

B.E.

Third Semester Examination, December-2008

Economics (HUM-201-E)

Note : Attempt any five questions. All questions carry equal marks.

Q. 1. Define the term economics. Discuss its nature and scope:

Ans. Economics is a popular, useful and significant social study. It studies economic activities of a man. Economic activities are those activities which are concerned with the efficient use of such scarce means as can satisfy the wants of man.

Economics is not concerned with lifeless matter as in the case of natural sciences like physics & chemistry.

The term economics is derived from two words of Greek language, namely, *Oikos* (household) & *nemein* (to manage) meaning thereby household management.

Wealth definition	Adam Smith
Welfare definition	Marshall
Scarcity definition	Robbins

Robert Awn, "Economic problem is the problem relating to the necessity of choosing what, how & for whom to produce & how to achieve economic growth."

Leftwich, "Economic problem is concerned with the use of scarce resources among alternative human wants and in using these resources towards the end of satisfying wants as fully as possible."

Causes of Economic Problem

(i) **Unlimited Wants :** Human wants that can be satisfied by consuming goods & services are unlimited. No individual can fully satisfy his wants. It can therefore, be said that at any given time, there do exist innumerable unsatisfied wants in a community.

(ii) **Limited Means :** Large number of goods & services are needed to satisfy human wants. To satisfy human hunger, one needs bread, fruit or milk. A patient needs the services of a doctor. These include, factories, fields, machines, tools etc.

Scarcity is the root cause of economic problems.

Q. 2. Discuss law of equi-marginal utility.

Ans. Dr. Marshall, In order to get maximum satisfaction, a consumer should spend his limited income on different commodities in such a way that rupee spent on each commodity yields him equal marginal utility.

R.J. Branes, The law of EMU states that a consumer will so dispose of his income that the marginal utility from a unit of income spent on each line of consumption is equal.

Samuelson, A consumer gets maximum satisfaction when the ratio of marginal utilities of all commodities & their prices are equal.

$$\frac{MU_1}{P_1} = \frac{MU_2}{P_2} = \frac{MU_3}{P_3}$$

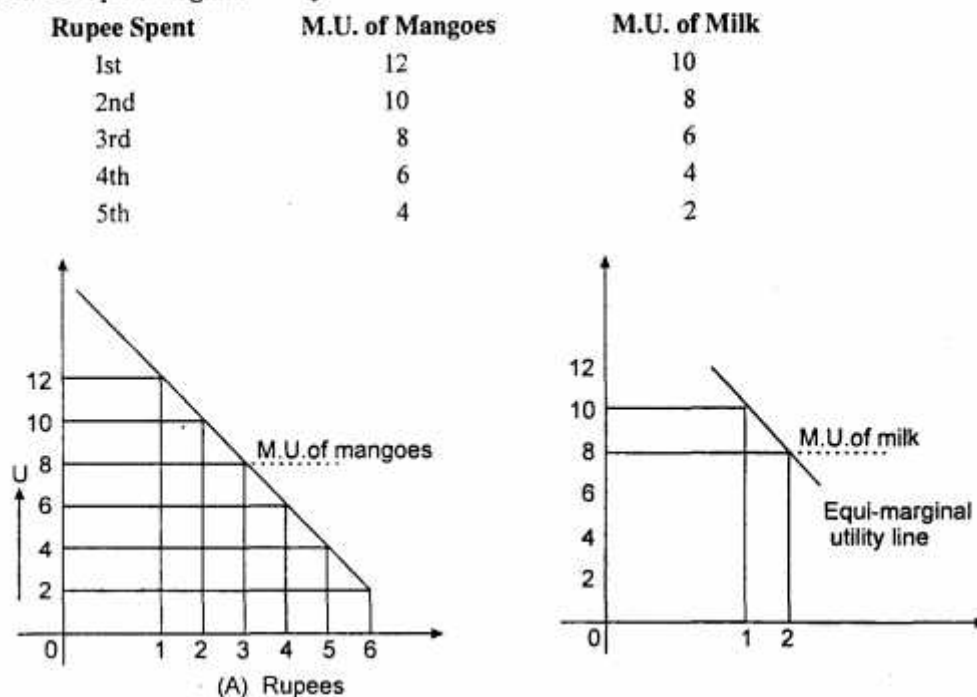
If the prices of commodities are equal, then maximum satisfaction to the consumer can be indicated in the following equation

$$MU_1 = MU_2 = MU_3$$

Assumptions :

- (i) Cardinal measurement of utility is possible.
- (ii) Consumer is rational, that is, he wants maximum satisfaction from his income.
- (iii) Income of the consumer remains constants.
- (iv) Marginal utility of money remains constant.
- (v) Prices of the commodities remains constant.
- (vi) Commodity is divisible into small units.
- (vii) Consumption takes place at a given time period.

Law of Equi-Marginal Utility



Q. 3. What is elasticity of demand? What are the determinants of price elasticity of demand?

Ans. J.S. Mill & Cournot were the early economists who referred to elasticity of demand in economics. But this concept was actually developed by Dr. Marshall in his book "Principles of Economics."

Dooley : "The elasticity of demand measures the responsiveness of the quantity demanded of a good, to change in its price, price of other goods, & changes in consumer's income.

Alfred Marshall : He was the one who introduce the concept of elasticity of demand.

Price elasticity of demand is the ratio of percentage change in the quantity demanded of a commodity to a percentage change in its price.

$$E = \frac{(-) \text{Percentage change in quantity demanded}}{\% \text{ change in price}}$$

Factors determining the price elasticity of demand :

(i) **Nature of the Commodity** : In economics, all goods are divided into three categories, necessities, comforts & luxuries. Thus, change in their prices has no effect on their demand. Change in price of jewellery etc. has great impact on their demand.

(ii) **Availability of Substitutes** : Goods having substitutes available at reasonable price such as tea & coffee, pen & ball pens, milk shake etc. have elastic demand commodities that do not have any substitute, cigarrate, liquor etc. have inelastic demand.

(iii) **Goods with Different Uses** : Goods that can be put to different uses have elastic demand, example, electricity has many uses.

(iv) **Postponement of the Use** : Goods whose demand can be postponed to a later period have elastic demand. Example, if demand for building houses can be postponed then demand for building material such as bricks, cement etc.

(v) **Income of the Consumer** : People having very high or very low income, ordinarily, have inelastic demand. It is so because rise or fall in the prices has very little effect on their demand.

(vi) **Habit of Consumer** : Demand for those goods is inelastic to which consumers become habituated. Ex. cigarette, coffee etc.

Q. 4. Define the term production. Discuss the various factors of production.

Ans. Anatol Murad, "Production may be defined as creation of utilities".

Art. Smith, "Production is the process that creates utility in goods."

Michalson, "Production means an increase in the value of commodity".

Factors of Production :

Ulmer, "The sources of services which enter into the process of the production are called factors of production."

Marshall, "In a sense, nature and man are the only factors of production."

Factors :

(i) Land (ii) Labour (iii) Capital (iv) Organisation (v) Enterprise

(i) **Land** : It is free gift of nature. It does not refer to the surface alone. It includes all natural resources such as forests, minerals, mountains etc.

(ii) **Labour** : It is a human factor of production. It includes all those mental & physical activities of man which are undertaken to earn reward.

(iii) **Capital** : Man made physical factor of production which is used for further production.

Example : Machines, tools etc.

(iv) **Organization** : Also a human factor of production. That factor of production which organises, land, labour, capital etc. to produce things at a set plan. Example, services of a general manager.

(v) **Enterprise** : Yet another & highly specialised human factor of production. It alone undertakes all the risks of production & gives practical shape to new inventions.

Q. 5. What is marginal cost? Distinguish between fixed cost and variable cost.

Ans. Marginal cost is the increase in total cost when output is increased by one unit.

Definition :

Mc Concell, "Marginal cost may be defined as the additional cost of producing one more unit of output."

Ferguson, "Marginal cost is the addition to total cost due to addition of one unit of output."

$$MC = \frac{\Delta TC}{\Delta \theta} = T_{C_n} - T_{C_{n-1}}$$

$$MC = \frac{\Delta TC}{\Delta \theta} = \frac{\Delta FC}{\Delta \theta} + \frac{\Delta VC}{\Delta \theta} = \frac{\Delta VC}{\Delta \theta} \left(\text{since } \frac{\Delta FC}{\Delta \theta} = 0 \right)$$

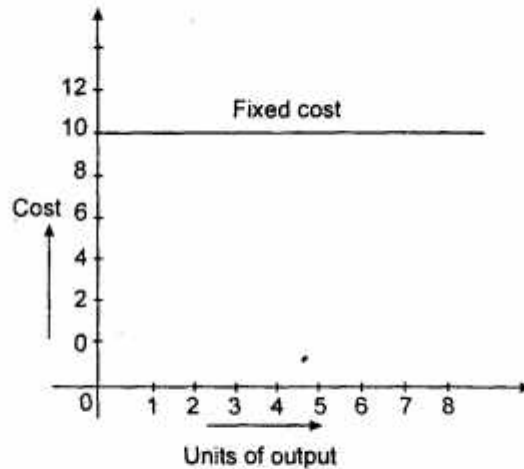
Fixed Cost : The fixed cost is equal to the unit of fixed factors multiplied by its price.

$$TFC = \text{Units of fixed factors} \times \text{Price of the factor}$$

Ferguson, "Total fixed cost is the sum of short run explicit fixed costs and the implicit cost incurred by an entrepreneur".

Fixed Cost :

Quantity of Output	Fixed Cost (Rs)
0	10
1	10
2	10
3	10
4	10
5	10
6	10
7	10
8	10

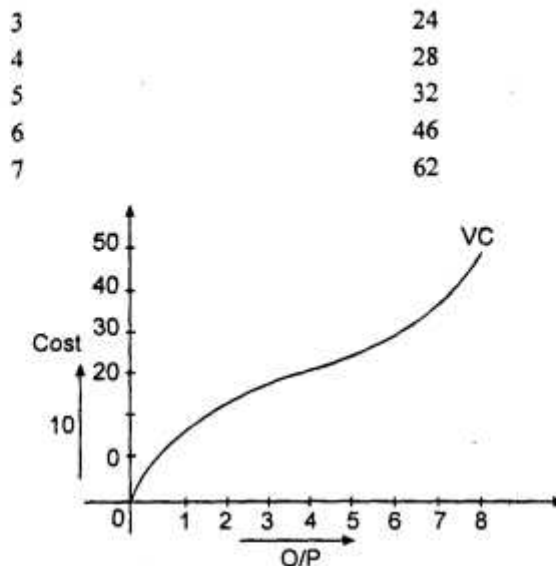


Variable Cost :

Ferguson, Total variable cost is the sum of amounts spent for each of the variable input used".

Variable Costs

Output	Variable cost
0	0
1	10
2	18



Q. 6. Discuss the price determination in the market situation of monopoly.

Ans. Since monopolist is the only seller in the market, demand curve of his product, constitutes market demand curve. There being no close substitute of the commodity & being the sell producer & seller the monopolist has full control over the price of commodity.

Determination of price & Equilibrium under monopoly.

A monopolist will so determine the price of a product as to get maximum profit. A monopolist is in equilibrium, when he produces that amount of output which yields him maximum total profit.

A monopolist is also in equilibrium in the short period, when he incurs minimum loss. Under monopoly, price & equilibrium are determined by two different approaches :

- (i) Total Revenue & total cost analysis.
- (ii) Marginal revenue & marginal cost analysis.

Q. 7. What do you mean by Privatization? Discuss its merits and demerits.

Ans. Narrow Meaning of Privatization : In narrow sense, Privatization implies the private ownership of public enterprises.

Broader Meaning of Privatization : In broad sense, privatization implies transferring the ownership of public sector to private sector or managing & controlling of public sector by private individual without transferring the ownership.

Merits of Privatization :

(i) **Reduction in Economic Burden :** Economic burden on government is reduced because private sector also makes the combustion.

(ii) **Increase in Efficiency :** Privatization of ownership of public sector industries, increases their productivity, profitability & effectiveness.

(iii) **Reduction in Sense of Irresponsibility :** Wide spread bureaucracy, red-tapism & sense of irresponsibility in public sector is removed to a great extent with the advent of privatization.

(iv) **Encouragement to New Inventions :** Privatization encourages new inventions & the entrepreneur feels inspired.

Demerits of Privatisation :

(i) **Industrial Sickness** : Privatization does not necessarily add to efficiency, widespread industrial sickness in India is a glaring example.

(ii) **Lack of Social Welfare** : Under, private entrepreneurs are keen to invest their capital in those industries which margin of profit is very high.

(iii) **Increase in Inequality** : Privatization gives rise to increased possibility of economic inequality as it results in concentration of economic power.

(iv) **Ignores Weaker Section** : Profit motive is the guiding principle of privatization. Production aims at maximizing profit. Entrepreneurs are more inclined to produce goods than cater to luxuries.

Q. 8. Discuss the main features of Indian Economy.

Ans. Features :

(i) **Stagnant Per Capita Income** : During fifty years of prior to Independence (1947) growth rate of per capita income per annum has been less than 1 percent. After independence, no doubt, as a result of planning Indian economy got a stimulus, yet the rate of increase in per capita remained around 1-9% per annum.

(ii) Low Level of Per Capita Income

Country	Per Capita Income (dollars) Year 2005-2006
USA	43,740
Japan	38,950
UK	37,600
China	1740
Shri Lanka	1160
India	720
Pakistan	690

(iii) **Low Standard of Living** : On account of low per capita income, level of consumption of such necessities of life as food, clothing, shelter in India is low. Consequently per capita income is low. Because of low income, that poor countries continue to be poor.

(iv) **Unequal Distribution of Income & Wealth** : In India, on one hand, per capita income is low and on other hand, there is large inequality in distribution of wealth & income. Consequently, very little amount of wealth is left for capita formation.

During the period of planning in India, instead of reduction in the disparities in the distribution of wealth & income. The same have actually increased.

(v) **Excessive Dependence on Agriculture** : In India about 54% of population depends on agriculture. Too much dependence is another sign of underdeveloped nature of Indian economy.

Other Features are :

(vi) Lack of proper Industrialisation.

(vii) Lack of proper Banking facilities.

(viii) Less development of means of transport.

(ix) Pressure of population.

(x) Unemployment & under employment.

(xi) Lack of Capital.

(xii) Underdeveloped Natural Resources.

(xiii) Outdated social Institution.