# OCTOBER - 2016

[Time : 3 hours] **ECONOMICS [XII] (With key)** [Marks : 200]

## PART - A

**Note :** Answer **all** the questions.

**I.** Choose the **correct** answer **14 × 1 = 14**

1. The concept of Net Economic Welfare has been given by :
   (*a*) Samuelson (*b*) Alfred Marshall
   (*c*) Adam Smith (*d*) Lionel Robbins
2. Traditional economy is a :
   (*a*) Subsistence economy
   (*b*) Market economy
   (*c*) Command economy
   (*d*) Monetary economy
3. Utility is a :
   (*a*) Social concept
   (*b*) Subjective/Psychological concept
   (*c*) Political concept
   (*d*) Scientific concept
4. Law of Demand establishes :
   (*a*) Inverse relationship between Price and Quantity
   (*b*) Positive relationship between Price and Quantity
   (*c*) Both
   (*d*) None
5. The degree of response of demand to change in price is :
   (*a*) Income elasticity of demand
   (*b*) Cross-elasticity of demand
   (*c*) Price elasticity of demand
   (*d*) All the above
6. At the point of equilibrium :
   (*a*) Only one price prevails
   (*b*) Quantity demanded = Quantity supplied
   (*c*) The demand curve intersects the supply curve
   (*d*) All the above
7. Production refers to :
   (*a*) Destruction of utility
   (*b*) Creation of utilities
   (*c*) Exchange value
   (*d*) None
8. Real cost is :
   (*a*) Pain and Sacrifice
   (*b*) Subjective Concept
   (*c*) Efforts and Foregoing leisure
   (*d*) All the above
9. Most important form of selling cost is :
   (*a*) Advertisement (*b*) Sales
   (*c*) Homogeneous Product
   (*d*) None
10. The author of the concept of quasi-rent is :
    (*a*) Adam Smith (*b*) Marshall
    (*c*) Ricardo (*d*) Samuelson
11. The macro economic thinking was revolutionized by :
    (*a*) David Ricardo (*b*) J.M. Keynes
    (*c*) Adam Smith (*d*) Malthus
12. The Central problem in macro economics is:
    (*a*) Income and employment
    (*b*) Price and output
    (*c*) Interest and Money
    (*d*) None

13. Currency with the public is known as :
(*a*) $M_1$ (*b*) $M_2$ (*c*) $M_3$ (*d*) $M_4$

14. In ZBB every year is considered as a :
(*a*) Base year (*b*) Financial year
(*c*) New year (*d*) Academic year

**II.** Fill in the blanks with suitable answers : **12 × 1 = 12**

15. Economics is a _____ Science.

16. Production possibility curve is also known as _____.

17. _____ means using up of goods and services.

18. Goods that are demanded for their social prestige come under _____ effect.

19. Modern economists divide time periods into _____ and _____.

20. "An enquiry into the nature and causes of wealth of nations" was written by _____.

21. Total cost is the sum _____.

22. Firms realize the importance of _____ under oligopoly.

23. Money wages are also known as _____ wages.

24. The magnified effect of initial investment on income is called _____ effect.

25. Deflation is a period marked by _____ prices.

26. The classification of direct and indirect taxes is based on criterion of _____ tax.

**III.** Match the following : **12 × 1 = 12**

| | | | |
|---|---|---|---|
| 27. | Polis | (a) | Walker |
| 28. | Opportunity Cost | (b) | Ragi, bajra |
| 29. | Principles of Economics | (c) | Planning curve |
| 30. | Giffen paradox | (d) | D > S |
| 31. | Excess demand | (e) | Gold and Silver |
| 32. | a + b >1 | (f) | State |
| 33. | The long run average cost curve | (g) | C + S |
| 34. | Global market | (h) | Increasing returns to scale |
| 35. | Residual claimant theroy | (i) | Bank rate |
| 36. | Y | (j) | Revenue and expenditure are equal |
| 37. | Quantitative credit control | (k) | Next alternative forgone. |
| 38. | Balanced Budget | (l) | Marshall |

**IV.** Answer each of the following questions in a **word** or **two** : **12 × 1 = 12**

39. What are the subjects that econometrics make use of?

40. Is traditional economy a subsistence economy?

41. What is the other name for the law of equi-marginal utility?

42. Give the formula for point method.

43. Who has introduced the time element?

44. What is the other name for Isoquant?

45. What is break-even point?

46. In which year the MRTP Act was passed?

47. According to Ricardo, do all lands get rent?

48. Give the formula for Multiplier

49. What is the other name for $M_1$?

50. What are the main kinds of Budget?

## PART - B

V. ***Note :*** (i) Answer **any ten** of the following questions. **10 × 3 = 30**

(ii) Answer for each question should be about **four** or **five** lines.

51. Distinguish between free goods and economic goods?
52. List The basic features of socialism?
53. Is India a Mixed Economy? Explain.
54. What are the properties of Indifference curve?
55. What is demand?
56. Differentiate the short period from the long period?
57. Write a short note on market period?
58. Define Labour?
59. What is production function and what are its classification?
60. Define opportunity cost.
61. Define marginal cost.
62. What is standard of living theory of wages?
63. What is effective demand?
64. Define Money.
65. What is the subject matter of Public Finance?

## PART - C

VI. ***Note :*** (i) Answer **any six** of the following questions.

(ii) Answer for each question should be about **a page**. **6 × 10 = 60**

66. Explain the salient features of capitalism?
67. Explain the shift in demand curve with the help of a diagram.
68. What are the functions of entrepreneur?
69. Give a note on Long-Run Average Cost Curve.
70. Explain the relationship between SAC and SMC.
71. What are the methods of controlling Monopoly?
72. What are the Criticisms of Say's Law?
73. What are the assumptions of Keynes' Simple Income Determination?
74. Explain the canons of taxation.
75. Define Budget. Explain the balanced and unbalanced budget?

## PART - D

VII. ***Note :*** (i) Answer **any three** of the following questions.

(ii) Answer for each question should be about **three** pages.

**3 × 20 = 60**

76. Discuss the relationship between economics and other Social Sciences?
77. Describe the Law of Diminishing Marginal Utility with a Diagram.
78. Discuss the Law of demand.
79. Explain the price and output determination under monopolistic competition.
80. Discuss Keynesian theory of interest.
81. Discuss the objectives and instruments of Monetary Policy?

## ANSWERS

**I.** 1. (a) 2. (a) 3. (b)
4. (a) 5. (c) 6. (d)
7. (b) 8. (d) 9. (a)
10. (b) 11. (b) 12. (a)
13. (a) 14. (c)

**II.** 15. Social
16. Transformation/Production Possibility Frontier
17. Consumption
18. Veblen effect
19. Short period and long period
20. Adam Smith
21. total fixed cost and total variable cost
22. Mutual co-operation
23. Nominal
24. Multiplier
25. falling
26. Shifting of the incidence

**III.** 27. (f) 28. (k) 29. (l)
30. (b) 31. (d) 32. (h)
33. (c) 34. (e) 35. (a)
36. (g) 37. (i) 38. (j)

**IV.** 39. Statistics, mathematics, economics
40. Yes
41. Gossen's second law
42. $\left[ ep = \frac{\text{lower segment of the demand curve}}{\text{upper segment of the demand curve}} \right]$
43. Alfred Marshall
44. Iso - product curve
45. No-profit no-loss point
46. 1969
47. No
48. $\left[ k = \frac{1}{1 - MPC} \right]$
49. Narrow money
50. Balanced and unbalanced budget

## PART - B

**V.**

51.

| Free Goods | Economic Goods |
|---|---|
| (i) free gift of nature | (i) Goods which have money value. |
| (ii) Abundantly available in nature | (ii) Scarce in nature |
| (iii) Has no market value | (iii) Has market value |
| (iv) Eg: Air, Sunshine etc. | (iv) Table, chair etc. |

52. 1. Limited right to private property
2. Central planning Authority
3. Social welfare Motive
4. No Market forces

53. 1. Yes, India is a mixed economy
2. co-existence of public and private sector
3. Both public and private institutions exercise economic control

54. • Slope downwards to the right.
• Convex to the origin.
• No two Indifference curves can ever cut each other.

55. • Demand for a commodity refers to the desire backed by ability to pay and willingness to buy it.
• If a person below poverty line wants to buy a car, it is only a desire but if a rich man wants to buy a car it is demand.
• Thus, desire backed by purchasing power is demand.

56.

| Short period | Long period |
|---|---|
| (a) Short period at least one factor is fixed | (a) Long period all the factors are variable |
| (b) Supply is inelastic | (b) Supply is more elastic |
| (c) Demand determines the price | (c) Supply determines the price |

57. ♦ Market period is otherwise known as very short period.
    ♦ Supply is fixed.
    ♦ It is a period of one hour one day or a month.
    ♦ Perishable goods like flowers, fruits and vegetables are good example for market period.

58. Marshall defines Labour as "the use or exertion of body or mind, partly or wholly with a view to secure an income apart, from the pleasure derived from the work."

59. ♦ The functional relationship between inputs and outputs is known as production function.

    **Classification:**
    ♦ Short run – Law of variable proportions
    ♦ Long run – Returns to scale
    ♦ Who is an entrepreneur

60. The opportunity cost of an actions the value of next best alternative forgone the consideration of opportunity cost is one of the key differences between the concepts of "economic cost" and "accounting cost".

61. ♦ Marginal cost is defined as the addition made to the total cost by the production of one additional unit of output.

$$\boxed{MC_n = TC_n - TC_{n-1}}$$

    ♦ $MC_n$ = Marginal cost $TC_n$ = Total cost of producing n units
    ♦ Marginal cost curve is 'U' shaped.

62. This theory tells that wages depend upon the standard of living of workers. The standard of living of workers in a country depends upon the real wages.

63. ♦ All the demand are not effective.
    ♦ Effective demand is the ability and willingness to spend by individuals, firms and government.
    ♦ Effective demand is that point where the ADF and ASF are equal.

64. Walker has said "Money is that which money does".

65. 1. Public expenditure
    2. Public Revenue
    3. Public debt
    4. Financial administration and
    5. Federal finance

## PART - C

**VI.**

66. **The salient features of capitalism are.**

**Right to Private Property :**
1. Individual have the right to buy a own property.
2. There is no limit to have any amount of property.
3. They also have legal rights to use their property.

**Profit-Motive :**
1. profit is the only motive of capitalist economy.
2. Production decisions involving high risks are taken by individual only for profit motive.

**Freedom of Choice :**
1. The question what to produce? Will be determined by the producers.
2. They have freedom to decide.
3. Consumers have the freedom to buy anything they want.

**Market Forces :**
1. Like demand, supply and price are the signals to direct the system.

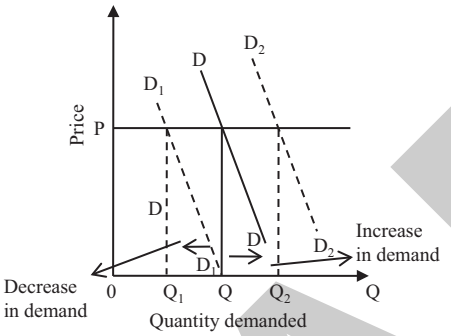
2. Most of the economic activities are centered on price mechanism

**Minimum Role of the Government :**

1. Basic economic problems are solved by market forces.
2. The role of the government will be limited to some important functions like defence foreign policy, currency regulation of market etc.

67. **Shift in demand:**
    1. One of the basic assumption of economic theory is 'other things being equal'.
    2. When there is a change in other factors demand curve itself shifts its position.

**Shift in demand**




OP = Price

OQ = Quantity of demand

- The increase in demand is shown by the shifts of the demand curve to right from DD to $D_2D_2$.
- The decrease in demand is shown by the shift to the left from DD to $D_1D_1$.
- The increase and decrease in demand are shifts in the demand curves.

68. **Identifying Profitable Investible opportunities:**
    - Conceiving a new and most promising and profitable idea or capturing a new idea available in the market.

**Deciding the size of unit of production**

- An entrepreneur has to decide the size of the unit – whether big or small depending upon the nature of the product.

**Deciding the location of the production unit:**

- A rational entrepreneur will always locate his unit of production nearer to both factor market and the end use market.

**Identifying the optimum combination of factors of production**

- He decides in what combinations he should combine these factors so that maximum output is produced at minimum cost.

**Making innovations:**

- According to Schumpeter, basically an entrepreneur is an innovator of new markets and new techniques of production.

**Deciding the reward payment**

- The factors used in production have to be rewarded on the basis of their productivity.
- Reward is the crucial function of an entrepreneur.

**Taking Risks and facing uncertainties:**

- According to Hawley, a business is nothing but a bundle of risks.
- One who is ready to accept risk becomes a successful entrepreneur.
- According to Knight one of the important functions of entrepreneur is uncertainty bearing.

69. **Long run average cost curve:**
    (i) In the long run all factors are variable
    (ii) Therefore the firm can change the size of the plant (Capital equipment, machinery etc) to meet the changes in demand.
    (iii) A long-run average cost curve depicts the functional relationship between output and the long run cost of production.
    - SAC, is relevant for a small size plant, $SAC_2$ for a medium size plant and $SAC_3$ for a large size plant.

- In the short period, when the output demanded is OA, the firm will chose the smallest size plant.
- Output beyond OB, the firm will choose medium size plant as the average cost of small size plant is higher for the same output (JC > KC)
- For output beyond OD, the firm will choose large size plant $SAC_3$.
- The long-run cost of production is the least possible cost of production of any given level of output.
- The long run average cost curve is called 'planning curve', or 'envelope curve' or 'group of short-run average cost curve'.

**Long-run average cost curve:**

**Figure - 1**

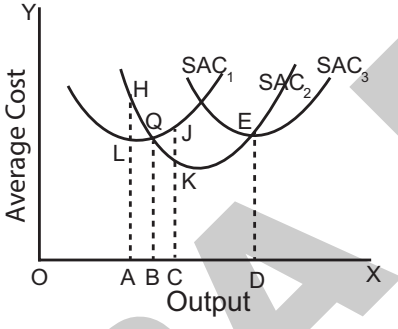
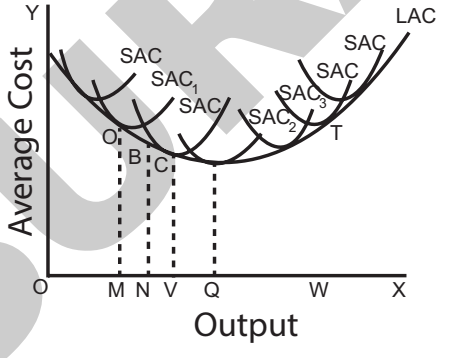


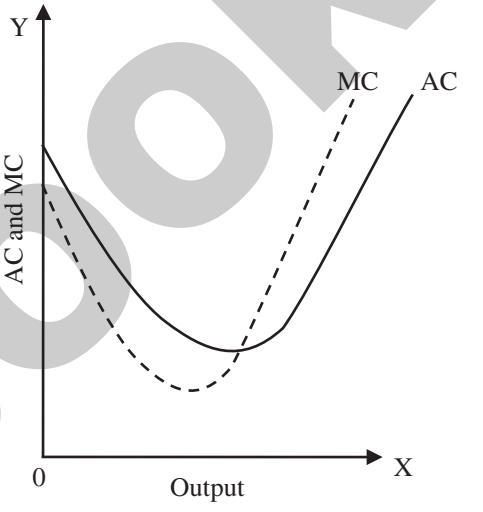

**Figure - 2**




70. **Relationship between short-run average and short run marginal cost curves:-**
    - The relationship between the marginal and the average cost is more a mathematical one rather than economic.

**The Relationship can be given as follows:**

1. When marginal cost is less than average cost, average cost is falling.
2. When marginal cost is greater than the average cost, average cost is rising.
3. The marginal cost curve must cut the average cost curve AC's minimum point from below. Thus at the minimum point of AC, MC is equal to AC




71. **Methods of Controlling Monopoly :**

**A. Legislative Method:**

1. Government can control monopolies by legal actions.
2. Anti-monopoly legislation has been enacted to check the growth of monopoly.
3. In India, the Monopolies and Restrictive Trade Practices Act was passed in 1969.
4. This act is to prevent the unwanted growth of private monopolies and concentration of economic power in the hands of a small number of individuals and families.

**B. Controlling price and output:**

1. This method can be applied in the case of natural monopolies.
2. Government would fix either price or output or both.

**C. Taxation:**

1. Taxation is another method by which the monopolistic power can be prevented or restricted.
2. Government can impose a lump-sum tax on a monopoly firm, irrespective of its level of output.

**D. Nationalisation:**

1. Nationalisation big companies in one of the solutions.
2. Government may take over such monopolistic companies, which are exploiting the consumers.

**E. Consumer's Association:**

1. The growth of monopoly power can also be controlled by encouraging the formation of consumers associations to improve the bargaining power of consumers.

72. **Criticism of Say's Law:-**

**The main points of criticism of the law are:**

1. Great Depression made Say's law unpopular.
2. All incomes earned are not always spend on consumption.
3. Similarly whatever is saved is not automatically invested.
4. The law was based on wrong analysis of market.
5. It suffers from the fallacy of aggregation.
6. Aggregate supply and aggregate demand are not always equal.
7. Rate of interest is not the equilibrating factor.
8. Capitalist system is not self-adjusting always.
9. Perfect competition is an unrealistic assumption.
10. Money is a dominant force in the economy.
11. The law is applicable only for long period.
12. Say's law holds good only in a barter economy.

73. **Simple Income Determination:**

**Assumptions:**

1. There are only two sectors viz. Consumers (C) and Firms (I).
2. Government influence on the economy is nil so government expenditure (G) is zero.
3. There is a closed economy so foreign trade is zero.
4. Wages and prices remain constant.
5. There are unemployed resources and hence less than full employment equilibrium prevails.
6. There is no variation in the rate of interest.
7. Investment is autonomous and it has on effect on price level or rate of interest.
8. The Consumption expenditure is stable. The basic equation $Y = C + I + G + (X - M)$ has been reduced to $Y = C + I$

74. **Canons of taxation:-**

Canons of taxation are considered as fundamental principles of taxation. Adam Smith laid down the following Canons of taxation

(a) Canon of equity

(b) Canon of Certainty

(c) Canon of Convenience

(d) Canon of economy

**(a) Cannon of Equity:**

This canon is also called the 'ability to pay' Principle of taxation. It means that taxes should be imposed according to the capacity of the tax payer. Poor should be taxed less and rich should be taxed more. This canon involves the principles of justice. All persons contribute according to their ability. As the cost of running the government should be equally borne by all, this canon is justified.

**(b) Canon of certainty:**

Every tax payer should know the amount of tax to be paid, when to be paid, and

where to be paid and also should be certain about the rate of tax to make investment decisions.

**(c) Canon of convenience:**

Tax payment should be convenient and less burdensome to the taxpayer. e.g. income tax collected at sources, sales tax collected at the time of sales and land tax collected after harvest.

**(d) Canon of economy:**

This canon signifies that the cost of collecting the revenue should be kept at the minimum possible level. The tax laws and procedures should be made simple, so as to reduce the expenses in maintaining people's income tax accounts i.e. administrative expenditure to be kept at a minimum.

75. **Definition of a Budget:**

Prof. Dimock says, "A budget is a balanced estimate of expenditures and receipts for a given period of time. In the hands of the administration, the budget is record of past performance, a method of current control and projection of future plans".

**(a) Balanced Budget**

A balanced budget is that over a period of time, revenue does not fall short of expenditure. In other words government budget is said to be balanced when its tax revenue and expenditure are equal.

**(b) Unbalanced Budget**

Unbalance budget is that over a period of time, revenue exceeds expenditure (Surplus) or expenditure exceeds revenue (Deficit budget).

(i) Surplus Budget

(ii) Deficit Budget

**(i) Surplus Budget:** When there is an excess of income over expenditure. It is called as surplus budget.

**(ii) Deficit budget:** When there is an excess of expenditure over income. It is a case of deficit budget.

## PART - D

**VII.**

76. **(i) Introduction:**

- Economics is a Social Science which deals with human wants and their Satisfaction.
- We shall discuss economics in its relation to other science.

**(ii) Economics in relation to other Social Sciences:-**

- Economics is related to other Social Sciences like Sociology, Politics, history, ethics, jurisprudence and Psychology.

**(iii) Economics and Sociology:-**

- Social Sciences like political and economics are the branches of Sociology.
- Sociology is a general Social Science which discussion facts and Laws of Society as a whole.
- Sociology deals with all aspects of a society but economics deals only with the economic aspects.
- For students of sociology, social institutions like marriage, religion, political condition and economic condition are all important subjects for study, but in economics we are interested to know how it affect the economic life of a society.

**(iv) Economics and Politics:-**

- There is a close connection between economics and politics.
- Politics is the Science of state
- Politics studies about man in his relation to the state.
- It may be related to a government policy but planning is a economic Policy.

- Some important questions like nationalization, privatization and prohibition are all economic as well as political questions.
- So that the early economics described economics as a political economy.

**(v) Economics and History**

- Economics and History are closely related
- History is a record of past events.
- We Survey economic, Political and Social conditions of the people in the past.
- A student of history, love affairs, Marriages and even murders of kings are important subjects of study.
- For students of economics, things like taxation, other sources of revenue and standard of living in the past is important subjects.

  "Economics without history has no root: History without economics has no Fruits".

**(vi) Economics and Ethics**

- Ethics deals with moral questions
- It deals with questions of right and wrong for promoting good life.
- According to Marshall Economics and ethics are closely related at Promoting moral welfare.
- Marshall considered economics as a handmaid of ethics.

**(vii) Economics and Jurisprudence:-**

- Jurisprudence is the Science of Law.
- The economic progress of a nation depends to a great extent on its legal system.
- Good laws promote economic progress and bad Laws act as an impediment to growth.

**(viii) Economics and Psychology:-**

- Psychology is the Science of mind which deals with all kinds of human behaviour
- Many important laws of economics are based on psychology for e.g. Law of Diminishing Marginal Utility.
- This psychology has become important in analyzing economic problems.
- To deal with labour problems we must understand industrial psychology.
- A good businessman must understand the psychology of buyers.

**(ix) Economics, Mathematics and Statistics:-**

- Economics is related to mathematics and statistics is the science of average and counting.
- In economics, statistics helps to make tables and diagrams for statistical analysis.
- In modern economics, statistics and mathematical methods are largely used which is called Econometrics.

77. **Introduction :**

- The Law of diminishing Marginal utility explains an ordinary experience of a consumer.
- If a consumer takes more and more units of commodity the additional utility he derives from a extra unit of the commodity goes on falling.
- This idea was first developed by Gossen, Bentham Jevons, Karl Menger, so this law is also known as Gossen's First Law.

- But Alfred Marshall perfected these ideas and made it as a Law.

**Definition :**

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

**Assumptions of the Law :**

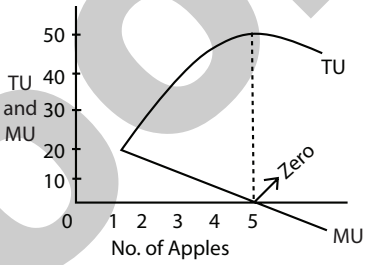
- The consumption must be in standard units eg: a cup of coffee or cup of tea.
- The units of commodity must be identical in all aspects like taste, quality, colour and size.
- The process of consumption continues without any time gap.
- The consumer's taste remains the same.
- The Income of the consumer remains constant.
- The consumer is a rational economic man and he wants to Maximize the total utility.
- Utility is Measurable.

| Units of apple | Total utility | Marginal utility |
|---|---|---|
| 1 | 20 | 20 |
| 2 | 35 | 15 |
| 3 | 45 | 10 |
| 4 | 50 | 5 |
| 5 | 50 | 0 |
| 6 | 45 | − 5 |
| 7 | 35 | −10 |

**Explanation :**

- If a consumer consumes first apple given. Utility measures i.e (20 Utility)
- If he consumes Second apple he get the Satisfaction of 15 utility like wise 10, 50 − 5, −10
- Total utility goes on increasing reaches maximum and declines.
- Marginal utility goes on declining reaches 'O' and becomes negative.
- X axis represents number of Apples consumed.
- Y axis represents total utility and Marginal Utility.
- TU - represents total utility.
- MU - represents Marginal utility.

***Law of Diminishing Marginal Utility***




**Importance:**

- The Law of Diminishing Marginal Utility (DMU) is the foundation for various other economic laws. i.e, the Law of Demand.
- The Law of DMU operates in the case of money also.
- Alfred Marshall assumed that the marginal utility of money remains constant.
- This Law is a handy tool for the Finance Minister for increasing tax rate on the rich.

**Criticism:**

- A single commodity consumption mode but in real life a consumer consumes more than one good at a time.
- Consumer should consume successive units of the same good continuously but in real life it is not so.
- Marginal utility of money remains constant when money stock changes.

78. **Introduction**

- Demand for a commodity refers to the desire backed by ability to pay and willingness to buy it.
- The law of demand status that there is a negative or inverse relationship between the price and quantity demanded of a commodity over a period of time.

**Definition:**

Alfred Marshall stated that "The greater the amount sold, The smaller must be the price at which it is offered, in order that it may find purchasers, or in other words, the amount demanded increases with a fall in price and diminishes with rise in price"

**Assumptions of the law:**

- No change in the consumer's income.
- No change in consumer's tastes and preferences.
- No changes in the prices of other goods.
- No new substitutes for the goods have been discovered.
- People do not feel that the present fall in price is a prelude to a further decline in price

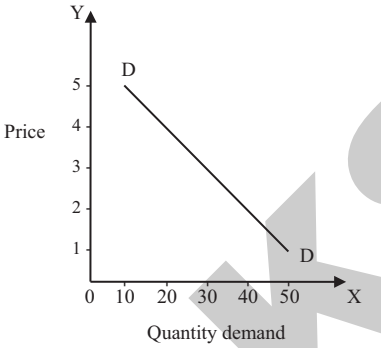
**Demand schedule:**

It is a tabular statement showing how much of a commodity is demanded at different prices.

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

**Demand curve:**

The demand schedule can be converted into a demand curve by measuring price on vertical axis and quantity on horizontal axis.




(i) DD is the demand curve.

(ii) The curve slopes downwards from left to right showing that, when price rises, demand is less and vice versa.

**Why does the demand curve slope downwards:**

- The demand curve slopes downwards mainly due to the law of diminishing marginal utility.
- The consumer will buy more goods only at a lower price when price increases demand decline.

**Individual demand and market demand schedules:**

Individual demand schedule tells the quantities demanded by an Individual consumer at different prices.

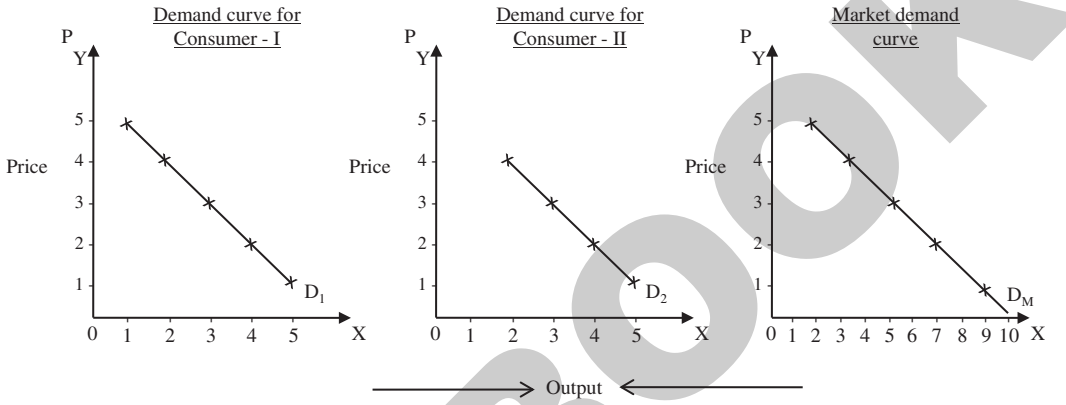
| Price of oranges (Rs) | Quantity of oranges |
|---|---|
| 5 | 1 |
| 4 | 2 |
| 3 | 3 |
| 2 | 4 |
| 1 | 5 |

- When the price falls to Rs. 4 he demands 2 oranges.
- When the price falls further to Rs.3, he demands 3 oranges.

**Market demand schedule:**

- It can be constructed by adding up demand schedules of the individual consumers in the market.

| Price of oranges (in Rs) | Quantity demanded | | |
|---|---|---|---|
| | Consumer I | Consumer II | Market demand |
| 5 | 1 | - | 1 |
| 4 | 2 | 1 | 3 |
| 3 | 3 | 2 | 5 |
| 2 | 4 | 3 | 7 |
| 1 | 5 | 4 | 9 |




- The quantity demanded by consumer I and II are measured on the horizontal axis.
- Market price is measured on the vertical axis.
- The total demand of these two consumers i.e. $D_1 + D_2 = DD_m$
- $DD_m$ - Market demand curve.

**Exceptions to the law of demand:-**

- There are certain peculiar cases in which the law of demand will not hold good.
- In these cases more will be demanded at a higher price.
- The demand curve in those cases slopes upwards.

**(1)Veblen Effect:-**

There are some goods demanded by very rich people for their social prestiage.

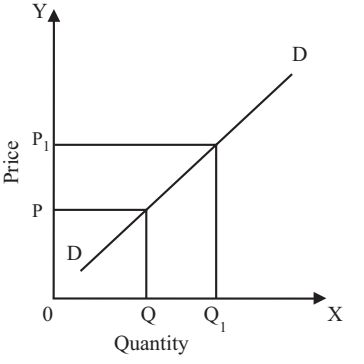
(eg) Diamonds.

**(2)Giffen Paradox:**

The rise in price of inferior goods sometimes results in the increases in quantity demanded.

(eg) Ragi, Cholam.

**Exceptions to the law of demand**




**Conclusion:-**

- The above mentioned explains the relationship between price and demand.

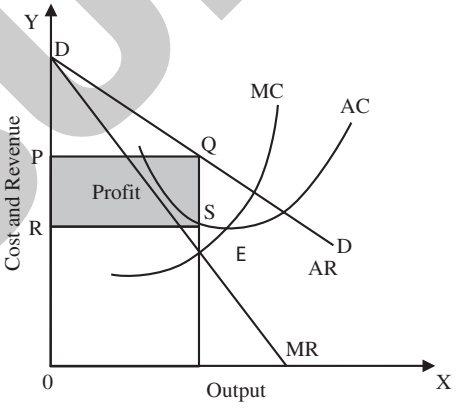
79. **(a) Monopolistic Competition:**
1. Monopolistic competition was introduced by Prof. E. H. Chamberlin
2. Monopolistic competition, as the name itself implies, is a blending of monopoly and competition.
3. Monopolistic competition refers to the market situation in which a large number of sellers produce goods which are close substitutes of one another.
4. The products are similar but not identical

**(b) Examples of Monopolistic Competition:**
1. Shampoo – Sunsilk, Clinic Plus, Pantene, etc.
2. Tooth paste – Binaca, Colgate, Forhans, etc.

**(c) Determination of Equilibrium price and output under monopolistic competition:**
1. The monopolistic competitive firm will come to equilibrium on the principle of equalising MR with MC.
2. Each firm will choose that price and output where it will be maximising its profit.

**(d) The following figure show the Equilibrium of the individual firm in the Short Period**

**Short period equilibrium of a monopolistic competitive firm with profit**




1. MC and AC are the short period Marginal cost and average cost curves.
2. The slopping down average revenue and Marginal Revenue curves are shown as AR and MR
3. The Equilibrium point is E Where MR = MC.
4. The difference between average cost and average revenue is SQ.
5. The output is OM. So, the supernormal profit for the firm is shown by the rectangle PQSR.
6. The firm by producing OM Units of its commodity and selling it at a price of OP per unit realizes the maximum profit in the short run.

The different firms in monopolistic competition may be making either abnormal profits or losses in the short period depending on their costs and revenue curves.

**(e) In the Long run:**
1. If the existing firms earn super normal profits, the entry of new firms will reduce its share in the market.
2. If the existing firms incur losses in the long-run, some of the firms will leave the industry increasing the share of the existing firms in the market.
3. Thus under monopolistic competition, all the existing firms will earn normal profit in the long run.

80. **(a) Introduction:-**
1. Generally people prefer to hold a part of their assets in the form of cash.
2. Cash is a liquid assets.
3. According to Keynes, interest is the reward for parting with liquidity for a specified period of time.

**(b) Three Motives of Liquidity Preference:**

(i) Transaction Motive

(ii) Precautionary Motive

(iii) Speculative Motive

**(i) Transaction Motive:**

- It refers to the money held to finance day to day spending.

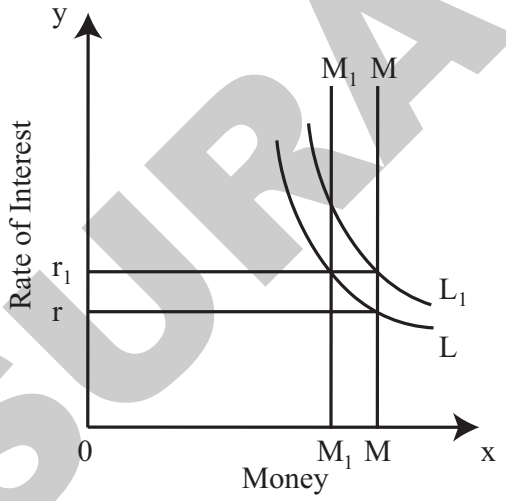
**(ii) Precautionary Money:**

- Held to meet an unforeseen expenditure.

**(iii) Speculative Motive:**

- 'The object of securing profit from knowing better than the market what the future will bring forth".
- Of the three motives, speculative motive is more important in determining the rate of interest
- He believed that the amount of money held for speculative motive would vary inversely with the rate of interest
- "Keynes was the view that the rate of interest was determined by liquidity preference on the one hand and the supply of money on the other.

Liquidity preference theory of Interest




**(c) Explanation:-**

(i) Liquidity preference is shown by L and the supply of money is represented by M and the rate of interest is indicated by r.

(ii) Rate of interest is determined by the intersection of L and M curves.

(iii) Increase in the rate of interest to $r_1$.

(iv) Increase in demand for money to $L_1$ (or) decrease in the supply of money to $M_1$.

**(d) Criticism:**

(i) Keynesian Theory is a general theory of interest and it is far superior to the earlier theories of interest.

(ii) But critics say that Keynes has over-emphasized liquidity preference factor in the theory of interest.

(iii) Moreover, only when a person has savings the question of parting with liquidity arises.

(iv) The rate of interest is the return for "Saving without liquidity".

81. **Objectives of Monetary Policy :**

1. Full employment
2. Price Stability
3. Rapid Economic growth
4. Balance of payments equilibrium
5. Economic Justice

**Instruments of Monetary Policy :**

Monetary policy can be divided into

(a) Quantitative credit control measures and

(b) Selective Credit Control measures

**(a) Quantitative Credit Control Measure :**

**(i) Bank rate:**

The bank rate is the minimum rate at which the Central bank of a country will lend money to other bank. Suppose, there is too much money in circulation, then the central bank should take some money in circulation.

**(ii) Variation Cash Reserve Ratios:**

Generally to control inflation, the central bank will increase the bank rate.

**(iii) Open Market Operation:**

(a) The success of open market operations as a weapon of credit control depends mainly on

1. Presence of well developed bill market.
2. The possession by the Central bank of adequate volume of securities.
3. Stability of cash reserve ratios maintained by commercial bank.

So, open market operation have not become a powerful weapon of credit control in our country.

**(b) Selective Credit Controls:**

Selective credit controls can play an important role in an under developed money market with a planned economy. They not only prevent flow of credit into undesirable channels, but also direct flow of credit into useful channels.

The weapons of selective credit control include

(a) Fixing minimum margin of lending or for purchase of securities.

(b) Ceiling on the amount of Credit for expansion

(c) Different rate of interest will be changed to encourage certain sectors and to discourage certain other sector.

(d) The central bank will persuade the commercial bank to follow certain policies through normal suasion.

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