

**Note:**

- (1) All questions are compulsory
- (2) Draw tables / diagrams wherever necessary.
- (3) Figures to the right indicate full marks
- (4) Write answers to all question on new pages.

**Q.1 (A) Choose the correct option.**

- (1) The branch of economics that deals with the allocation of resources. (05)  
 (a) Micro economics (b) Macro economics (c) Econometrics (d) None of these  
 Options: (i) a, b and c (ii) a and b (iii) only a (iv) None of these
- (2) Homogeneous product is a feature of this market.  
 (a) Monopoly (b) Monopolistic competition  
 (c) Perfect competition (d) Oligopoly  
 Options: (i) c and d (ii) a, b and c (iii) a, c and d (iv) only c
- (3) Statements that are incorrect in relation to index numbers.  
 (a) Index number is a geographical tool.  
 (b) Index numbers measure changes in the air pressure.  
 (c) Index numbers measure relative changes in an economic variable.  
 (d) Index numbers are specialized averages.  
 Options: (i) c and d (ii) a and b (iii) b and c (iv) a and d
- (4) Trends shown by Public expenditure of any Government shows following trend.  
 (a) Constant (b) Increasing (c) Decreasing (d) Fluctuating  
 Options: (i) only a (ii) only b (iii) only c (iv) only d
- (5) Role of foreign trade is \_\_\_\_\_.  
 (a) To earn foreign exchange  
 (b) To encourage investment  
 (c) Lead to division of labour  
 (d) Bring change in composition of exports  
 Options: (i) a and b (ii) a, b and c (iii) b and d (iv) None of these

<b>Ans.</b>	(1) (iii) only a	(2) (i) c and d	(3) (ii) a and b	(4) (iv) only d	(5) (ii) a, b and c
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**Marking Scheme: 1 mark for each correct answer**

**Q.1 (B) Complete the correlation.**

- (1) Money market : Short term funds :: \_\_\_\_\_ : Long term funds
- (2) Straight line demand curve : Linear demand curve :: \_\_\_\_\_ : Non linear demand curve.
- (3) Demand curve : \_\_\_\_\_ :: Supply curve : Upward.
- (4) Laaspeyre's index : \_\_\_\_\_ :: Paasche's index: Current year quantities.
- (5) \_\_\_\_\_ :  $C + I + G + (X - M)$  :: GNP :  $C + I + G + (X - M) + (R - P)$ .

<b>Ans.</b>	(1) Capital Market	(2) Convex to origin	(3) Downward
	(4) Base year quantities	(5) GDP	

**Marking Scheme: 1 mark for each correct answer**

(05)

- |             |                   |                              |          |
|-------------|-------------------|------------------------------|----------|
| <b>Ans.</b> | (1) Recurring A/c | (2) Very short period market | (3) Land |
|             | (4) Advertising   | (5) GST                      |          |

**Marking Scheme:** 1 mark for each correct answer

**(05)**

- (1) Development financial institutions were established to \_\_\_\_\_.
  - (a) *provide short term funds.*
  - (b) *develop industry, agriculture and other key sectors.*
  - (c) *regulate the money market.*
  - (d) *regulate the capital market.*
- (2) While estimating national income, we include only value of final goods and services in order to the nation \_\_\_\_\_.
  - (a) *make computation easier*
  - (b) *avoid double counting*
  - (c) *maximize national welfare of the people*
  - (d) *evaluate the total economic performance*
- (3) Net addition made to the total revenue by selling an extra unit of a commodity is \_\_\_\_\_.
  - (a) *Total Revenue*
  - (b) *Marginal Revenue*
  - (c) *Average Revenue*
  - (d) *Marginal Cost.*
- (4) Point of Satiety means \_\_\_\_\_.
  - (a) *TU is rising and MU is falling*
  - (b) *TU is falling and MU is negative*
  - (c) *TU is maximum and MU is zero*
  - (d) *MU is falling and TU is rising.*
- (5) Commercial banks act as intermediaries in the financial system to \_\_\_\_\_.
  - (a) *make profits*
  - (b) *accelerate the country's economic growth.*
  - (c) *mobilize the savings and allocating them to various sectors of the economy.*
  - (d) *control the credit.*

<b>Ans.</b>	(1) (b)	(2) (b)	(3) (b)	(4) (c)	(5) (c)
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**Marking Scheme:** 1 mark for each correct answer

**(06)**

- Ans.** Transfer payments. On one hand they are a part of individual income and on the other hand, they are part of Government expenditure.

- Ans.** Micro economics. Micro economics thus deals with a small part of the national economy.

(3) Kavita consumed five units of oranges one after the other.

**Ans.** Total Utility. Total utility refers to the aggregate of utility derived by the consumer from all units of a commodity consumed.

(4) ABC bank provides d-mat facility, safe deposit lockers, internet banking facilities to its customers.

**Ans.** Commercial Bank. Banking Regulation Act of 1949: "Banking means the accepting for the purpose of lending or investment, of deposits of money from the public repayable on demand or otherwise, and withdrawable by cheque, demand draft order or otherwise."

(5) Maharashtra purchased wheat from Punjab.

**Ans.** Internal Trade: Buying and selling of goods and services within the boundaries of a nation are referred to as 'Internal Trade' or 'Domestic Trade' or 'Home Trade'.

**Marking Scheme:** 1 mark to identify the correct concept and 1 mark for explanation of correct concept. Total = 2 marks each

### Q.1 (B) Distinguish between (Any three).

#### (1) Stock and Supply.

Ans.	Stock	Supply
(i)	Stock is the total quantity of commodity available for sale with a seller at a particular point of time.	(i) Supply refers to the relation between market prices and the amount of goods that producers are willing to supply.
(ii)	It is the source of supply.	(ii) Supply is a flow concept.
(iii)	It is potential supply.	(iii) Supply is a relative term.
(iv)	Increasing production, stock can be increased.	(iv) It is always expressed in relation to price, time and quantity.

#### (2) Price Index and Quantity Index.

Ans.	Price Index	Quantity Index
(i)	The prices of the different commodities of the base year to derive $\Sigma p_0$ .	(i) The quantities of the different commodities of the base year to derive $\Sigma q_0$ .
(ii)	The prices of the different commodities of the current year to derive $\Sigma p_1$ .	(ii) The quantities of the different commodities of the current year to derive $\Sigma q_1$ .
(iii)	Price Index Number $P_{01} = \frac{\Sigma p_1}{\Sigma p_0} \times 100$	Quantity Index Number $Q_{01} = \frac{\Sigma q_1}{\Sigma q_0} \times 100$

#### (3) Developmental expenditure and Non-developmental expenditure.

Ans.	Developmental expenditure	Non-developmental expenditure
(i)	Developmental expenditure is productive in nature.	(i) Non-Developmental Expenditure is unproductive in nature.
(ii)	The expenditure which results in generation of employment, increase in production, price stability etc. is known as developmental expenditure.	(ii) On the other hand, that government expenditure which does not yield any direct productive impact on the country is called non-developmental expenditure.
(iii)	E.g. Expenditure on health, education, industrial development, social welfare, Research and Development (R & D) etc.	(iii) E.g. Administration costs, war expenditure etc. These are unproductive in nature.

(4) **Desire and Demand**

Ans.

Desire		Demand	
(i)	Desire means an urge to have something.	(i)	Demand means a desire which is backed by willingness and ability to pay.
(ii)	Desire = Desire	(ii)	Demand = Desire + Willingness to purchase + Ability to pay.
(iii)	Desire has no relation with price, place and time.	(iii)	Demand has relation with price, place, time.

(5) **Perfectly elastic demand and Perfectly inelastic demand.**

Ans.

Perfectly elastic demand		Perfectly inelastic demand	
(i)	Zero change in the price brings about an infinite change in the quantity demanded of that commodity, it is called perfectly elastic demand.	(i)	Percentage change in price has no effect on the quantity demanded of a commodity it is called perfectly inelastic demand.
(ii)	For example, 10% fall in price may lead to an infinite rise in demand.	(ii)	For example, 20% fall in price will have no effect on quantity demanded.
(iii)	Perfectly elastic demand $E_d = \infty$ .	(iii)	Perfectly inelastic demand $E_d = 0$ .
(iv)	Demand curve is a horizontal line parallel to the X axis.	(iv)	Demand curve is a vertical straight line parallel to the Y axis.

**Marking Scheme:** 1 mark each for correct point. Any two points needed. Total = 2 marks each

**Q.3 Answer the following (Any three).**

(12)

**(1) Explain the features of Micro economics.**

Ans. Micro means a small part of a thing. Following features of micro economics.

- (i) **Study of Individual Units:** Micro economics is the study of the behavior of small individual economic units, like individual firm, individual price, individual household etc.
- (ii) **Price Theory:** Micro economics deals with determination of the prices of goods and services as well as factors of production. Hence, it is known as price theory.
- (iii) **Partial Equilibrium:** Equilibrium is the balance between two factors. Micro economic analysis deals with partial equilibrium which analyses equilibrium position of an individual economic unit i.e. individual consumer, individual firm, individual industry etc. It isolates an individual unit from other forces and studies its equilibrium independently.
- (iv) **Based on Certain Assumptions:** Micro economics begins with the fundamental assumption, "Other things remaining constant" (Ceteris Paribus) such as perfect competition, laissez-faire policy, pure capitalism, full employment etc. These assumptions make the analysis simple.
- (v) **Slicing Method:** Micro economics uses slicing method. It splits or divides the whole economy into small individual units and then studies each unit separately in detail.
- (vi) **Use of Marginalism Principle:** The concept of Marginalism is the key tool of micro economic analysis. The term 'marginal' means change brought in total by an additional unit. Marginal analysis helps to study a variable through the changes. Producers and consumers take economic decisions using this principle.
- (vii) **Analysis of Market Structure:** Micro economics analyses different market structures such as Perfect Competition, Monopoly, Monopolistic Competition, Oligopoly etc.
- (viii) **Limited Scope:** The scope of micro economics is limited to only individual units. It doesn't deal with the nationwide economic problems such as inflation, deflation, balance of payments, poverty, unemployment, population, economic growth etc.

## (2) Explain Assumptions of the Law of Supply.

**Ans.** The law of supply is based on the following assumptions :

- (i) **Constant cost of production:** It is assumed that there is no change in the cost of production. A change in cost of production will affect the profits of the seller. Therefore less quantity will be supplied at the same price.
- (ii) **Constant technique of production:** It is also assumed that technique of production does not change. Improved technique of production may lead to an increase in production. This in turn may lead to an increase in the supply at the same price.
- (iii) **No change in weather conditions:** It is assumed that there is no change in the weather conditions. Natural calamities like floods, earthquakes etc. may decrease supply.
- (iv) **No change in Government policy:** It is also assumed that government policies like taxation policy, trade policy etc. remain unchanged.
- (v) **No change in transport cost:** It is assumed that there is no change in the condition of transport facilities and transport cost. For example, better transport facility increases supply at the same price.
- (vi) **Prices of other goods remain constant:** Prices of other goods are assumed to remain constant. If they change, the law of supply may not hold true because producer may transfer resources to other products.
- (vii) **No future expectations:** The law also assumes that the sellers do not expect future changes in the price of the product.

## (3) Explain the features of Monopoly.

**Ans.** Following are the main features of monopoly market :

- (i) **Single seller:** In monopoly, there is no competition as there is only one single producer or seller of the product. But, the number of buyers is large.
- (ii) **No close substitute:** There are no close substitutes for the product of the monopolist. Therefore, the buyers have no choice. They have to either buy the product from the monopolist or go without it. The cross elasticity of demand for his product is either zero or negative.
- (iii) **Barriers to entry:** Entry of the rivals is restricted due to legal, natural, technological barriers which do not allow the competitors to enter the market.
- (iv) **Complete control over the market supply:** The monopolist has complete hold over the market. He is the sole producer or seller of the product.
- (v) **Price maker:** A monopolist can fix the price of his own product as he controls the whole market supply. Monopolist is a price maker.
- (vi) **Price discrimination:** Monopolist being a price maker, he can charge different prices to different consumers for the same product, on the basis of time, place etc. Thus, price discrimination is an important feature of monopoly market. For example, students and senior citizens are provided railway tickets at concessional rates.
- (vii) **No distinction between firm and industry:** A monopolist is the sole seller and producer of the product. A monopoly firm itself is an industry.

## (4) Explain non-tax sources of revenue of the Government.

**Ans.** Public revenue received by the government administration, public enterprises, gifts and grants etc. are called as non-tax revenue. These sources are different than the taxes.

These sources are follows :

- (i) **Fees:** A tax is paid compulsorily without any return service whereas, fee is paid in return for certain specific services rendered by the government. For example- education fee, registration fee, etc.
- (ii) **Prices of public goods and services:** Modern governments sell various types of commodities and services to the citizens. A price is a payment made by the citizens to the government for the goods and services sold to them. For example- railway fares, postal charges etc.
- (iii) **Special Assessment:** The payment made by the citizens of a particular locality in exchange for certain special facilities given to them by the authorities is known as 'special assessment.' For example- local bodies can levy a special tax on the residents of a particular area where extra/ special facilities of roads, energy, water supply etc. are provided.
- (iv) **Fines and Penalties:** The government imposes fines and penalties on those who violate the laws of the country. The objective of the imposition of fines and penalties is not to earn income, but to discourage the citizens from violating the laws framed by the Government. For example, fines for violating traffic rules. However, the income from this source is small.
- (v) **Gifts, Grants and Donations:** The government may also earn some income in the form of gifts by the citizens and others. The government may also receive grants from the foreign governments and institutions for general and specific purposes. Foreign aid has become an important source of development finance for a developing country like India. However, this source of revenue is uncertain in nature.
- (vi) **Special Levies:** This is levied on those commodities, the consumption of which is harmful to the health and well-being of the citizens. Like fines and penalties, the objective is not to earn income, but to discourage the consumption of harmful commodities by the citizens. For example- duties levied on wine, opium and other intoxicants.
- (vii) **Borrowings:** The government can borrow from the people in the form of deposits, bonds etc. It also gets loans from foreign governments and organizations such as IMF, World Bank etc. Loans are becoming more and more popular source of revenue for the governments in the modern times.

**(5) Explain the reforms of capital market in India.**

**Ans.** Following are important reforms in the capital market in India:

- (i) Securities and Exchange Board of India (SEBI) was established in 1988 but given statutory powers in 1992 to protect the interest of the investors and promote the development of the securities market.
- (ii) National Stock Exchange (NSE), the leading stock exchange in India was established in 1992.
- (iii) Computerized Screen Based Trading System (SBTS) was introduced as a part of modernization.
- (iv) Demat account has been introduced since 1996 to facilitate easy purchase and sale of shares by the investors through the electronic method.
- (v) Increased access to global funds by Indian companies was permitted through American Depositary Receipts (ADRs) and Global Depositary Receipts (GDRs).
- (vi) Investor Education and Protection Fund (IEPF) was established in 2001 to promote investors' awareness and protecting the interest of the investors.

**Marking Scheme:** 1 mark each for correct point. Any four points. Total = 4 marks each

**Q.4 State with reasons whether you agree or disagree with the following statements (Any three).** (12)

**(1) There are many theoretical difficulties in the measurement of national income**

**Ans.** YES, I agree this statements.

The following points explain the statement :

- Reasons:** (i) **Transfer payments:** Individuals get pension, unemployment allowance etc. but whether these transfer payments should be included in national income or not, is a major problem. On one hand they are a part of individual income and on the other hand, they are part of Government expenditure. Hence, these transfer payments are not included in national income.
- (ii) **Illegal income:** Illegal incomes like income from gambling, black marketing, theft, smuggling etc. are not included in national income.
- (iii) **Unpaid services:** For the purpose of calculating national income, only paid goods and services are considered. However, there are a number of unpaid services which are not accounted for in the calculation of national income. For example, services of housewives and the services provided out of love, affection, mercy, sympathy, charity etc. are not included in national income.
- (iv) **Production for self consumption:** The products kept for self consumption by the farmers and other allied producers do not enter the market. Hence, it is not accounted for in the national Income.
- (v) **Income of foreign firms:** According to IMF, income of a foreign firm, should be included in the national income of the country, where the firm actually undertakes the production work.
- (vi) **Valuation of Government Services:** Government provides a number of public services such as law and order, defence, public administration, education, health services etc. The calculation of these services at market price is difficult, as the real value of these services is not known. Therefore, it is difficult to calculate national Income.
- (vii) **Changing price level:** Difficulties in calculating national income also arise due to changes in price levels. For example, when the price level rises, the national income may show an increase even though the production may have decreased. Also, when the price level falls, the national income may show a decrease even though there may be an increase in production.

Hence, I agree this statement.

**(2) When price of Giffen goods fall, the demand for it increases.**

**Ans.** No, I disagree with statement.

The following reasons explain the disagreement:

- Reasons:** (i) Sir Robert Giffen from England noticed that in the case of inferior goods / giffen goods, the law of demand does not hold good. When the price of giffen goods falls, buyers real income gets increased. As its effect they demand more of superior goods.
- (ii) For example, when the price of red wheat falls, the demand for wheat increased.
- (iii) Thus, fall in prices of giffen goods are leads to fall in their demand. Therefore giffen goods are considered as exception to the law of demand. This phenomenon is known as Giffen's paradox.

Thus, when price of giffen goods falls the demand for it does not increase but decreases.

(3) **Foreign trade leads to division of labour and specialization at world level.**

Ans. YES. I agree this statement.

**Reasons:** (i) Trade is an engine of growth of an economy, because it plays an important role for economic development. In developed countries it represents a significant share of Gross Domestic Product.

(ii) Foreign trade leads to division of labour and specialization at world level. Some countries have abundant natural resources, they should export raw material and import finished goods from countries which are advanced in skilled manpower.

(iii) Thus, foreign trade gives benefits to all countries thereby leading to division of labour and specialization.

(4) **Perfectly inelastic demand curve are parallel to the 'y' axis**

Ans. YES. I agree this statement.

**Reasons:**

(i) When a percentage change in price has no effect on the quantity demanded of a commodity it is called perfectly inelastic demand.

(ii) For example,  
20% fall in price will have no effect on quantity demanded.

In the diagram,

when price rises from OP to  $OP_1$  or

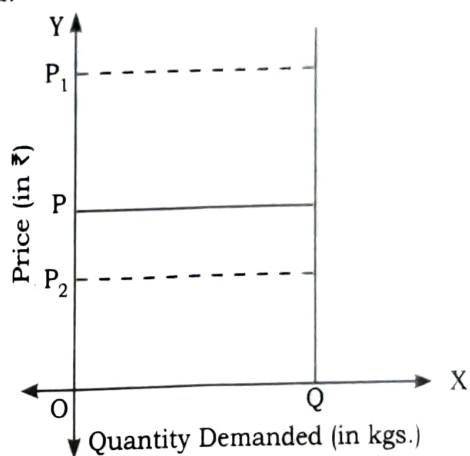
when price falls from OP to  $OP_2$ ,

demand remains unchanged at OQ.

Therefore, the demand curve is

a vertical straight line parallel to the Y axis,

indicating perfectly inelastic demand.



(5) **Total utility and marginal utility is the same.**

Ans. YES, I agree this statement.

**Reasons:** (i) **Total Utility (TU)** : Total utility refers to the aggregate of utility derived by the consumer from all units of a commodity consumed.

(ii) **Marginal Utility (MU)**: Marginal utility refers to the additional utility derived by a consumer from an additional unit of a commodity consumed. In other words, it is the addition made by the last unit.

(iii) Marginal utility derived from various units of a commodity and its total utility are interrelated.

(iv) Total utility and marginal utility of the very first unit of x consumed, are the same. As the consumer consumes further units of x, the total utility increases at a diminishing rate and marginal utility goes on diminishing. (TU MU). At a particular stage, total utility reaches to its maximum and remains constant whereas marginal utility becomes zero. This is called the point of satiety. (TU highest, MU = 0). After this point, any additional unit consumed further results in a decline in the total utility, while marginal utility becomes negative. (TU MU negative). After reaching the point of satiety, a rational consumer should stop his consumption since the maximum limit of satisfaction is reached and there is no addition to total utility by any further increase in the stock of a commodity. Consumption beyond the point of satiety transforms satisfaction into dissatisfaction.

**Marking Scheme:** 1 mark for writing correct agree or disagree;  
3 marks for giving any three correct reasons Total = 4 marks each

**Q.5 Study the following and answer the questions given below it (Any two).** (04)

**(A) Read the given passage and answer the questions.**

The conventional notion of social security is that the government would make periodic payments to look after people in their old age, ill-health, disability and poverty. This idea should itself change from writing a cheque for the beneficiary to institutional arrangements to care for beneficiaries, including by enabling them to look after themselves, to a large extent. The write-a-cheque model of social security is a legacy from the rich world at the optimal phase of its demographic transition, when the working population was numerous enough and earning enough to generate the taxes to pay for the care of those not working. This model is ill-suited for less, well-off India with growing life expectancy, increasing urbanization and resultant migration. Social security under urbanization will be different from social security in a static society.

**(1) State the conventional notion of social security.**

**Ans.** The conventional notion of social security is that the government would make periodic payments to look after people in their old age, ill-health, disability and poverty.

**(2) What kind of conceptual change is suggested in the given paragraph.**

**Ans.** This idea should itself change from writing a cheque for the beneficiary to institutional arrangements to care for beneficiaries, including by enabling them to look after themselves.

**(3) What is a legacy of social security from the rich world?**

**Ans.** The write-a-cheque model of social security is a legacy from the rich world at the optimal phase of its demographic transition.

**(4) Which features of India make the traditional model of social security ill-suited for the economy?**

**Ans.** This model is ill-suited for less, well-off India with growing life expectancy, increasing urbanization and resultant migration.

**(B) Observe the following table and answer the questions.**

Sr. No.	Direction of India's imports Countries / Organisations	Percentage 1990 - 1991	Percentage 2015 - 2016
1	OECD	54.0	28.8
2	OPEC	16.3	23.6
3	Eastern Europe	7.8	1.9
4	Developing Nations	18.6	43.2
5	Others	1.4	2.5

**(1) Which organisation has the least share in the direction of India's imports in 2015-16?**

**Ans.** Eastern Europe.

**(2) Which organisation has maximum share in India's direction of imports in 1990-91?**

**Ans.** OECD.

**(3) How much is the percentage of increase in the imports of developing nations in 2015-16 as compared to 1990-91?**

**Ans.** 24.6

**(4) State your opinion regarding the direction of India's imports.**

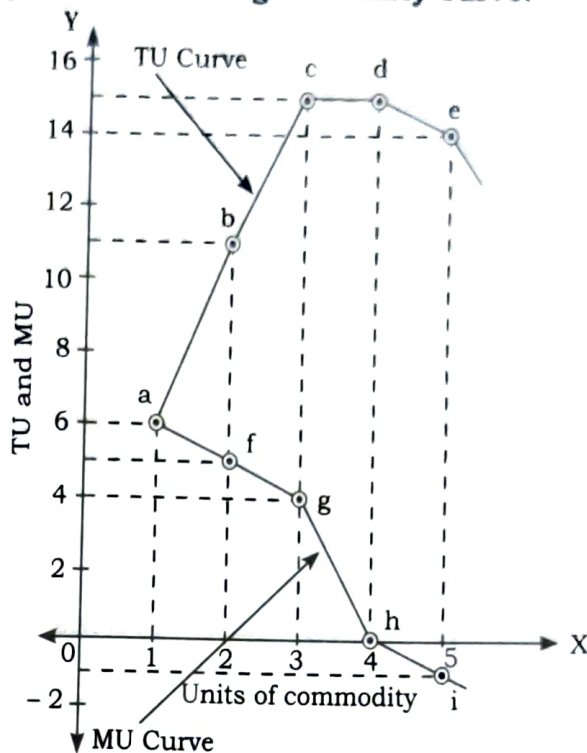
**Ans.** India's Imports are increasing.

(C) Observe the given table and answer the questions.

Unit of a commodity	TU units	MU units
1	6	6
2	11	5
3	15	4
4	15	0
5	14	-1

(1) Draw total utility curve and marginal utility curve.

Ans.



(2) (a) When total utility is maximum marginal utility is \_\_\_\_\_.

Ans. Zero

(b) When total utility falls, marginal utility becomes \_\_\_\_\_.

Ans. Negative

**Marking Scheme:** 1 mark each for correct answer; Total = 4 marks each

**Q.6 Answer in detail (Any two).**

(16)

(1) Explain the practical difficulties involved in the measurement of national income.

Ans. In practice, a number of difficulties arise in the collection of statistical data required for estimation of national income. Some of the practical difficulties are as follows :

- Problem of double counting:** The greatest difficulty in calculating national income is of double counting. It arises from the failure to distinguish properly, between a final and an intermediate product. For example, flour used by a bakery is an intermediate product and that by a household is final product.
- Existence of non-monetized sector:** In India, especially in rural areas, there exists the non-monetized sector. Agriculture, still being in the nature of subsistence farming, a major part of production is partly exchanged for other goods and services. It is excluded while counting national income.
- Inadequate and unreliable data:** Adequate and correct data on production and cost data relating to crops, fisheries, animal husbandry, forestry, construction workers, small enterprises etc., are not available in a developing country. Besides this, data on unearned incomes, consumption and investment expenditure of rural

and urban population are also not available. This does not reveal the actual size of national income.

- (iv) **Depreciation:** Depreciation refers to wear and tear of capital assets, due to their use in the process of production. There are no uniform, common or accepted standard rates of depreciation applicable to the various capital assets. Thus, it is difficult to make correct deductions for depreciation.
- (v) **Capital gains or losses:** Capital gains or capital losses, which accrue to the property owners by increase or decrease in the market value of their capital assets or changes in demand, are not included in the national income because these changes do not result from current economic activities.
- (vi) **Illiteracy and ignorance:** Due to ignorance and illiteracy, small producers do not keep an account of their production. So they cannot give information about the quantity or value of their output.
- (vii) **Difficulties in the classification of working population:** In India, working population is not clearly defined. For instance, farmers in India are not engaged in agriculture round the year. Obviously, in the off season, they engage themselves in alternative occupations. In such a case, it is very difficult to identify their incomes from a particular occupation.
- (viii) **Valuation of inventories:** Raw materials, intermediate goods, semi-finished and finished products in the stock of the producers are known as inventories. Any mistake in measuring the value of inventory, will distort the value of the final production of the producer. Therefore, valuation of inventories requires careful assessment.

**Marking Scheme:** 1 mark for each correct point; Total = 8 marks.

## (2) State and explain the law of demand with exceptions.

**Ans. Introduction:** The law of demand was introduced by Prof. Alfred Marshall in his book, 'Principles of Economics', which was published in 1890. The law explains the functional relationship between price and quantity demanded.

### Statement of the Law:

According to Prof. Alfred Marshall, "Other things being equal, higher the price of a commodity, smaller is the quantity demanded and lower the price of a commodity, larger is the quantity demanded."

In other words, other factors remaining constant, if the price of a commodity rises, demand for it falls and when price of a commodity falls demand for the commodity rises. Thus, there is an inverse relationship between price and quantity demanded. Symbolically, the functional relationship between demand and price is expressed as:

$$D_x = f(P_x),$$

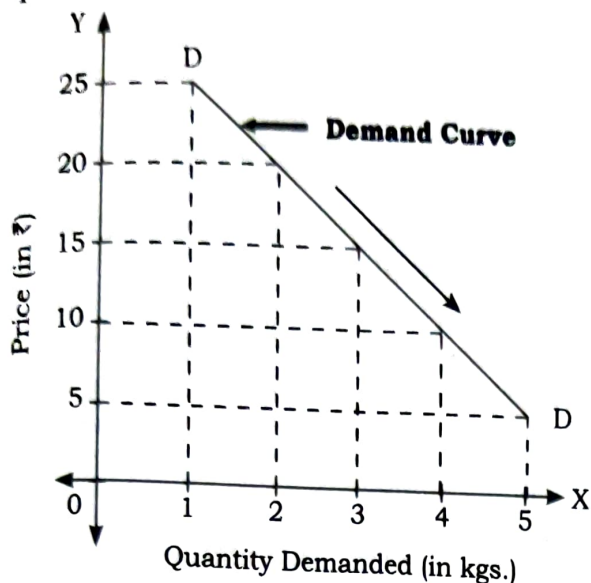
where  $D$  = Demand for a commodity,  $x$  = Commodity,  
 $f$  = Function,  $P_x$  = Price of a commodity

The law of demand is explained with the help of the following demand schedule and diagram.

Demand Schedule	
Price of commodity 'x' (in ₹)	Quantity demanded of commodity 'x' (in kgs)
25	1
20	2
15	3
10	4
5	5

As shown in the table, when price of commodity 'x' is ₹25, quantity demanded is 1 kg. When price falls from ₹25 to ₹20, quantity demanded rises from 1 kg to

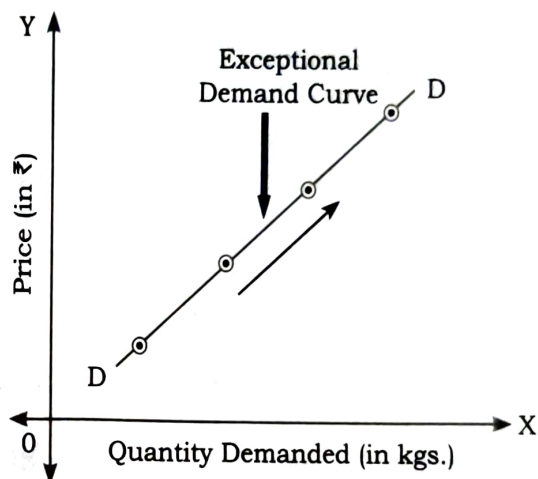
2 kgs. Similarly, at price ₹15, quantity demanded is 3 kgs and when price falls from ₹10 to ₹5, quantity demanded rises from 4 kgs to 5 kgs. Thus, as the price of a commodity falls, quantity demanded rises and when price of commodity rises, quantity demanded falls. This shows an inverse relationship between price and quantity demanded.



The curve shows, X-axis represents the demand for the commodity and Y-axis represents the price of commodity x. 'DD' is the demand curve which slopes downward from left to right due to an inverse relationship between price and quantity demanded.

### Exceptions to the Law of Demand :

There are certain exceptions to the law of demand. It means that under exceptional circumstances, consumer buys more when the price of commodity rises and buys less when price of commodity falls. In such cases, demand curve slopes upwards from left to right. i.e. the demand curve has a positive slope as shown in the adjacent diagram.



### Following are the exceptions to the law of demand:

- (i) **Giffen's paradox:** Inferior goods or low quality goods are those goods whose demand does not rise even if their price falls. At times, demand decreases when the price of such commodities fall. Sir Robert Giffen observed this behavior in England in relation to bread. He noted that, when the price of bread declined, people did not buy more because of an increase in their real income or purchasing power. They preferred to buy superior good like meat. This is known as Giffen's paradox.
- (ii) **Prestige goods:** Expensive goods like diamond, gold etc. are status symbol. So rich people buy more of it, even when their prices are high.
- (iii) **Speculation:** The law of demand does not hold true when people expect prices to rise still further. In this case, although the prices have risen today, consumers will demand more in anticipation of further rise in price. For example, prices of oil, sugar etc. tend to rise before Diwali. So people go on purchasing more at a high price as they anticipate that prices may rise during Diwali.
- (iv) **Price illusion:** Consumers have an illusion that high priced goods are of a better quality. Therefore, the demand for such goods tend to increase with a rise in their prices. For example, branded products which are expensive are demanded even at a high price.

- (v) **Ignorance:** Sometimes, due to ignorance people buy more of a commodity at high price. This may happen when consumer is ignorant about the price of that commodity at other places.
- (vi) **Habitual goods:** Due to habit of consumption, certain goods like tea is purchased in required quantities even at a higher price.

**Marking Scheme:** 1 mark for introduction, 2 marks for statement of law, 1 mark for schedule, 1 mark for diagram and 3 marks for exceptions (any 3 points); Total = 8 marks.

**(3) Explain various reasons for the growth of public expenditure.**

**Ans.** The reasons for the growth of public expenditure are as follows:

- (i) **Increase in the Activities of the Government:** As mentioned earlier, the modern government performs many functions for the social and economic development of the country. These functions include spread of education, public health, public works, public recreation, social welfare schemes etc. It is observed that new functions are continuously being undertaken and old functions are being performed more efficiently on a large scale by the government. This leads to increase in public expenditure.
- (ii) **Rapid Increase in Population:** Population of developing countries like India is increasing fast. In 2011 Census, it was 121.02 crores. As a result, the government has to incur greater expenditure to fulfil the needs of the increasing population.
- (iii) **Growing Urbanization:** Spread of urbanization is a global phenomenon of the day. This leads to increase in the government expenditure on water supply, roads, energy, schools and colleges, public transport, sanitation etc.
- (iv) **Increasing Defence Expenditure:** In modern times, defence expenditure of the government is increasing even in the peace time due to unstable and hostile international relationships.
- (v) **Spread of Democracy:** Majority of the countries in the world are democratic in nature. A democratic form of government is expensive due to regular elections and other such activities. This results in the increase in total expenditure of the government.
- (vi) **Inflation:** Just like a private individual, the government has to buy goods and services from the market for the spread of economic and social development. Normally, prices show a rising trend. Due to this, the government has to incur increasing costs.
- (vii) **Industrial Development:** Industrial development leads to an increase in production, employment and overall growth in the economy. Hence, the government makes huge efforts for implementing various schemes and programmes for industrial development. This results in increase in government expenditure.
- (viii) **Disaster Management:** Many natural and man-made calamities like earthquakes, floods, cyclones, social unrest etc. are occurring more frequently. The government has to spend a huge amount for the disaster management which increases total expenditure. Modern governments are working for 'welfare state'. Hence, there is a continuous increase in the public expenditure.

**Marking Scheme:** 1 mark for each correct point; Total = 8 marks.