SPECIMEN PAPER - 5 (With Solution)

[Time : 3 Hours] [Maximum Marks : 80]

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. **(05)**

(1) Concepts studied under Macro Economics :
(a) Whole economy *(b) Economic development*
(c) Aggregate supply *(d) Product pricing*
Options : *(i) a, b and c* *(ii) b, c and a* *(iii) only d* *(iv) a, b, c and d*

(2) Individual investors have lost confidence in the capital market due to :
(a) lack of financial instruments *(b) high transaction cost*
(c) low returns *(d) financial scams*
Options : *(i) only a* *(ii) only b* *(iii) only c* *(iv) only d*

(3) Wrongly matched pair :

(a)	National Income Committee	–	1949
(b)	Financial year	–	1st April to 31st March
(c)	Income method	–	National Income = Rent, Wages + Interest + Profit + Mixed Income + Net Income from Abroad
(d)	Expenditure method	–	National Income = Rent, Wages + Interest + Profit

Options : *(i) only a* *(ii) only b* *(iii) only c* *(iv) only d*

(4) In Economic sense, market includes following activities :
(a) The place where goods are sold and purchased
(b) An arrangement through which buyers and sellers come in contact with each other directly or indirectly
(c) A shop where goods are sold
(d) All of the above
Options : *(i) a and b* *(ii) b and c* *(iii) a, b and c* *(iv) only d*

(5) Optional functions of government :
(a) Protection from external attack
(b) Provision of education and health services
(c) Provision of social security measures
(d) Collection of tax
Options : *(i) a, b and c* *(ii) b and c* *(iii) b, c and d* *(iv) all of these*

Ans.	(1) (i)	(2) (iv)	(3) (iv)	(4) (i)	(5) (ii)

Marking Scheme: *1 mark for each correct answer*

Q.1 (B) Find the odd word out. **(08)**

(1) Selling Cost : Free gifts, advertisement hoardings, window displays, patents.

(2) Unregular Financial Intermediates : Mutual funds, Nidhi, Chit fund, loan companies.

(3) Non - Tax Revenue : Donation fees, GST, Fines and penalties.

(4) Types of Demand : Direct demand, Indirect demand, Corporate demand, Market demand.

(5) Features of utility : Subjective concept, Relative concept, Multipurpose concept, Time utility.

Ans.	(1) patents	(2) mutual funds	(3) GST	(4) market demand	(5) time utility

Marking Scheme: *1 mark for each correct answer*

Q.1 (C) Assertion and Reasoning type questions. **(05)**

(1) Assertion (A) : Degree of price elasticity is less than one in case of relatively inelastic demand.

Reasoning (R) : Change in demand is less than the change in price.

Options : *(1) (A) is True, but (R) is False*
(2) (A) is False, but (R) is True
(3) Both (A) and (R) are True and (R) is the correct explanation of (A)
(4) Both (A) and (R) are True and (R) is not the correct explanation of (A)

(2) Assertion (A) : Regional stock exchanges have witnessed a sharp decline in the volume of trade.

Reasoning (R) : Investors prefer to trade in securities listed in stock exchanges like BSE, NSE etc.

Options : *(1) (A) is True, but (R) is False*
(2) (A) is False, but (R) is True
(3) Both (A) and (R) are True and (R) is the correct explanation of (A)
(4) Both (A) and (R) are True and (R) is not the correct explanation of (A)

(3) Assertion (A) : Marginal utility increases at a diminishing rate.

Reasoning (R) : Then total utility goes on diminishing.

Options : *(1) (A) is True, but (R) is False*
(2) (A) is False, but (R) is True
(3) Both (A) and (R) are True and (R) is the correct explanation of (A)
(4) Both (A) and (R) are True and (R) is not the correct explanation of (A)

(4) Assertion (A) : Simple index number are assumed as base years.

Reasoning (R) : Every commodity is given equal importance.

Options : *(1) (A) is True, but (R) is False*
(2) (A) is False, but (R) is True
(3) Both (A) and (R) are True and (R) is the correct explanation of (A)
(4) Both (A) and (R) are True and (R) is not the correct explanation of (A)

(5) Assertion (A) : Perfect competition prevails when the demand for output of each producer is perfectly elastic.

Reasoning (R) : A single uniform price prevails under perfect competition which is determined by the interaction of demand and supply.

Specimen

Options: (1) (A) is True, but (R) is False
(2) (A) is False, but (R) is True
(3) Both (A) and (R) are True and (R) is the correct explanation of (A)
(4) Both (A) and (R) are True and (R) is not the correct explanation of (A)

Ans.	(1) (3)	(2) (2)	(3) (1)	(4) (3)	(5) (3)

Marking Scheme: *1 mark for each correct answer*

Q.1 (D) Complete the following statements. **(05)**

(1) Commercial banks act as intermediates in the financial system to _____.
(a) *make profits*
(b) *accelerate the country's economic growth*
(c) *mobilise the savings and allocating them to various sectors of the economy*
(d) *control the credit*

(2) In India, National Income is estimated using _____.
(a) *Output method*
(b) *Income method*
(c) *Expenditure method*
(d) *Combination of Output and Income method*

(3) Other factors remaining constant, when less quantity is supplied only due to fall in price, it shows _____.
(a) *contraction of supply* (b) *decrease of supply*
(c) *expansion of supply* (d) *increase of supply*

(4) Price elasticity of demand in a linear demand curve at the Y-axis is equal to _____.
(a) *zero* (b) *one*
(c) *infinity* (d) *greater than one*

(5) The relationship between price and quantity demand is _____.
(a) *Direct* (b) *Indirect* (c) *Contraction* (d) *Expansion*

Ans.	(1) (c) mobilise the savings and allocating them to various sectors of the economy	
	(2) (d) Combination of Output and Income method	(3) (a) contraction of supply
	(4) (a) zero	(5) (b) indirect

Marking Scheme: *1 mark for each correct answer*

Q.2 (A) Identify and explain the concepts (Any three). **(06)**

(1) Rohan uses interdependence and advertising to grow his business.

Ans. Oligopoly.

Oligopoly market where there are a few sellers (firms) in the market producing either a homogeneous product or a differentiated product.

(2) 60% fall in price of a commodity leads to 60% rise in quantity demanded.

Ans. Unitary elastic demand.

Unitary elastic demand refers a percentage change in price, leads to a proportionate change in quantity demanded.

(3) Neha taught her grandmother some computer tasks.

Ans. Knowledge utility.

When a consumer acquires knowledge about a particular product, it is called knowledge utility.

(4) Keshav sent ₹2,00,000 to his uncle from Mumbai with the help of a bank.

Ans. NEFT.

It is an electronic transfer process, through which money can be sent from one bank account to another within the country in a safe and hassle free manner.

(5) Assuming 2015 as the base year, the government of Kerala fixed the value for 2019.

Ans. Price Index number.

Price index number compares the level of a price between two different time periods.

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

Q.2 (B) Distinguish between (Any three). **(06)**

(1) Money market and Capital Market

Ans.

	Money Market		Capital Market
(i)	Money market is a market for lending and borrowing of short term funds.	(i)	Capital market is a market for long term funds - both equity and debt raised within and outside the country.
(ii)	Trade bills, Government securities etc.	(ii)	Funds demanded banks, Corporate savings etc.

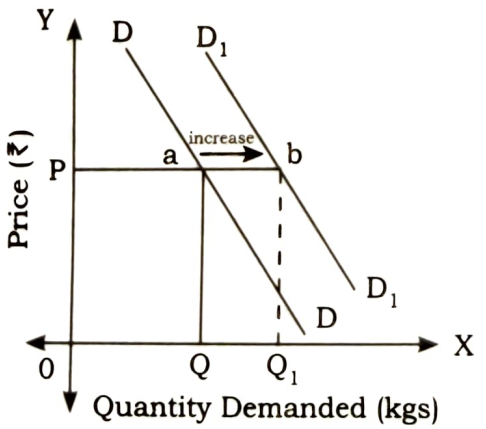
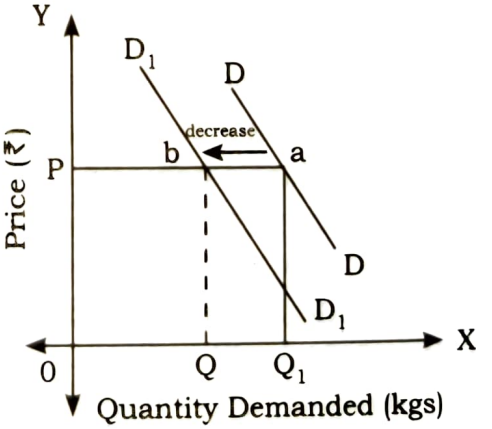
(2) Simple Index Numbers and Weighted Index Numbers.

Ans.

	Simple Index Numbers		Weighted Index Numbers
(i)	In this method, every commodity is given equal importance.	(i)	In this method, suitable weights are assigned to various commodities.
(ii)	It is the easiest method.	(ii)	It is the weights method.
(iii)	Price index Quantity index, Value index can be applied to this method.	(iii)	Laspeyre's and Paasche's Price index can be applied in this method.

(3) Increase in demand and Decrease in demand.

Ans.

	Increase in Demand		Decrease in Demand
(i)	Increase in demand refers to increase in quantity demanded due to favourable changes.	(i)	Decrease in quantity demanded due to unfavourable changes.
(ii)	Demand curve shifts to the right side of the original demand curve.	(ii)	Demand curve shifts to the left side of the original demand curve.
(iii)		(iii)	

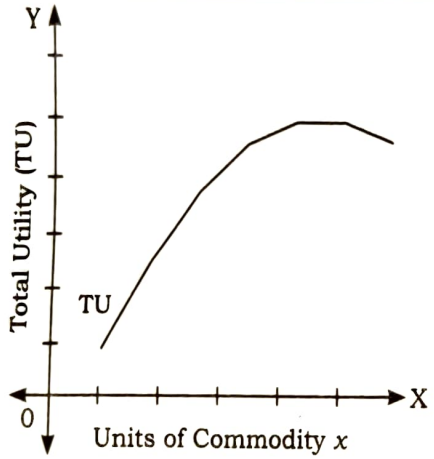
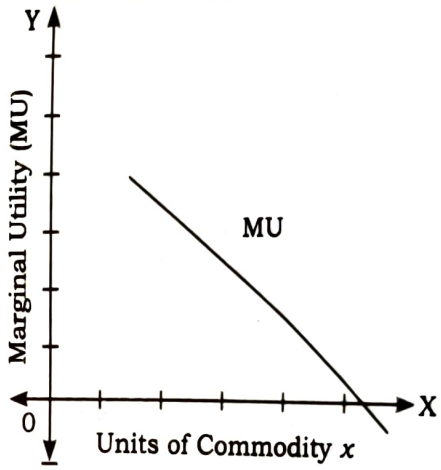
(4) Marginal Cost (MC) and Marginal Revenue (MR).

Ans.

	Marginal Cost (MC)		Marginal Revenue (MR)
(i)	Marginal Cost (MC) is net addition made to total cost by producing one more unit of output.	(i)	Marginal Revenue (MR) is the net addition made to total revenue by selling an extra unit of the commodity.
(ii)	$MC_n = TC_n - TC_{n-1}$.	(ii)	$MR_n = TR_n - TR_{n-1}$.

(5) Total Utility and Marginal Utility.

Ans.

	Total Utility		Marginal Utility
(i)	Total Utility (TU) is the sum total of individual utilities derived from the consumption of a single unit of good.	(i)	Marginal Utility (MU) is the addition made to the total utility from every additional unit consumed.
(ii)	$TU = \Sigma MU$	(ii)	$MU_n = TU_n - TU_{(n-1)}$
(iii)		(iii)	

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. (i) **Study of Individual Units:** Micro economics is the study of the behaviour 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. For example, study of individual income out of national income, study of individual demand out of aggregate demand etc.

(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 .

(2) Explain the functions of commercial bank.

Ans. Commercial banks act as intermediaries in the country's financial system to bring the savers and investors together. Scheduled commercial banks are those included in the second schedule of the Reserve Bank of India Act, 1934. In terms of ownership and function, commercial banks in India can be classified into four categories:

- Public sector banks
- Private sector banks
- Regional rural banks
- Foreign banks

Definitions of 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."

Prof. Cairncross : "A bank is a financial intermediary, a dealer in loans and debts."

Functions of Commercial Banks:

(i) **Acceptance of deposits:** Deposits constitute the main source of funds for commercial banks. Savings lead to the creation of deposits. Deposits are categorized as (a) Demand deposits and (b) Time deposits.

(a) **Demand Deposits:** Deposits that are withdrawable on demand are known as demand deposits. They are in the form of Current account and Savings account deposits.

- Current account is usually opened by businessmen, corporations, industrial houses, trusts etc. They are provided with overdraft facility. Overdraft means withdrawal in excess of the balance in the account.
- Savings account are operated by a large number of people, particularly the salaried class, small traders etc. who wish to save a part of their income with the bank.

(b) **Time deposits:** Deposits that are repayable after a certain period of time are known as time deposits. They are in the form of recurring deposits and time deposits.

- Recurring deposit refers to a deposit wherein a customer deposits a fixed amount at regular intervals for a specified period of time.
- Fixed deposits refer to a lumpsum amount deposited by a customer for a specified period of time. Compared to all other deposits, fixed deposits carry a high rate of interest.

(ii) **Providing loans and advances:** Commercial banks mobilize savings and lend these funds to institutions and individuals for various purposes. Based on the tenure, loans include call loans, short term, medium term and long term loans. Longer the duration of the loans, greater will be the rate of interest. Besides this, banks also provide cash credit, overdraft facility as well as discount bills of exchange.

(iii) **Ancillary functions:** Commercial banks also provide a range of ancillary services such as transfer of funds, collection of money, making periodical payments on behalf of the customer, merchant banking,foreign exchange, safe deposit lockers, D-mat facility, internet banking, mobile banking etc.

(iv) **Credit Creation:** Credit creation is an important function of commercial banks. Commercial banks are creators of credit. Demand and time deposits constitute the primary deposits of banks. After meeting the reserve requirements out of the net demand and time liabilities, the balance amount is used for giving loans. Thus, secondary deposits or 'derivative deposits' are created out of the loans given by the banks. For instance, when the bank provides loan to its customer, the loan amount is credited into the bank account of the customer. The bank that receives the loan amount as a deposit, keeps aside a certain portion in the form of reserves. After meeting the reserve requirements, the bank lends the remaining amount. This procedure is followed by the entire banking system in the country, leading to creation of credit. In short, commercial banks create deposits out of the loans given thereby leading to crediton.

(3) Explain features of oligopoly market.

Ans. That market where there are a few firms (sellers) in the market producing either a homogeneous product or a differentiated product. For example, mobile service providers, cement companies etc.

Features of oligopoly:

(i) **Few firms or sellers:** Under oligopoly market, there are few firms or sellers. These few firms dominate the market and enjoy a considerable control over the price of a product.

(ii) **Interdependence:** The seller has to be cautious with respect to any action taken by the competing firms. Since there are few sellers in the market, if any firm makes the change in the price, all other firms in the industry also try to follow the same to remain in the competition.

(iii) **Advertising:** Advertising is a powerful instrument in the hands of oligopolist. A firm under oligopoly can start an aggressive and attractive advertising campaign with the intention of capturing a large part of market.

(iv) **Entry barriers:** The firm can easily exit from the industry whenever it wants. But has to face certain entry barriers such as Government license, patents etc.

(v) **Lack of uniformity:** There is a lack of uniformity among the firms in terms of their size. Some firms may be small while others may be of bigger size.

(vi) **Uncertainty:** There is a considerable element of uncertainty in this type of market due to different behaviour patterns. Rivals may join hands and co-operate or may try to fight each other.

(4) Explain role of Foreign Trade.

Ans. 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.

Role of foreign trade can be justified on the basis of the following points:

(i) **To earn foreign exchange:** Foreign trade provides foreign exchange which can be used for very productive purposes. Foreign trade is a remarkable factor in expanding the market and encouraging the production of goods.

(ii) **Encourages Investment:** Foreign trade creates an opportunity for the producers to reach beyond the domestic markets. It encourages them to produce more goods for export. This leads to an increase in total investment in an economy.

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

(iv) **Optimum allocation and utilization of resources:** Due to specialization, resources are channelized for the production of only those goods which would give highest returns. Thus, there is rational allocation and specialization of resources at the international level due to foreign trade.

(v) **Stability in price level:** Foreign trade helps to keep the demand and supply position stable which in turn stabilizes the price level in the economy.

(vi) **Availability of multiple choices:** Foreign trade provides multiple choices of imported commodities. As foreign trade is highly competitive it also ensures a good quality and standard products. This raises the standard of living of people.

(vii) **Brings reputation and helps earn goodwill:** Exporting country can earn reputation and goodwill in the international market. For example, countries like Japan, Germany, Switzerland etc. have earned a lot of goodwill and reputation in foreign market for their qualitative market for their qualitative production of electronic goods.

(5) 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. E.g. 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.

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) Micro economics uses slicing method.

Ans. Yes, I **agree** with statement.

Reasons: (i) Micro economics uses slicing method. It splits or divides the whole economy into small individual units and then studies each unit separately in detail.

(ii) For example, study of individual income out of national income, study of individual demand out of aggregate demand etc.

(iii) Then its studies economic behaviour of each Individual economic Units is separately. Therefore micro economics use slicing method .

(2) Index numbers can be constructed without the base year.

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

Reasons: (i) Main features are index number is selection of the base year.

(ii) The year with which the changes are measured is called the base year. Base Year : The year with respect to which comparisons are made is the base year. It is denoted by the suffix 'o'.

(iii) The base year's index is assumed as 100 and accordingly the value of the current year is calculated.

(iv) Base year is also called the reference year. It is the year against which comparisons are made.

Then base year should be normal i.e. it should be free from natural calamities. It should not be too distant in the past.

So, I disagree with statement.

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

Ans. Yes, I **agree** with statement.

Reasons: (i) Foreign trade leads to division of labour and specialization at world level. Because Some countries have abundant natural resources.

(ii) 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.

So, I agree with the statement.

(4) No close substitute in the monopoly market.

Ans. Yes, I **agree** with statement.

Reasons: (i) There are no close substitutes for the product of the monopolist. Therefore, the buyer have no choice.

(ii) They have to either buy the product from the monopolist or go without it.

(iii) The cross elasticity of demand for his product is either zero or negative.

(5) Credit creation is the function of commercial bank.

Ans. Yes, I **agree** with statement.

Reasons: (i) Credit creation is an important function of commercial banks. Commercial banks are creators of credit. Demand and time deposits constitute the primary deposits of banks.

(ii) After meeting the reserve requirements out of the net demand and time liabilities, the balance amount is used for giving loans.

(iii) Thus, secondary deposits or 'derivative deposits' are created out of the loans given by the banks. For, instance, when the bank provides loan to its customer, the loan amount is credited into the bank account of the customer.

(iv) The bank that receives the loan amount as a deposit, keeps aside a certain portion in the form of reserves.

So, I agree with statements.

> ***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). **(08)**

(A) Observe the following table and answer the questions.

Price in ₹	Supplied in units
10	200
15	
20	300
25	350
30	
35	
40	

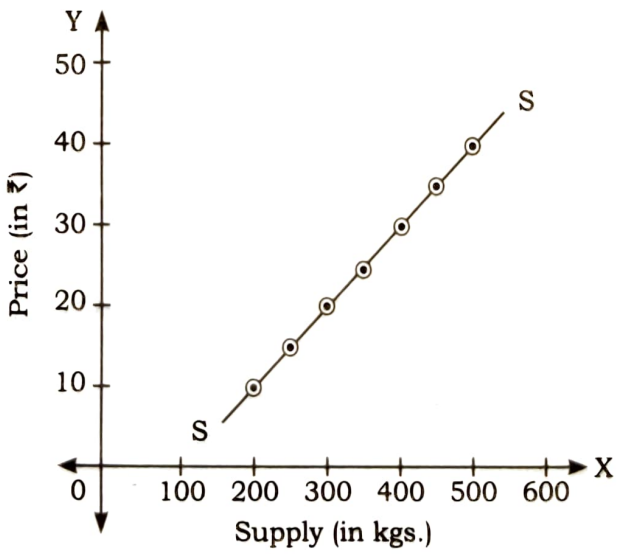
(1) Complete the above supply schedule.

Ans.

Price in ₹	Supplied in units
10	200
15	250
20	300
25	350
30	400
35	450
40	500

(2) Draw a diagram for the above supply schedule.

Ans.



(B) Solve the following.

Commodity	A	B	C	D
Price in 2005 (₹)	04	14	22	06
Price in 2012 (₹)	06	16	26	08

Calculate Price Index number from the above data

Ans.

Commodity	Price in 2005 (₹)	Price in 2012 (₹)
A	04	06
B	14	16
C	22	26
D	06	08
Total	$\Sigma p_0 = 46$	$\Sigma p_1 = 56$

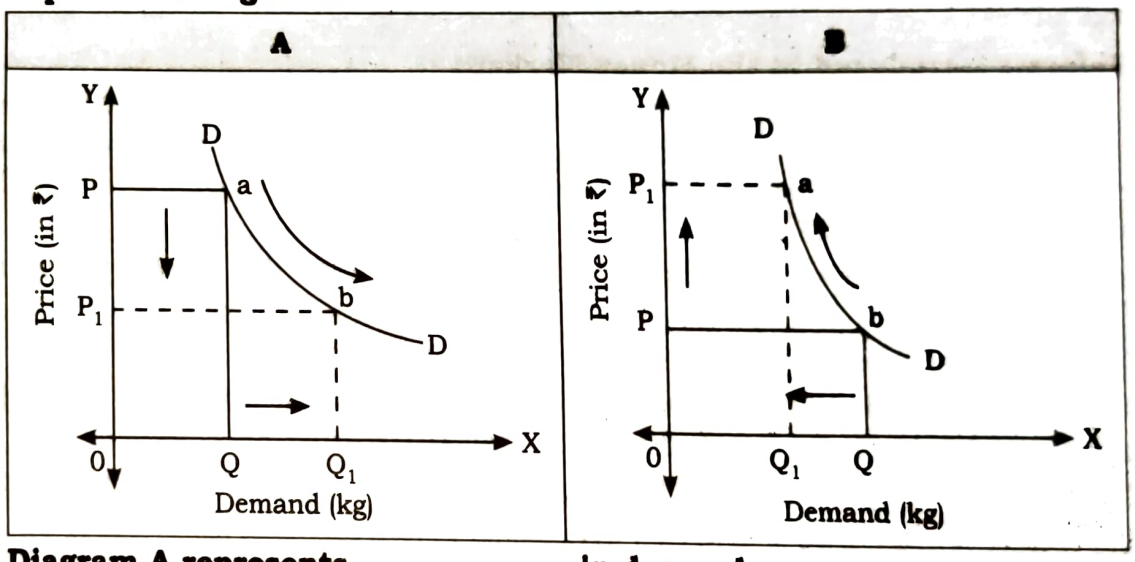
Price Index Number $P_{01} = \frac{\Sigma p_1}{\Sigma p_0} \times 100$

where, Σp_1 = Sum total of the prices of the current year

Σp_0 = Sum total of the prices of the base year

$\therefore P_{01} = \frac{56}{46} \times 100 = 121.74$

(C) Explain the diagrams.



(1) Diagram A represents _____ in demand.

Ans. Diagram A represents expansion in demand.

(2) In diagram 'B' movement of demand curve is in _____ direction.

Ans. In diagram 'B' movement of demand curve is in upward (from right to left) direction.

Marking Scheme: *2 marks each for correct answer Total = 4 marks each*

Q.6 Answer in detail (Any two). **(16)**

(1) Explain the role of money market in India and explain its reforms.

Ans. Role of Money Market in India following points explain the role of money market in India :

(i) **Short-term requirements of borrowers:** Money market provides reasonable access for meeting the short-term financial needs of the borrowers at realistic prices.

(ii) **Liquidity Management:** Money market is a dynamic market. It facilitates better management of liquidity and money in the economy by the monetary authorities. This, in turn, leads to economic stability and development of the country.

(iii) **Portfolio Management:** Money market deals with different types of financial instruments that are designed to suit the risk and return preferences of the investors. This enables the investors to hold a portfolio of different financial assets which in turn, helps in minimizing risk and maximizing returns.

(iv) **Equilibrating mechanism:** Through rational allocation of resources and mobilization of savings into investment channels, money market helps to establish equilibrium between the demand for and supply of short-term funds.

(v) **Financial requirements of the Government:** Money market helps the Government to fulfill its short term financial requirements on the basis of Treasury Bills.

(vi) **Implementation of Monetary policy:** Monetary policy is implemented by the central bank. It aims at managing the quantity of money in order to meet the requirements of different sectors of the economy and to increase the pace of economic growth. A well-developed money market ensures successful implementation of the monetary policy. It guides the central bank in developing an appropriate interest policy.

(vii) **Economizes the use of cash:** Money market deals with various financial instruments that are close substitutes of money and not actual money. Thus, it economizes the use of cash.

(viii) **Growth of Commerce, Industry and Trade:** Money market facilitates discounting bills of exchange to local and international traders who are in urgent need of short-term funds. It also provides working capital for agriculture and small scale industries.

- **Reforms introduced in the Money Market :**

Following are some of the important reforms introduced in the money market :

(i) Introduction of new instruments such as Treasury bills of varying maturity periods,Commercial Papers (CPs), Certificate of Deposits (CDs) and Money Market Mutual Funds (MMMFs).

(ii) RBI Repos and Reverse Repos were introduced under the Liquidity Adjustment Facility (LAF).

(iii) Interest rates to be largely determined by market forces.

(iv) National Electronic Fund Transfer (NEFT) and Real Time Gross Settlement (RTGS) were introduced as an improved payment infrastructure.

(v) Electronic dealing system was introduced to bring about technological upgradation.

Marking Scheme: *4 marks for role of money market and 4 marks for reforms.*

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

Ans. Reasons for Growth in Public Expenditure: It is observed that there is a continous growth in public expenditure in a developing country like India.

(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 2011Census, it was 121.02 crores. As a result, the government has to incur greater expenditure to fulfill 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 point, eight points expected.*

3) State and explain the law of demand with assumptions.

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:

$$Dx = f(Px),$$

where D = Demand for a commodity, x = Commodity,

f = Function, Px = Price of a commodity

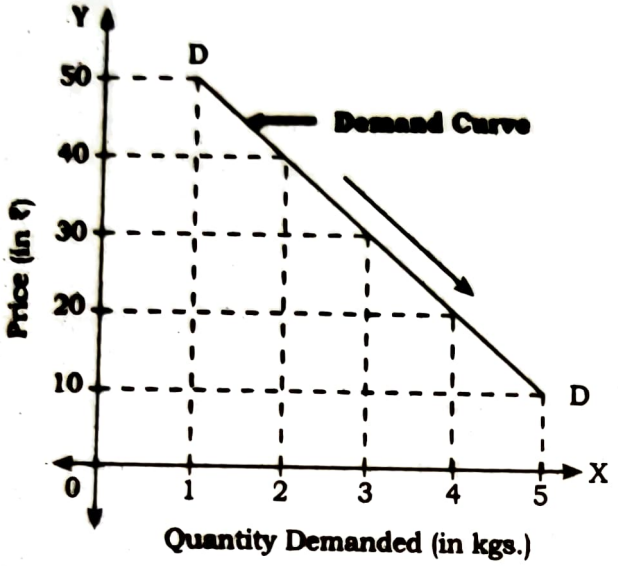
The law of demand is explained with the help of the following demand schedule and diagram.

Demand Schedule

Price of commodity 'x' (in ₹)	Quantity demanded of commodity 'x' (in kgs)
50	1
40	2
30	3
20	4
10	5

As shown in the table, when price of commodity 'x' is ₹50, quantity demanded is 1 kg. When price falls from ₹50 to ₹40, quantity demanded rises from 1 kg to

2 kgs. Similarly, at price ₹30, quantity demanded is 3 kgs and when price falls from ₹20 to ₹10, 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.



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.

- **Assumptions :**

Law of demand is based on the following assumptions :

(i) **Constant level of income :** If the law of demand is to find true operate then, consumers' income should remain constant. If there is a rise in income, people may demand more at a given price.

(ii) **No change in size of population:** It is assumed that the size of population remains unchanged. Any change in the size and composition of population of a country affects the total demand for the product.

(iii) **Prices of substitute goods remain constant:** It is assumed that the prices of substitutes remain unchanged. Any change in the price of the substitute will affect the demand for the commodity.

(iv) **Prices of complementary goods remain constant:** It is assumed that the prices of complementary goods remain unchanged because a change in the price of one good will affect the demand for the other.

(v) **No expectations about future changes in prices:** It is assumed that consumers do not expect any further change in price in the near future. If consumers expect a rise in prices in future, they may demand more in the present even at existing high price.

(vi) **No change in tastes, habits, preferences, fashions etc.:** It is assumed that consumers' tastes, habits, preferences, fashions etc. should remain unchanged. Any change in these factors will lead to a change in demand.

(vii) **No change in taxation policy:** Taxation policy of the government has a great impact on demand for various goods and services.

Therefore, it is assumed that there is no change in the policy of taxation declared by Government.

Marking Scheme: *4 marks for law explanation, 4 marks for assumptions.*