SECTION – "A"

Q. 2 (a) Each economy has a stock of limited resources labour, technical knowledge, factories and tools, land, energy. In deciding what and how things should be produced, the economy is in reality deciding how to allocate its resources among the thousands of different possible commodities and services.

Faced with the undeniable fact that goods are scare relative to wants, an economy must decide how to cope with limited resources. It must choose among different potential bundles of goods (the what), select from different techniques of production (the how), and decide in the end who will consume the goods (the for whom).

Factors of production can be classified into three broad categories: land, labour, and capital.

- Land or, more generally, natural resources represents the gift of nature to our productive processes. It consists of the land used for farming or for underpinning houses, factories, and road; the energy resources that our cars and heat our homes; and the nonenergy resources like copper and iron ore and sand. It today's congested world, we must broaden the scope of natural resources to include our environmental resources, such as clean air and drinkable water.
- Labour consists of the human time spent in production working in automobile factories, tilling the land, teaching school, or baking pizzas. Thousands of occupations and tasks, at all skill level, are performed by labour. It is at once the most familiar and the most crucial input for an advanced industrial economy.
- Capital resources form the durable goods of an economy, produced in order to produce yet other goods, Capital goods include machines, roads, computers, hammers, trucks, steel mills, automobiles, washing machines, and buildings, As we will see later, the accumulation of specialized capital goods is essential to the task of economic development.

Restating the three economic problems in terms of inputs and outputs, a society must decide (1) what outputs to produce, and what quantity; (2) how to produce them that is, by what techniques inputs should be combined to produce the desired outputs; and (3) for whom the outputs should be produced and distributed.

Q. 2 (b) **SIGNIFICANCE OR USEFULNESS OF ECONOMICS:**

Economics is useful for (a) knowledge sake and (b) for practical purposes.

a) **For knowledge sake** – Some people study economics because they get fascinated by its logical and scientific nature. It is of little concern to them whether the subject-matter is relevant to the solution of any of the world's problems: for them economics has its own justification. They get deeply involved into the subject i.e. how production takes place, how consumers react, how economics grow, etc.

b) For practical usefulness – The practical usefulness for various economic functionaries

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is as follows:

i) **For housewife** – Economics is highly useful for a housewife. She is the person who holds the purse strings and she is the main decision-maker of the family. She can maximise family well being by allocating family income on various family needs. A study of consumer's equilibrium can help her in her purchasing decisions. She can benefit from the study of market behaviour of specific goods, e.g., the prices of agricultural goods, especially foodgrains, are lower at the time of harvesting than in the rest of the year.

ii) **For Businessman** – Economic tools help a businessman in his decision making exercise. First of all, on the basis of demand forecasting, he can make a choice about the goods to he produced. Once this decision is taken, the decisions regarding locating, size, product-mix, factor-mix, pricing, marketing, etc., can be made with the aid of various economic tools. The theories of production, cost and revenues help him in maximising his profits and minimising his costs.

iii) **For social worker** – Economic and social conditions are interrelated. Social backwardness and economic backwardness often go hand in hand. A study of economics helps a social worker in understanding causes for backwardness of society and helps him to suggest ways for reducing it.

iv) **For administrator** the role of state in economic matters is increasing. It is therefore, necessary that the administrator should be aware of the economic problems and various economic tools for reducing these problems.

v) **For Planners** – The knowledge of economics is of immense value for planners also. Economic planning as a technique of economic growth has been adopted by many economies and for this, understanding of economic problems and techniques available to attack these problems is very essential. The knowledge of economics is essential at every stage – laying of objectives, analysis of human, physical and financial resources, making administrative arrangements for implementation of programmes and lastly for review and evaluation of the progress.

vi) **For interest holders** – This world is full of puzzles and some people take to Economics to understand economic puzzles. As for example, why is water, which is more essential to life than diamond, so much cheaper than diamonds? Or why do farmers sometimes grow crops and then destroy them? Why are some things in our society done publicly and others privately? Economics provides behavioural explanations of these phenomena and thus interests people who seek an explanation of these problems.

Thus, we find that economics touches almost every aspect of life and a study of economics is essential to understand the economy, its functioning, its components and the behaviour of people as individuals and as aggregates. It provides and insight into various economic problems faced by a country and often provide solutions to solve these problems. At micro level, it deals with problems and questions that affect almost all kinds of individuals in their capacities as consumers and producers. Thus, an adequate knowledge of science of Economics is a prerequisite for understanding the economy and its various aspects.

Microeconomics explains economic relationships at the level of the individual consumer, firm, or industry, addressing such questions as what determines people's demand for goods, why some prices increase while other decrease and why some people earn higher

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incomes than others.

Macroeconomics considers the economic behaviour of the entire economy, addressing such questions as what determines national economic growth and why unemployment and inflation occur.

Though micro and macro economics deal with different subjects they are highly inter-dependent.

Q. 2 (c) ELASTICITY OF SUPPLY:

The elasticity of supply is defined as the percentage change in quantity offered for supply as a result of percentage change in price. Thus, it measures the responsiveness of the quantity supplied to change in price.

The elasticity of supply of a commodity is the rate at which the quantity offered for sale changes.

Thus $Es = \frac{\text{Percentage change in quantity supplied}}{\text{Percentage change in price}}$

or $\frac{\text{Change in quantity supplied}}{\text{Quantity supplied}} \div \frac{\text{Change in price}}{\text{Price}}$

or $\frac{\Delta q}{q} \div \frac{\Delta p}{p}$ Where q is original quantity supplied

or $\frac{\Delta q}{\Delta p} \times \frac{p}{q}$ p is the original price

Δp denotes change in price

Δq denotes change in supply

Types of elasticity of supply:

(i) Highly elastic supply

(ii) Perfectly elastic supply

(iii) Unit-elastic.

(iv) Relatively less elastic supply:

(v) Perfectly inelastic supply:

Measurement of elasticity of supply:

As explained above, the elasticity of supply is the relative change in quantity supplied as a result of relative change in price; or

$$Es = \frac{\Delta q}{\Delta p} \times \frac{p}{q}$$

Where p and q are price and quantity supplied respectively and Δp, Δq are changes in price and quantity supplied respectively.

Thus, given the supply functions we can easily measure the elasticity at any price by the

SUGGESTED ANSWERS

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formula.

$$Es = \frac{dq}{dp} \times \frac{p}{q}$$

Where dq is the derivative of supply function as a result of a small change in price p and q are price and quantity supplied respectively.

For example, if we have to find the elasticity of supply at price Rs. 10, given the supply function as:

$$qs = -50 + 10p$$

we will find out elasticity at price Rs. 10 as follows:

$$Es = \frac{dq}{dp} \times \frac{p}{q}$$

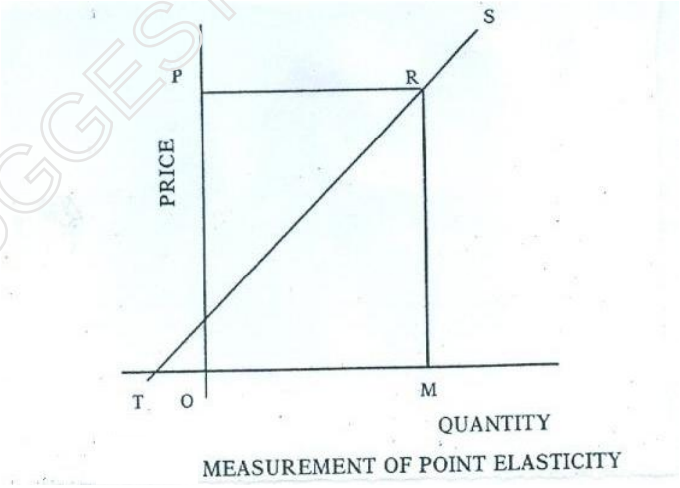
$$\frac{dq}{dp} = 10 \qquad p = Rs.10$$

at Rs.10 $q = -50 + 10(10)$

$= 50$

$$Es = 10 \times \frac{10}{50} = 2$$

Graphically also, we can measure elasticity at any price or we say at any point on the supply curve. For this, consider supply curve ST. We have to find out elasticity at point R on it.



MEASUREMENT OF POINT ELASTICITY

Q. 3 (a) CONSUMER'S SURPLUS:

The concept of consumer's surplus occupies an important place not only in economic theory but also in economic policy making. This concept was evolved by Dr. Alfred Marshall.

It has been observed that people normally pay lesser for a commodity than they are ready to pay for it. In other words, people get more satisfaction (or utility) from the consumption of goods than the price they pay for them.

Marshall defined the concept of consumer's surplus as "excess of the price which a consumer would be willing to pay rather than go without a thing over that what he actually

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does pay, is the economic measure of this surplus satisfaction. It may be called consumer's surplus.

A person demands a particular good because he derives utility or satisfaction from it. For getting this utility or satisfaction, he is ready to pay a price. The greater the satisfaction (or utility) he expects, the greater is the amount of money he is willing to pay for the good. Therefore, the marginal utility of a unit of a good determines the price a consumer is prepared to pay for that unit. The total utility obtained from a good is equal to the sum of marginal utilities of the units of good purchased; the total price which he pays is equal to the price per unit multiplied by the number of units purchased.

Thus,

Consumer's Surplus = What a consumer is ready to pay minus what he actually pays.

= Sum of Marginal Utilities – (Price X Units purchased)

The concept of Consumer's Surplus's can be easily understood from the following illustration. Consider in Table, in which the marginal utility of different units of commodity Y alongwith the market price of Y are shown in columns 2 and 3 respectively. Column 4 shows consumer's surplus at each level of consumption. By now, we are familiar with the law of diminishing marginal utility which states that as we purchase more units of a good, its marginal utility goes on diminishing. The consumer is in equilibrium when marginal utility becomes equal to the given price. In other words, consumer buys that many units of a good at which the marginal utility becomes equal to price. That means the margin, i.e. for the last unit what he is willing to pay is equal to what he actually pays. For the previous units, however, he pays less than what he actually would have paid. The difference is his surplus. It is to be noted that we are assuming that the price of the commodity is constant.

Now, consider Table,

TABLE – CONSUMER'S SURPLUS

No. of units (1)	Marginal Utility (2)	Price (3)	Consumer s Surplus (4)
1	40	28	12
2	38	28	10
3	36	28	8
4	34	28	6
5	32	28	4
6	30	28	2
7	28	28	0
8	26	28	-
			Rs. 42

We are assuming that the price of Y of Rs. 28 which is given and constant. Now, when the consumer is buying only one unit, he is prepared to pay Rs. 40 for it because he expects that much of satisfaction from it. His consumer's surplus is 12 (40 – 28) when second unit is bought, he is ready to pay only Rs. 38 for it because he expects lesser satisfaction from it. Since the price does not change, and is Rs. 28 only, he gains extra satisfaction worth Rs. 10. Similarly, for 3rd, 4th, 5th and 6th units, he derives extra satisfaction or consumer's surplus worth Rs. 8, Rs. 6, Rs. 4 and Rs. 2 respectively. However, for the seventh unit, the consumer's surplus is zero. That means now he is actually paying what he was willing to pay, i.e., Rs. 28 only. The consumer is in equilibrium here because here his marginal utility is equal to the price of the commodity. Thus, given the price equal to Rs. 28 per unit, the total consumer's surplus is Rs. 42 (column 4). This can also be found as follows:

Consumer's surplus = Sum of marginal utilities – (Price X No. of units bought)

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= [40+36+34+32+30+28] – [28 X 7]

= Rs. 42

Usefulness of the concept:

(1) the concept of consumer's surplus helps one to understand diamond-water parabox. One issue which had always perplexed the economists was – why is that water which is necessity of life should be much cheaper than diamonds, which are a luxury and in no way essential for life. The answer to this is to be found in the concept of consumer's surplus. Accordingly, the value-in-use, i.e. total valuation of water consumed is much greater than that of diamonds but its additional or marginal valuation (and hence its price) is low due to its excess supply. The difference is big consumer surplus obtained from water. On the other hand, value-in-use, i.e., total valuation of diamonds consumed is very small but due to its shortage, its marginal benefit (or valuation) is high and therefore its price is very high compared to water. The difference is a very small consumer surplus got from diamonds.

(2) The concept shows that what we pay for a good (value in exchange) is much less than the utility or satisfaction derived from it (value-in-use). There are several things in our day-to-day life such as salt, newspaper, public transport, telephone services, etc., whose utility or value in use is much more than the value in exchange (i.e., price paid).

(3) The concept is very useful to the Government in imposing taxes on various goods. Taxes on commodities raise their prices. The consumers of these commodity will have to pay more and their consumer's surplus will come down. Commodity taxes, therefore result in a loss of consumer's surplus to the consumers. But they will also result in increasing revenues of the Government. The loss to the consumers should be matched against the gains to the Government. If the loss to the consumer is greater than the gains to the Government, the tax is not proper; on the other hand, if the gain to the Government is greater than loss of satisfaction to the consumers, the tax is proper. Thus, the concept of consumer's surplus is useful in analysing the effects of taxes.

(4) The concept is also a very important tool in the hands of a monopolist. Since monopolist can discriminate prices in different markets, while fixing these prices, he has to see the amount of consumer's surplus which buyers are deriving from the commodity. He will try to charge the prices in such a manner that he leaves little or no consumer's surplus to his customers.

(5) Another important usage of this concept is in cost-benefit analysis of various projects. While understanding any project (say making bridge) the Government usually undertakes its cost-benefit analysis both in economic terms and in non-economic terms. The amount of consumer's surplus (in terms of time saving. Fuel saving, etc.) expected to be derived from the project of making bridge is considered to be an important benefit flowing from this project.

(6) Besides, the concept of consumer's surplus helps one to understand the benefit of exchange especially of international trade. Through, international trade, a country generally gets goods at lower price than they are prepared to pay for them. Accordingly, people get larger consumer's surplus from imported goods. Thus, the concept of consumer's surplus is useful in measuring the benefits in terms of satisfaction which the people of different countries will get through foreign trade.

Drawbacks of the Concept of consumer's surplus:

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(1) According to many economists, the concept of consumer's surplus is quite hypothetical and imaginary. They say, that a consumer cannot afford to pay for a commodity more than his income. In other words, the total sum of money spent by him on the goods cannot be more than his money income. Thus, in totality what he is willing to pay for all commodities actually coincides with what he actually pays. As against this, other economists argue that it is not the monetary benefits but mental satisfaction which the concept actually measures.

(2) The concept of consumer's surplus ignores the interdependence between the goods, i.e., it does not consider the effect of presence or absence of substitutes and complementary goods on the consumption of a particular good.

(3) Another criticism is that when consumer goes to the market he accepts the price prevailing and pays it. It is very difficult for him to tell how much he would be willing to pay rather than go without it.

(4) Consumer's surplus is based on the assumption that it is possible to measure total utility and marginal utility in quantitative terms. But in actual situation, it is not possible.

(5) Consumer's surplus cannot be measured in terms of money because the marginal utility of money changes as surpluses are made and the consumer's stock of money get diminished. But, Marshall assumed that the marginal utility of money to be constant.

It may, however, be pointed out that in order to overcome the above shortcomings, the concept of consumer's surplus has also been derived through the technique of indifference curves. This technique has rehabilitated concept of consumer's surplus.

Q. 3 (b) THE LAW OF EQUI-MARGINAL UTILITY:

The law of equi-marginal utility is another important law, which helps us understand the consumer's behaviour. This law shows how a consumer attains equilibrium. A consumer has a given income, which is to be spent on a number of goods and services. Now, the question is how he would divide his income on a number of goods and services so that he is in equilibrium state, i.e., so that he maximises his utility. We assume here that the consumer is rational and that he aims at maximising his satisfaction or getting the greatest enjoyment out of material things which are open to him.

Suppose there are only two commodities say X and Y and the consumer has to spend his given money income on them. The law of equi-marginal utility states that the consumer will distribute his money expenditure on X and Y in such a manner that the marginal utility derived from each commodity purchased is equal to respective prices of X and Y, i.e.,

$$\frac{MUx}{Px} = \frac{MUy}{Py}$$

But the equality achieved is not only at one level but at various different levels of expenditure. The problem is how far the consumer will go on spending his money income. The consumer will go on spending till the marginal utility of expenditure on each good becomes equal to the marginal utility of money. Thus for X and Y, the consumer will be in equilibrium when:

$$\frac{MUx}{Px} = \frac{MUy}{Py} = \text{MU of money which is constant}$$

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or

$$\frac{MUx}{MUy} = \frac{Px}{Py}$$

In other words, a consumer is in equilibrium when he equalises the ratio of marginal utilities of goods with the ratio of corresponding prices for goods consumed.

An example to this effect would make the law clear. Consider a consumer who has Rs. 38 to spend on goods X and Y. The price of X and Y are Rs. 4 and Rs. 6 respectively. Let us assume that he is able to measure the marginal utility (say in terms of utils) derived from each successive unit of such commodity. His data is given below:

TABLE – MARGINAL UTILITY OF X AND Y

Units	MUx(utils)	MUy (utils)
1	40	48
2	36	42
3	32	36
4	28	30
5	24	18
6	20	6

TABLE MARGINAL UTILITY OF EXPENDITURE

Units	MUx/Px	MUy/Py
1	10	8
2	9	7
3	8	6
4	7	5
5	6	3
6	5	1

By looking at the table we find that MUx/Px is equal to 6 utils when the consumer is buying 5 units of good X and MUy/Py is equal to 6 utils when he buys 3 units of Y. Therefore, the consumer will be in equilibrium or will be maximising his satisfaction when he is buying 5 units of X and 3 units of Y and will be spending Rs. 38 on them. No other allocation of money expenditure will give greater satisfaction than when he is buying 5 units of X and 3 units of Y and is spending Rs. 38.

In short, we can say that the consumer will be attaining maximum utility or satisfaction from his money income when he spends it in such a manner that the marginal utility of a rupee spent on each commodity bought is equal.

Limitations of the Law of Equi-marginal Utility:

It has been observed that many a times that people do not follow the law exactly and act in haste and thus do not get maximum satisfaction. This is because:

(i) Consumers are generally driven by habits and fashions. They spend their income on different commodities without giving any particular thought whether the particular allocation maximises their utility or not.

(ii) In order to apply the law, the consumers must measure in quantitative terms the marginal utilities obtained from various goods. But utility is not something which we can weigh objectively. It differs from person to person and place to place. Therefore, it is not possible for the consumers to state objectively the utility derived from various commodities.

(iii) Certain goods are indivisible,, i.e., it is not possible to divide them. For example,

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care is indivisible. Therefore, a consumer who is to spend his money on car and rice, will find it difficult to equate the marginal utilities of both.

SECTION – "B"

Q. 4 (a) NATIONAL INCOME:

National income is the money value of all the final goods and services produced by an economy in a specific period of time. Since in an economy, different types of goods and services are produced, it is not possible to physically add them. For example, foodgrains are measured in kilograms, milk is measured in litres, cloth is measured in metres. Moreover, besides the goods, in an economy different types of services are also rendered such as those of doctors, lawyers, engineers, singers, etc. Hence, national income cannot be stated as so many million kilograms of foodgrains, so many million litres of milk, etc. Therefore, all these goods and services are measured in terms of money. The value of different goods and services produced during a year is found out (without duplication) in terms of money and added together to find the value of national income or national output.

Methods of Measuring National Income:

The national income can be seen in three ways, namely in terms of the operations of the producing units, in terms of people as suppliers of the primary factors of production and in terms of the spending units. There are, thus, three aspects of national income, namely as an aggregate of net products, as an aggregate of primary incomes and as an aggregate of final expenditure. Correspondingly, we have three methods of measuring national income, namely, the production method, the income method and the expenditure method respectively.

Each method gives a different viewpoint of national income. The production method gives net national product on the basis of the industrial origin of value added, the income method yields national income on the basis of factor incomes and the expenditure method gives net national expenditure based on aggregate expenditure. Yet the total of these methods must be equal because these methods are only different viewpoints of the same flow of goods and services.

(1) Production method or value added method:

In this method, the producing units are classified into three major sectors viz, primary sector, the secondary sector and the tertiary sector. These sectors are further subdivided into sub-sectors. The primary sector may thus be divided into agriculture, animal husbandry, fishery, forestry etc., the secondary sector may be divided into consumer goods units and capital goods units and the service sector may be divided into trade, transport, communication, banking, finance, etc.

For each producing unit, data regarding its gross output, intermediate goods and services used and depreciation of capital goods is required. From the gross output the value of raw material and intermediate products is subtracted to get the value of gross value-added. From this, the value of depreciation is subtracted to get the net-value added by the producing unit. When the net-value added of all the producing units are added, we get net-value added by a particular sub-sector. By adding the net-value added by all the sub-sectors we get net-value added by a sector and on adding net-value added by all the sectors we get net-value added by the economy which is

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nothing but Net Domestic Product. If the information regarding the final output and intermediate goods is available in terms of market price we can convert it in terms of factor costs by subtracting indirect taxes and adding subsidies. To this figure when we add net income from abroad we get Net National Product at factor cost which is National Income.

(2) Income Method:

Since whatever is produced by a producing unit is distributed among the factors of production for their services; we can also find national income by aggregating the factor incomes of all the producing units.

It is to be noted that only incomes earned by the factors of production, as a result of their productive activities, are included in national income. Secondary or transfer incomes are not included in it. Thus, we include wages of labourers but exclude pension of retired workers. Labour incomes include besides wages and salaries, bonus, commission, employer's contribution to provident fund, compensation in kind like food, clothing etc. Capital income includes dividends, undistributed profits of companies before taxes, interest, rent, royalties, and profits of unincorporated enterprises and of Government enterprises.

Sometime it is difficult to separate labour incomes from capital incomes especially in the cases of self-employed people like lawyers, engineers, traders, proprietors etc. Moreover, in case production takes place for subsistence basis, as is the case with many under-developed countries it becomes difficult to differentiate between labour income and non-labour income. In such cases, incomes of the people would be mixed type. In order to tackle such cases, a new category of income, called mixed income, has been introduced which includes all those incomes, which are difficult to segregate.

It should be noted that transfer incomes are not to be included in the national income. These incomes are a part of household or personal income but not of national income.

Net income from abroad needs to be added if national income is calculated from data regarding incomes paid out by producers. But if it is calculated from data regarding income received by the people then net income from abroad need not be added separately as it is already included in the incomes received by the people.

(3) Expenditure Method:

The incomes received by the various factors of production are either spent by these factors or are saved. Or we say these incomes are either spent on consumer goods and services or are spent on non-consumption goods or capital goods.

While calculating national income by expenditure method, only expenditure on final goods and services is included; expenditure on raw materials and intermediate goods and services is excluded because otherwise there would be double counting of some items of national income. Expenditure on financial assets (except for net expenditures on foreign financial assets) and expenditure on goods produced during the preceding period are also excluded while calculating national income by this method.

Q. 4 (b) INFLATION:

A continuous increase in the price level is called inflation. Inflation is mainly of three types

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demand pull inflation, cost-push inflation and stagflation while demand pull inflation is caused by an increase in aggregate demand, cost push inflation results when aggregate supply falls short of aggregate demand. Stagflation is a period of stagnating real GDP, inflation and relatively high levels of unemployment.

Inflation has been variously defined. J.M. Keynes defined inflation as "an expansion in the supply of money relatively to the supply of things to purchase". Emile James, a French Scholar defined it as "self perpetuating and irreversible upward movement of prices caused by an excess of demand over capacity to supply". In simple words, inflation is a persistent and appreciable rise in the general price level. A persistent rise means a general upward trend of the price level for the period of time and appreciable meanings an increase in price level beyond 3 per cent. It is to be noted that all price rises may not be inflationary. For example, foodgrains may be expensive in a particular year, but other prices may remain steady. Moreover, when an economy moves upward from the bottom of a recession to a higher level of business activity, there will be some rise in prices. A mild increase in the price level is regarded desirable.

Measures to check inflation:

Since inflation is caused when the aggregate demand persistently exceeds the aggregate supply, the measures to check inflation would include measures to check the growth of demand and measures to remove the supply constraints so that the balance between demand and supply is attained. These measures are discussed under the following main heads:

(i) Monetary measures – In the situation of demand-pull inflation, reduction in aggregate demand is a very important factor for tackling inflation. For this, one technique is the use of monetary measures. Monetary measures consist of quantitative and qualitative measures to control money supply. The supply of money can be reduced by open market operations. Accordingly, the Central Bank can sell Government securities in the open market and thus reduce excess liquidity in the market. This would put a check on the purchasing power of people and thus curtail inflation.

(ii) Fiscal Measures – Fiscal measures refer to the measures taken by the government with regard to taxation, public expenditure and government borrowings. Thus while monetary measures affect aggregate demand more indirectly viacontrol of the supply of money, fiscal measures have a more direct bearing because in their case the Government itself enters into the market by incurring public expenditure or withdraws from the market through its curtailment of expenditure. Fiscal measures can be effectively used for checking inflation. Thus, direct tax rates can be increased for reducing disposable income of the people, or high indirect taxes can be imposed on the luxury items or public expenditure can be curtailed for checking inflation. These measures, are, however, more successful in developed economies than in developing economies.

(iii) Control Over Investment – The initial investment generally leads to large increase in income due to the multiplier effect. This causes the demand for consumer and capital goods to go up fast. Therefore, it is necessary that projects undertaken for investment purposes should be such that they start yielding results quickly, i.e., these projects should have short gestation period. Moreover, those projects should

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be chosen which have low capital output ratio so that output flow is larger than the increase in the demand for the goods. An eye should also be kept on the speculative activities.

(iv) Increase in Output – Sustained increase in output of goods and services in response to rising demand holds the key to price stability. Thus, it is necessary that production of both agricultural and industrial sectors should go up in order to meet the rising demand and thus checking inflation. However it should be noted that there is no automatic inverse relationship between increase in supply and decrease in prices. Several non-market, extraneous forces may intervene to distort such a relationship. For example, any possible decline in foodgrain prices due to higher agricultural production, will be offset by higher procurement prices for foodgrains.

(v) Increased Imports – Imports of essential goods including foodgrains have been resorted to supplement internal supplies and to meet the shortages. In India imports of certain scarce raw materials have also been continued to keep up out-put levels in the manufacturing sector. These have helped in containing inflation to some extent.

(vi) Public Distribution System – Over the years supplies of essential consumer goods have often fallen short of their demand resulting in rapid price increase in general. To meet the situation, public distribution system (SDS) has been operating in the economy for a long time. Under the system, the Government through fair price shops provides essential commodities at fixed reasonable prices. The elaborate public distribution system has helped the masses to buy essential commodities at very low prices; however, the subsidy cost of PDS has been increasing every year, thereby adding to budgetary deficits.

Q. 5 (a) Role of Financial Institutions:

The Financial Institutions ever since their establishment have played an important role in providing large funds and other services for industrial development. These institutions have been set up to serve the special needs of the country which has plans for rapid industrial development. In the following paragraphs we will analyse the role played by these institutions :

- **Overcoming shortage of investment funds:**

  These institutions were set up for providing long-term and medium-term funds to large and small scale industries. This was essential because the country had practically no formal institutions to supply this kind of finance. Of course, there were banks and money-lenders. But their sphere of operations was very narrow. Further, there was very little of capital market for industries seeking funds. In such circumstances, the only solution was to sep up special institutions which would supply investment funds.

- **Encouraging Planned Development:**

  Industrial development along the predetermined lines necessitates setting up of special institutions. Since much of the industrial development, in particular of basic and capital goods industries, became a part of the planning process, it was essential to establish the required agencies for financing the programmes of industrial development as per plans. These institutions supply finances to both the public sector and the private sector encompassed by these plans. Moreover, these institutes help in developing

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industrially backward regions by locating themselves at these places and financing there industries.

- **Establishing public Institutions:**

  Since the setting up of these institutions involve enormous funds and they promise returns after a long time, the private sector is not interested in setting up of these institutions. It is thus necessary that these institutions are set up by the Government. Further such institutions, if set up in the public sector, can be handy to the Government in meeting a variety of other objectives. These objectives include, helping industries falling sick or getting into other difficulties, developing expertise for non-financial assistance like consultancy service for project-appraisal, management etc., ensuring dispersal of industries, etc.

Q. 5 (b) MONETARY POLICY:

The second major instrument of macroeconomics policy is monetary policy, which the government conducts through managing the nation's money, credit, and banking system. Monetary policy is the tool that countries most often rely on to stabilize the business cycle, although it becomes less potent in deep recessions.

Monetary policy, conducted by the central bank, determines short-run interest rates. It thereby affects credit conditions, including asset prices such as stock and bond prices and exchange rates. Changes in interest rates, along with other financial conditions, affect spending in sectors such as business investment, housing, and foreign trade. Monetary policy has an important effect on both actual GDP and potential GDP.

Generally, monetary policy is concerned with measures taken to regulate the supply of money for the realisation of general economic goals by the Central Bank of the country. However, in developing countries monetary policy cannot remain confined only to regulating the supply of money. It has to play a positive role in helping the economy to meet its specific goals.

Objectives of monetary policy:

The monetary policy of a nation is only a part of its over all economic policy. Therefore, the objectives of monetary policy are generally derived from the objective of economic policy. However, some of the objectives of monetary policy are as follows:

(1) A Rational Price System

(2) Attainment of Full Employment

(3) Exchange-rate Stability

(4) Rapid Economic Growth

(5) Social Justice

(1) A Rational Price System:

Depending upon the conditions in the economy, the monetary authority could have any of the following goals with regard to prices in the economy:

(i) Price-stability

(ii) Gradual rise in prices

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(iii) Fall in prices

Exchange-rate Stability – A part from maintaining internal price stability, stability in the external value of currency could also be one of the aims of monetary policy. For this, it ensures that there are no wide fluctuations in exports, imports or capital movements.

Attainment of Full Employment - These days, the most important objective of monetary policy is attainment of full employment without inflation. The objectives of price and exchange rate stability have been given a secondary important these days. The policy of full employment can be pursued through monetary measures as they can help in achieving and maintaining the rates of savings and investment at a level, which would ensure full employment. For this, monetary policy may help in raising the aggregate rate of savings and proper channelization of savings into desirable directions of investment. Several monetary measures can be adopted for raising the level of savings.

Rapid Economic growth - Economic growth refers to increase in real national output of an economy. Economic growth can be accelerated by increasing the rate of savings and investment in the economy. Therefore, a monetary policy aiming at the objective of rapid economic growth should employ measures to increase savings (such as raising interest rate, promoting and expanding banking services, maintaining price stability etc.) and investments (such as offering bank credit at reasonable terms, financing planned public investment, etc.) and ensuring adequate flow of money into desirable channels such as infrastructural facilities, basic and key industries.

Social Justice - Monetary policy also aims at social justice in the economy. For this certain selective credit control measures come handy. For example, if the authorities want to restrict wasteful expenditure on consumer goods, they may use variable interest rates or may increase the down payments while reducing the number of instalments for repaying the debt. Similarly, they may provide concessional credit to agricultural and small-scale units for promoting economic equality.

Limitations of Monetary Policy:

The following are important limitations of monetary policy:

(1) It has been pointed out that monetary policy is ineffective in tackling the complex situation of present day business. For example, the success of the Bank rate depends upon the amounts by which it is manipulated. A small change will hardly be noticed by the economic system in general. But a sharp and sudden change may totally shake the public confidence.

(2) It has been generally noticed that people's attitude to consumption and savings depends much upon their income and upon the institutional channels through which they save and much less on the interest which their savings get. That is why very few would notice 1-2 percent change in the Bank rate as to change their rate of consumption. Of course, if the rate of interest changes abnormally and dramatically, it is sure to attract saver's interest. But this seldom happens.

(3) Similarly, investment decisions are affected by many other considerations than the rate of interest such as future uncertainties and risks of business, the economic scene in the country, etc. Interest cost is only one factor in investment decisions. Moreover, this can be easily passed on to the consumers. It is very difficult to induce investment through easy credit during the times when business prospects are poor

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and no investment looks profitable. Similarly, it is difficult to squeeze investments by putting restrictions on credit when business conditions are bright.

(4) Selective credit controls are also ineffective because bank credit is not the only source of fund available to business in the present era. There are other sources as well-insurance companies, extended trade credit, indigenous money-lenders etc.

(5) Most of the development economies have under-developed money markets including the banking system. In such conditions, the use of orthodox monetary policy as an instrument of economic policy has very limited possibility of success.

SECTION – "C"

Q. 6 (a) ROLE OF ZARAI TARAQIATI BANK LIMITED (ZTBL)

Zarai Taraqiate Bank Limited formerly known as Agricultural Development Bank of Pakistan is now one the main credit supplier to the agricultural sector in the country. It was established in 1961 by the merger of Agricultural Development Finance Corporation (ADDFC) and the Agricultural Bank of Pakistan (ABP). The ZTBL has its head office in Islamabad. On reorganization, it has been converted into a public company. The ZTBL concentrates on modernization of agriculture, increased farm productivity with emphasis on the provision of credit to small farmers and rural women. The credit is provided to the farming community for the purchase of primary inputs like fertilizers, pesticides, machinery, poultry farming, dairy farming etc. It aims at rural self-employment and poverty reduction of the farmers in the villages.

Adoption of village based banking

The Zarai Taraqiate Bank Limited initially started branch based credit scheme to the farmers. As most of the farmers were not able to get benefit from the loans advanced by ADBP, it introduced Supervised Credit Scheme in 1979. The Supervised Credit Scheme is a farmer oriented scheme. Under this Scheme, the potential farmers are contracted in their fields. Their credit need is assessed at the farms and the credit and technology are provided to them after necessary documentation in their own villages. The Scheme is , therefore, village based rather than branch based.

the ZTBL advances, short, medium and long term loans to the farmers. The short terms loans are given for financing the cost of raising, processing, and marketing of crops and other agro-based industries. The medium term loans are provided for the purchase of agricultural implements, levelling of land and setting up of agro-based industries. The long term loans are provided for the purchase of tractors, installing of tube-wells, construction of warehouses, etc. The various loan operations are:

1. **Disbursement of loans.**
2. **ZTBL role poverty reduction.**
3. **Farm mechanization and water resource development.**
4. **One Window Operation.**
5. **Credit to Women Programme.**
6. **Micro Credit Scheme.**

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7. **Revolving Finance Scheme.**
8. **Crop maximization project.**
9. **White Revolution Scheme.**
10. **Sairab Pakistan Scheme.**
11. **Red Meat Financing Scheme.**
12. **Tea Financing Scheme.**

Q. 6 (b) PRIVATIZATION:

Privatization is a process by which the government of a country transfers the state owned enterprises to the private sector. It is thus the sale of public industries to the private sector. For the last over three decades, many countries of the world both developing and developed are carrying out the process of selling government assets through open bidding to the private ownership. The rationale for privatization is that government does not do business. It rather facilitates business in the private sector. The long term vision of the government, therefore is, to free the economy from the burden of publically owned businesses. It should focus on good governance and creation of healthy environment for the private sector to invest in business.

Arguments in favour of privatization

The main arguments advanced in favour of prizatization are as under:

(1) Reduction in cost. The state owned enterprises behave like bureaucrats. Most of the industries do not face tough competition in the market. There is no incentive for them to bring down the cost of production of goods. Generally they have top heavy management and the workers employed are overstaffed. The privatized company, on the other hand, primarily aims at reducing cost so as to increase profits.

(2) Increased choice and quality goods. The stated owned enterprises produce a limited range of goods of set quality. They never bother to improve the overall efficiency in production by producing quality and variety of goods which the consumers need. In contrast, the industries operated in the private sector, face tough competition in the market for the sale of goods. They, therefore, continuously struggle to provide quality goods with choices at comparatively lower prices to the consumers.

(3) Production of new goods with new technology. The public enterprises do not allocate resources in the most efficient manner. They do not also produce goods according to the tastes and preferences of the consumers with new methods of production. The private sector organizations on the other hand, have full knowledge of the consumers preferences for the goods. They use latest techniques in production and marketing of goods. The efficient allocation of resources and increased production and sale of goods increases the profits of the private enterprises.

(4) Larger share in ownership. The state owned organizations which are leased or sold to the employees create wide sharing ownership in them. The employees are no longer the paid workers. They are now a part owners in business. There is no distinction between the workers and capitalists as the workers are capitalists now.

SUGGESTED ANSWERS

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(5) Strengthening public finance. The privatization of state owned enterprises raises the revenue of the government. The government can use this amount for (i) reducing public borrowing for the year or (ii) paying off part of the pubic debt.

(6) Reduction in subsidies. Most of state owned organizations suffer huge monetary loses during the financial year. The government have no alternative but to meet the deficits in their budgets by subsidizing them. The sale of state owned assets will reduce the drain of government resources. It will help in releasing government resources for the development of social and physical infrastructure.

(7) Generating economic activity. The sale of state owned assets to the private sector will help in the modernization and upgradation of sick and unprofitable units. Privatization thus is generating and raising economic activity in the economy.

(8) Opening the economy for competition. With the disinvestments policy of the government the resources of the nation are but to optimal use. The economy opens for competition. The producers try to produce quality goods and sell them in the market at competitive prices.

(9) Reduction in bureaucratic control. The government does not do business. Its main role is that of regulator and facilitator in the private sector so that it carries out its business activities smoothly. With the gradual implementation of the privatization program, there is reduction or elimination of bureaucratic control which stands in the way of increasing output in the economy.

Criticism of Privatization:

The main criticism levied on the privatization process and disinvestments in brief is as under:

(1) **Under valuation of assets:** The Government is carrying out the privatization process in hasty and unplanned manner. There is considerable under pricing in the sale of assets. The reserve price of the assets is not properly calculated. This causes loss to the Government (Sale of Steel Mill has been declared void by the Supreme Court of Pakistan.

(2) The Government is also selling some of the assets which are providing income, profit, and tax to the state. There is no justification of privatizing such profitable entities.

(3) Another snag in the privatization process is that bid terms are revised after the acceptance of bid (case of PTCL, PSMC can be cited to support it).

(4) Still another constraint in the sale of assets is that the prequalification of the bidders is not properly examined. The bidders must be financially sound and posses management expertise.

(5) According to the Privatization Commission Ordinance 2000, the 90% of the privatization proceeds is to be used for paying off the debts and 10% for poverty reduction. The SBP Annual Reports indicate that privatization proceeds are increasingly being used to finance budget deficit. This is not in conformity with the law.

(6) There is wide spread anxiety among the workers of privatized industries. The fear of retrenchment and hence, of unemployment at any time is a cause of worry for all of them.

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Q. 7 **MAIN MEASURES OF ECONOMIC DEVELOPMENT:**

The measures of economic development are:

(i) **Increase in real GNP.** Before 1970's economic development was regarded as an increase in real national product of a country over a long period of time. A long run expansion in production was to be achieved by rapid industrialization of the country at the expense of agriculture and rural development. The growth and development at that time mainly meant the growth of material production.

(ii) **Increase in real per capita income,** Another traditional measure of economic development was an increase in real per capita income of a country. It was considered at time that if the rate of growth of income per capita increase over a long period of time, it would indicate that the country was moving towards higher standard of living and achieving economic goals. The increase in real per capita income can be achieved if the nation has the ability to expand its output at a rate faster than the changes in price level. r =y/p where r = real income, y = nominal income and p = price level. The problems of poverty, unemployment and mal-distribution of wealth were of secondary importance.

(iii) **Rise in overall wellbeing of the people.** The third traditional measure of economic development was an increase in the economic well-being of the people. According to this measure, if the citizens of country are able to get and consume more goods and services than before, people will be considered better off. The welfare of the people will rise. In the words of Okun and Richardson, "Economic development is a sustained and secular improvement in the material well-being which is reflected in increase in goods and services".

The basic defects with these definitions are that if an increase in the goods and services produced have been created at the expense of too much hard work, or unequal distribution of wealth or at the expense of health, safely and comfort or at the expense of dignity etc., it would be unjustified to link rise in income or material welfare to an increase in economic welfare or economic development of the country. Moreover these definitions do not include non-market goods and services such as goods produced for self-consumption, women work at home etc. The objective of economic development is a rise in national income by making an improvement in the quality of life of the people. The economists, therefore, are in search of other measures which serve as complements, or alternatives to the traditional measures.

(iv) **Basic Needs Approach.** Basic needs approach also called Physical Quality of Life Approach uses only three indicators for measuring economic development in a country. These indicators are (i) Life expectancy and age. (ii) Infant mortality and (iii) Literacy.

The basic approach is considered superior as it spells out in detail the human needs in terms of health, nutrition, shelter and education etc. It is also devoid of the flaws which exist in per capita, GNP measure. However, the approach is criticised on the ground that it does not include security, justice and human rights which are an important measures of quality of life.

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(v) Human Development Index. The modern economists are not satisfied with GNP, per capita or national income as the principal measures of economic progress. According to them, the issue is not only how much growth but what kind of growth. They formulated Human Development Index (HDI). There were number of measures which were included in this index, However, to keep the HDI simple and manageable, the following main variables were included in it (a) Life expectancy was chosen as a measure of long life (b) Literacy as an index of knowledge and (c) Real GDP per person.

(vi) Power generation. (each student will compose unique answer)

(vii) Agricultural loans / schemes. (each student will compose unique answer)

(viii) Communication. (each student will compose unique answer)

(ix) Political stability. (each student will compose unique answer)

(x) Law and order situation. (each student will compose unique answer)

Summing up, "Economic development includes not only economic growth but also a political, social and cultural change of society which contributes to better living standard.

THE END

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