points A and B lie on IC2, utilities derived from A and B are same. Similarly, as points A and C lie on the same indifference curve IC1, the utilities are same. From this, it follows that utility from point B and C are same. But this is clearly an absurd result as on B, the consumer gets a greater number of mangoes with the same quantity of bananas. So the consumer is better off at point B than at Point C. Thus, it is clear that intersecting indifference curves will lead to conflicting results. Thus, two indifference curves cannot intersect each other.

42. **Explain market supply curve with the help of a diagram.**
    Ans: The market supply curve shows the output levels that firms in the market produce in aggregate corresponding to different values of the market price.
    For example, there are firm 1, firm 2, firm3 in the market. Suppose the price is fixed at p. Then the output produced by these firms in aggregate will be supply of firm 1 + supply of firm 2 + supply of firm 3. So, the market supply at price p is the summation of the supplies of individual firms at that price. The supply curve geometrically with two firms in the market i.e., firm 1 and firm 2 is given below. The two firms have different cost structures. Firm 1 will not produce anything if the market price is less than P_1 while firm 2 will not produce anything if the market price is less than P_2. This can be represented in the diagram:
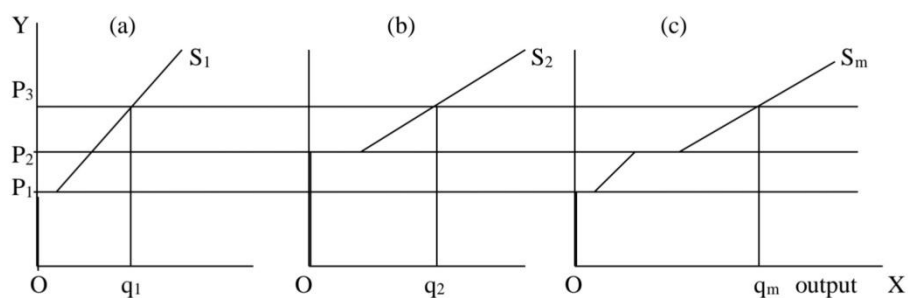
In the above diagram, output is measured in X axis and Price is measured in Y axis. The diagram (a) is the supply curve of firm 1 (S_1), diagram (b) is the supply curve of firm 2 (S_2) and the diagram (c) is the market supply curve (S_m). When the market price is below P_1, both the firms do not produce the goods. Hence the market supply will be zero. If the market price is greater than or equal to P_1, but less than P_2, only firm 1 will produce the goods. In this range, the market supply curve coincides with the supply curve of firm 1. If the market price is greater than or equal P_2, both firms will have positive output levels. If the price is P_3, the firm 1 will supply q_1 units of output and firm 2 supplies q_2 units of output. So, the market supply at price P_3 is q_m, where $q_m = q_1 + q_2$. The market supply curve S_m is obtained by taking a horizontal summation of the supply curves of the two firms in the market S_1 and S_2.

43. Suppose the demand and supply curves of wheat are given by $q_D=200-P$ and $q_S=120+P$
   a) Find the equilibrium price
   b) Find the equilibrium quantity of demand and supply
   c) Find the quantity of demand and supply when P is greater than equilibrium price
   d) Find the quantity of demand and supply when P is lesser than equilibrium price.

a) $q^D = q^S$

$200-P = 120+P$

$2P = 200-120$

$2P = 80$

$\boxed{P = 40}$

∴ The equilibrium price is 40

b) $200-P = 120+P$

$200-40 = 120+40$

$\boxed{160 = 160}$

∴ The equilibrium quantity of demand and supply is 160

c) P > Equilibrium price

$200-P = 120+P$

$200-45 = 120+45$

$\boxed{155 = 165}$

∴ When the price is greater than equilibrium price there is excess supply situation.

a) $q^D = q^S$

$\quad 200 - p = 120 + p$

$\quad 2p = 200 - 120$

$\quad 2p = 80$

$\quad \boxed{p = 40}$

$\therefore$ The equilibrium price is 40

b) $\quad 200 - p = 120 + p$

$\quad 200 - 40 = 120 + 40$

$\quad \boxed{160 = 160}$

$\therefore$ The equilibrium quantity of demand and supply is 160

c) P > Equilibrium price

$\quad 200 - p = 120 + p$

$\quad 200 - 45 = 120 + 45$

$\quad \boxed{155 = 165}$

$\therefore$ When the price is greater than equilibrium price there is excess supply situation.

d) P < Equilibrium price

$\quad 200 - p = 120 + p$

$\quad 200 - 35 = 120 + 35$

$\quad \boxed{165 = 155}$

$\therefore$ When the price is less than equilibrium price there will be excess demand situation

44. Explain the short run equilibrium of a monopoly firm with the help of the simple case of zero cost.

Ans: Every monopolist aims at maximizing profit. Here, we try to analyze the profit maximizing behaviour to determine the quantity produced by a monopoly firm and price at which it is sold.

Let us imagine that there exists a village situated far way from other villages. In this village, there is exactly one well from which water is available. All residents are completely dependent for their water requirements on this well. The well is owned by one person who is able to prevent others from drawing water from it except through purchase of water. The person who purchases the water has to draw the water out of the well. The well owner is thus a monopolist firm which bears zero cost in producing the good. We shall analyse this simple case of a monopolist bearing zero costs to determine the amount of water sold and the price at which it is sold.

The short run equilibrium of the monopolist with zero cost can be explained with the help of the following diagram:
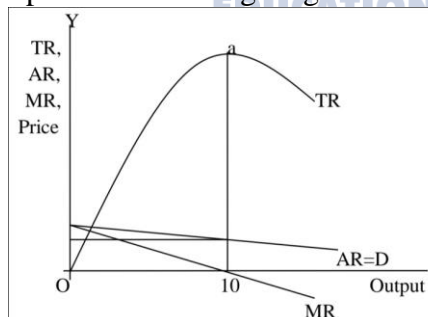
In the above diagram, TR, AR and MR curves are revenue curves. The profit received by the firm equal the revenue received by the firm minus the cost incurred. Since TC is zero, profit is maximum when TR is maximum. This occurs when output is of 10 units. This is the level when MR equals zero. The amount of profit is given the length of the vertical line segment from 'a' to the horizontal axis.

45. **Explain the macroeconomic identities.**

Ans: The macroeconomic identities are as follows:

a) **Gross Domestic Product (GDP):** Gross Domestic Product measures the aggregate Production of final goods and services taking place within the domestic economy during a year. But the whole of it may not accrue to the citizens of the country. It includes GDP at Market prices and GDP at Factor cost.

GDP at market price is the market value of all final goods and services produced within a domestic territory of a country measured in a year. Here everything is valued at market prices. It is obtained as follows:

$GDP_{MP} = C + I + G + X - M$

GDP at factor cost is gross domestic product at market prices minus net indirect taxes. It measures money value of output produced by the firms within the domestic boundaries of a country in a year.

$GDP_{FC} = GDP_{MP} - NIT$.

b) Gross National Product: It refers to all the economic output produced by a nation's normal residents, whether they are located within the national boundary or abroad. It is defined as GDP plus factor income earned by the domestic factors of production employed in the rest of the world minus factor income earned by the factors of production of the rest of the world employed in the domestic economy. Therefore,

GNP = GDP + Net factor income from abroad

c) Net National Product (NNP): A part of the capital gets consumed during the year due to wear and tear. This wear and tear is called depreciation. If we deduct depreciation from GNP the measure of aggregate income that we obtain is called Net National Product. We get the value of NNP evaluated at market prices. So,

NNP = GNP – Depreciation

d) **Net National Product (NNP) at factor cost:** The NNP at factor is the sum of income earned by all factors in the production in the form of wages, profits, rent and interest etc., belong to a country during a year. It is also known as National income. We need to add subsidies to NNP and deduct indirect taxes from NNP to obtain NNP at factor cost.

NNP_{FC} = NNP at market prices – indirect taxes + subsidies.

e) **Personal Income (PI):** It refers to the part of National income (NI) which is received by households. It is obtained as follows:

PI = NI – Undistributed Profits – Net interest payments made by the households – Corporate tax + Transfer payments to the households from the Government and firms.

f) **Personal Disposable Income (PDI):** If we deduct the personal tax payments (income tax) and Non-tax payments (fines, fees) from Personal Income, we get PDI. Therefore,

PDI = PI – Personal tax payments – Non-tax payments.

46. **Explain the functions of money?. How does money overcome the short comings of a barter system?**

Ans: The functions of Money are broadly classified as follows:
• Primary Functions
• Secondary Functions
• Contingent Functions

I Primary Functions:

The primary functions of money are as follows:

e) Medium of Exchange: Money plays an important role as a medium of exchange. It facilitates exchange of goods for money. It has solved the problems of barter system. Barter exchanges become extremely difficult in a large economy because of the high costs people would have to incur looking for suitable persons to exchange their surpluses. It helps the people to sell in one place and buy in another place. Money has widened the scope of market transactions. Money has become a circulating material between buyers and sellers.

f) Measure of Value/Unit of account: The money acts as a common measure of value. The values of all goods and services can be expressed in terms of money. As a measure of value, money performs following functions:

• The value of all goods and services measured and expressed in terms of the money.

• Rate of exchange of goods and services expressed in money.

• Facilitates the maintenance of accounts.

• It facilitates price mechanism.

• It makes goods and services comparable in terms of price.

For instance, when we say that the value of a book is Rs.500 we mean that the book can be exchanged for 500 units of money where a unit of money is rupee in this case. If the price of a pencil is Rs.5 and that of a pen is Rs.10 we can calculate the relative price of a pen with respect to a pencil i.e., a pen is worth 10/5=2 pencils.

II Secondary Functions: The secondary functions of money are as follows:

a) Store of value: People can save part of their present income and hold the same for future. Money can be stored for precautionary motives needed to overcome financial stringencies. Money solves one of the deficiencies of barter system i.e., difficulty to carry forward one's wealth under the barter system. For instance, we have an endowment of wheat which we do not wish to consume today entirely. We may regard this stock of surplus wheat as an asset which we may wish to consume or even sell off, for acquiring other commodities at some future date. But wheat is a perishable item and cannot be stored beyond a certain period. Also, holding the stock of rice required a lot of space. We may have to spend considerable time and resources looking for people with a demand for wheat when we wish to exchange our stock for buying other commodities. This problem can be solved if we sell our wheat for money. Money is not perishable land its storage costs are also less.

b) Standard of deferred payments: All the credit transactions are expressed in terms of money. The payment can be delayed or postponed. So, money can be used for delayed settlement of dues or financial commitments.

c) Transfer of value: Money acts as a transfer of value from person to person and from place to place. As a transfer of value, money helps us to buy goods, properties or anything from any part of the country or the world. Further, money earned in different places can be brought or transferred to anywhere in the world.

III Contingent Functions of Money: Other than Primary and Secondary functions, money also performs other functions which are as follows:

a) Basis of Credit: Money serves as a basis of the credit. The modern credit system exists only because of existence of money.

b) Distribution of National Income: Money helps in distribution of national income.

The reward paid to factors of production in the form of rent, wages, interest and profit are nothing but the distribution of National Income at factor prices.

c) Provides Liquidity and Uniformity: Money provides liquidity to all kinds of assets both moveable and immovable. Money can be converted into any type of asset and all assets can be converted into money.

d) Helps in consumers' and producers' equilibrium: All goods and services are expressed in terms of money. The consumer attains equilibrium when the price of a product is equal to his marginal utility. Similarly, the producers reach equilibrium if they get maximum satisfaction. Both consumers and producers try to achieve equilibrium with the help of money.

47. Write a short note on the gold standard.

Ans: The gold standard was prevailing from 1870 to 1914. All currencies were defined in terms of gold; indeed some were actually made of gold. Each participant country committed to guarantee the free convertibility of its currency into gold lat a fixed price. That means a domestic currency which was free convertible at fixed price into another asset acceptable in international payments. This also made it possible for each currency to be convertible into all others at a fixed price.

Exchange rates were determined by its worth in terms of gold. For example, if one unit currency A was worth one gram of gold, one unit of currency B was worth two grams of gold, currency B would be worth twice as much as currency A. Economic agents could directly convert one unit of currency B

into two units of currency A, without having to first buy gold and then sell it. The rates would fluctuate between an upper and a lower limit, these limits being set by the costs of melting, shipping and recoining between the two currencies. To maintain the official parity each country needed an adequate stock of gold reserves. All countries on the gold standard had stable exchange rates. Many problems caused the gold standard to break down periodically. Moreover, world price levels were at the mercy of gold discoveries. This can be explained by looking at the crude quantity theory of money, M=kPY, according to which, if output (GNP) increased at the rate of 4 percent per year, the gold supply would have to increase by 4 percent per year to keep prices stable. With mines not producing this much gold, price levels were falling all over the world in the late 19th century, giving rise to social unrest. For a period, silver supplemented gold introducing 'bi-metallism'. Also, fractional reserve banking helped to economize on gold. Paper currency was not entirely backed by gold; typically countries held one-fourth gold against its paper currency.

PART - E

VII. Answer any TWO of the following project and assignment oriented questions   2x5 = 10

49. A consumer wants to consume two goods. The Price of bananas is Rs.4 and price of mangoes is Rs.5. The consumer income is Rs.20.

    a) How much bananas can she consume if she spend her entire income on that good

    b) How much mangoes can she consume if she spend her entire income on that good

    c) Is the slope of budget line is downward or upward

    d) Are the bundles on the budget line equal to the consumers' income or not

    e) **If you want to have more of banana you have to give up mangoes. Is it true?**

    Ans: (a) 8 Bananas (40/5)

        (b) 4 Mangoes (40/10)

        (c) Slope of budget line is downward.

        (d) Yes, the bundles on the budget line are equal to the consumer's income.

        (e) True. If we want to have more of banana we have to give up mangoes.

50. Find the missing products of the following table.

Factor 1	TP	MP$_1$	AP$_1$
0	0	0	0
1	10	-	10
2	24	-	12
3	40	16	13.33
4	-	10	-
5	-	6	11.2
6	57	1	9.5

Ans:

Factor 1	TP	MP$_1$	AP$_1$
0	0	0	0
1	10	**10**	10
2	24	**14**	12
3	40	16	13.33
4	**50**	10	**12.5**
5	**56**	6	11.2
6	57	1	9.5

51. Name the currencies of any five countries of the following

   USA, UK, Germany, Japan, China, Argentina, UAE, Bangladesh, Russia

Countries	Currency
USA	US dollars
UK	British Pound
Germany	Euro
Japan	Japanese Yen
China	Chinese yuan
Argentina	Argentine peso
UAE	UAE dirham
Bangladesh	Bangladeshi taka
Russia	Russian Ruble

****

DEPARTMENT OF ECONOMICS

> Mr. Mahesh K N
> Mr. Umesh

www.creativeedu.in