



Biyani Girls College
I Internal Examination 2019-20
B.COM (I+H)Year
Subject- Business Economics

Time: 1.30 Hrs.

Set: B

MM: 40

[I] Multiple Choice Questions

(10*1=10)

1) Which one of the following is a factor of production?

- (a) Enterprise (b) enterprise
(c) Elasticity (d) Environment sustainability

Ans:a

2) The aggregate demand curve _____ a market demand curve _____ it _____ the sum of all market demand curves in the economy.

- (a) is not; and; is not (b) is; and; is
(c) is; but; is not (d) is not; but; is

Ans:b

3) Demand is determined by

- (a) Price of the product (b) Relative prices of other goods
(c) Tastes and habits (d) All of the above

Ans:d

4) The cost of one thing in terms of the alternative given up is called:

- (a) Real Cost (b) Production Cost
(c) Physical Cost (d) Opportunity Cost

Ans:d

5) Cardinal utility approach is based on the _____ school of thought.

- (a) Marshalling (b) Albert
(c) Economic (d) None of these

Ans:a

6) (6) Indifference Curve Slopes

- (a) Downward to the right (b) Upward to the right 3
(c) Downward to the left (d) Upward to the left

Ans:a

7) Micro economics is also known as

- (a) Price theory (b) Process theory
(c) Product theory (d) Projection theory

Ans: a

8) _____ represents the tabular form of quantity demanded of a particular product during a given period

- (a) Law of Demand (b) Demand Curve
(c) Demand Schedule (d) Cross Demand

Ans:c

9) _____ goods are those which can replace each other in use

- (a) Fact (b) No replace (c) substitute (d) none of these

Ans:c

10) Which of the following cost curve is U shaped?

For example, Suppose a boy purchases 5 ice-creams for Rs 50, and if the price of ice-cream falls to Rs 8, now he can purchase 6 ice-creams with the same amount of money income or may decide to buy the same quantity and save the rest of the money, as he is required to spend less.

3. **Utility-Maximizing Behavior:** The consumer theory posits that the consumer buys goods and services to maximize his total utility (satisfaction). We know, that the marginal utility decreases with each additional unit of the commodity and thus, this is one of the reasons for the downward slope of the demand curve, which shows that the demand for the normal goods increases with the fall in the prices.

A person exchanges his money income for the purchase of the commodity so as to maximize his satisfaction. He continues to buy the commodity as long as the marginal utility of money (MU_m) is less than the marginal utility of the commodity (MU_x).

4. **Large Number of Consumers:** The effect on demand due to the change in the number of consumers as a result of a change in the price also causes the demand curve to slope downwards. Such as, if the price of the commodity falls, then many new consumers who were earlier not able to afford the commodity due to its high price, starts purchasing it. And as a result, the demand for the commodity increases. On the other hand, if the price rises, then few rich people can buy it, and many consumers will withdraw themselves from the market. And as a result, the demand for the commodity decreases.
5. **Varied Uses of the Product:** This is one of the important reasons for the law of demand, which explains that the product has several uses and can be utilized for different purposes. When the price of the commodity rises, then the consumer restricts its usage for the most important purpose. On the other hand, if the commodity becomes cheap then it can be utilized for all kinds of purposes, whether important or not.

For example, if the price of coal increases, then it will be more used in the industries where it is an essential raw material, whereas its demand for less important use such as in household (bonfire) gets reduced.

Thus, these are the important factors that explain the slope of the demand curve and advocates that the law of demand is valid.

EXCEPTIONS OF LAW OF DEMAND:

1. **Giffen Goods:** Giffen goods are the inferior goods whose demand increases with the increase in its prices. There are several inferior commodities, much cheaper than the superior substitutes often consumed by the poor households as an essential commodity. Whenever the price of the Giffen goods increases its quantity demanded also increases because, with an increase in the price, and the income remaining the same, the poor people cut the consumption of superior substitute and buy more quantities of Giffen goods to meet their basic needs.

For Example, Suppose the minimum monthly consumption of food grains by a poor household is 20 Kg Bajra (Inferior good) and 10 Kg Rice (superior good). The selling price of Bajra is Rs 5 per kg, and the rice is Rs 10 per kg, and the household spends its total income of Rs 200 on the purchase of these items. Suppose, the price of Bajra rose to Rs 6 per kg then the household will be forced to reduce the consumption of rice by 5 Kg and increase the quantity of Bajra to 25 Kg in order to meet the minimum monthly requirement of food grains of 30 kg.

2. **Veblen Goods:** Another exception to the law of demand is given by the economist Thorstein Veblen, who proposed the concept of “**Conspicuous Consumption.**” According to Veblen, there are a certain group of people who measure the utility of the commodity purely by its price, which means, they think that higher priced goods and services derive more utility than the lesser priced commodities.

For example, goods like a diamond, platinum, ruby, etc. are bought by the upper echelons of the society (rich class) for whom the higher the price of these goods, the higher is the prestige value and ultimately the higher is the utility or desirability of them.

1. **Expectation of Price Change in Future:** When the consumer expects that the price of a commodity is likely to further increase in the future, then he will buy more of it despite its increased price in order to escape himself from the pinch of much higher price in the future.

On the other hand, if the consumer expects the price of the commodity to further fall in the future, then he will likely postpone his purchase despite less price of the commodity in order to avail the benefits of much lower prices in the future.

2. **Ignorance:** Often people are misconceived as high-priced commodities are better than the low-priced commodities and rest their purchase decision on such a notion. They buy those commodities whose price are relatively higher than the substitutes.
3. **Emergencies:** During emergencies such as war, natural calamity- flood, drought, earthquake, etc., the law of demand becomes ineffective. In such situations, people often fear the shortage of the essentials and hence demand more goods and services even at higher prices.
4. **Change in fashion and Tastes & Preferences:** The change in fashion trend and tastes and preferences of the consumers negates the effect of law of demand. The consumer tends to buy those commodities which are very much ‘in’ in the market even at higher prices.
5. **Conspicuous Necessities:** There are certain commodities which have become essentials of the modern life. These are the goods which consumer buys irrespective of an increase in the price. For example TV, refrigerator, automobiles, washing machines, air conditioners, etc.
6. **Bandwagon Effect:** This is the most common type of exception to the law of demand wherein the consumer tries to purchase those commodities which are bought by his friends, relatives or neighbors. Here, the person tries to emulate the buying behavior and patterns of the group to which he belongs irrespective of the price of the commodity.

For example, if the majority of group members have smart phones then the consumer will also demand for the smartphone even if the prices are high.

Thus, these are some of the exceptions to the law of demand where the demand curve is upward sloping, i.e. the demand increases with an increase in the price and decreases with the decrease in price.

2) Define Utility. Explain Law of Diminishing Marginal Utility.

Ans The “**Utility**” in Economics means the satisfaction derived or expected to be derived from the consumption of goods and services.

The **law of Diminishing Marginal Utility** posits that with the more and more consumption of the units of the commodity the utility derived from each successive unit goes on diminishing, provided the consumption of other commodities remain constant.

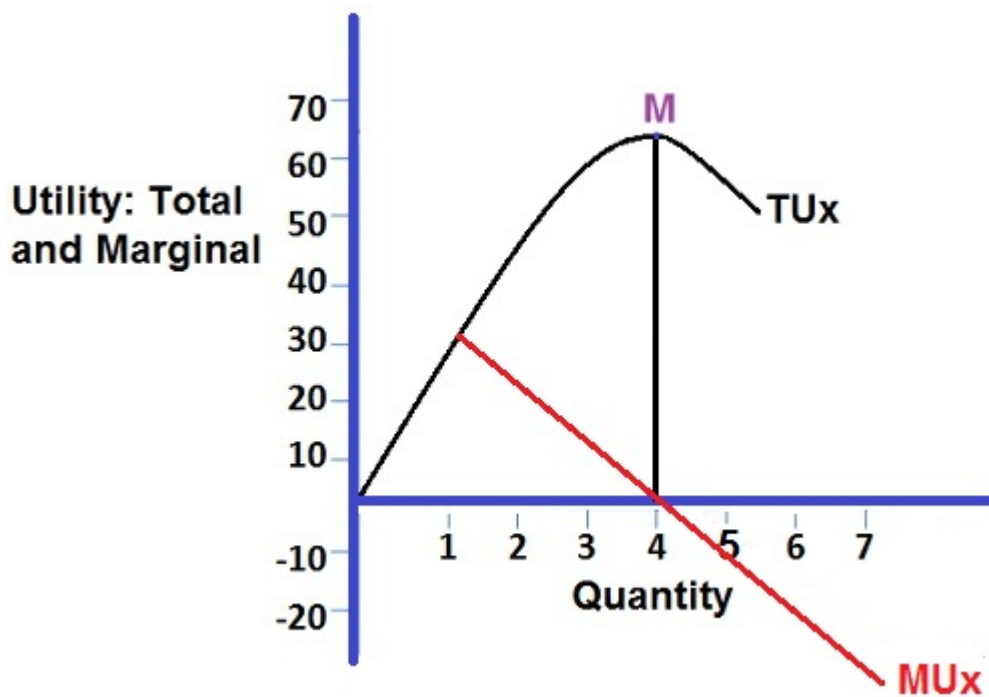
The concept of the law of diminishing marginal utility can be understood through a real life example. Suppose you are thirsty, and as you drink the first glass of water, keeping the

consumption of all other commodities constant, you get the maximum satisfaction, and with each successive glass of water, the additional benefit (utility) diminishes.

The law of diminishing marginal utility can be illustrated through the table given below. Suppose there is a commodity X, whose utility can be measured in the quantitative terms. Also, the total utility and marginal utility of the commodity is given in the table.

Units of Commodity X	Total Utility (Tux)	Marginal Utility (MUx)
1	30	30
2	50	20
3	65	15
4	70	5
5	65	-5
6	45	-20

As shown in the table., with the increase in the consumption of the units of commodity X, the total utility increases, but at a diminishing rate. The marginal utility also diminishes with the consumption of each successive unit of X.



As shown in the fig. TU_x increases as a result of the consumption of additional units of the commodity X while the MU_x is a downward sloping curve, which shows that the utility diminishes with the consumption of more and more units of the commodity X. At units 4, the TU_x reaches to the maximum point, the **Point of Saturation** denoted as **M**, from where the TU_x **starts declining**. Beyond this point, i.e. as the TU_x starts declining the MU_x becomes negative. The downward sloping Marginal utility curve illustrates the law of diminishing marginal utility.

The relationship between the Total Utility and Marginal Utility can be summarized as:

- When MU decreases, TU increases at a decreasing rate.
- When MU is Zero, TU is maximum.
- When MU is negative, TU starts declining.

Thus, the law of diminishing marginal utility holds universally, for both the durable and non-durable goods. In certain conditions, such as accumulation of money, a hobby of collecting old coins, stamps, visiting cards, etc. the marginal utility might initially increase, but eventually, it starts declining.

Assumptions of Law of Diminishing Marginal Utility

The law is said to hold true under certain conditions, and these conditions are referred to as the assumptions of the law of diminishing marginal utility. These are:

1. It is assumed that the **unit of the consumer good is a standard one**, i.e. the rational quantity of the commodity is consumed. Such as, a cup of tea, a pair of shoes, bottle of cold drink, glass of water, etc.
2. It is assumed that the **utility is measurable**, and the satisfaction of the consumers can be expressed in the **quantitative terms**.
3. The **consumer's tastes and preferences** remain same during the period of the consumption.

4. There must be **continuity in the consumption**. If a break is necessary, then the time interval between the consumption of two units should be appropriately short.
5. It is assumed that the **quality of the commodity remains uniform** during the period of consumption.
6. All the commodities consumed by the consumer are said to be **independent of each other**, such as the marginal utility of one commodity has no relation with the marginal utility of another commodity.
7. It is assumed that the **income** of the consumer and the **price of goods and services** remains unchanged during the period of consumption.
8. The **marginal utility of money remains constant** for the consumer.
9. The **mental condition** of the consumer should remain normal during the consumption period. For example, if a person drinks any alcoholic drink, then he will derive more pleasure with each additional glass of drink, this is because of a change in his mental status due to intoxication.

The conditions of diminishing marginal utility hold universally. But, however, in certain conditions such as accumulation of money, hobbies of collecting stamps, old coins, songs, etc. the marginal utility might initially increase, but eventually it decreases.

Exceptions or Limitations:

The limitations or exceptions of the law of diminishing marginal utility are as follows:

1. The law does not hold well in the rare collections. For example, collection of ancient coins, stamps etc.
2. The law is not fully applicable to money. The marginal utility of money declines with richness but never falls to zero.
3. It does not apply to the knowledge, art and innovations.
4. The law is not applicable for precious goods.
5. Historical things are also included in exceptions to the law.
6. Law does not operate if consumer behaves in irrational manner. For example, drunkard is said to enjoy each successive peg more than the previous one.
7. Man is fond of beauty and decoration. He gets more satisfaction by getting the above merits of the commodities.
8. If a dress comes in fashion, its utility goes up. On the other hand its utility goes down if it goes out of fashion.
9. The utility increases due to demonstration. It is a natural element.

Causes of Diminishing Marginal Utility:

Three important causes of the diminishing marginal utility are:

1. Satisfaction of a Particular Want:

Although human wants are unlimited, a particular want is limited. So it can be satisfied. As a person consumes more and more of a commodity, his indication becomes less and less. So his marginal utility from the successive units becomes gradually smaller. It means that too many units of a commodity bring complete satisfaction.

2. Introspection:

The validity of the law can be established through introspection (i.e., an examination of one's own thought or mental reaction). The classical economists used to look into their minds for their own psychological reaction to the extra consumption of a particular thing (say, an apple, an ice-cream, a chocolate, etc.) and tested the truth of the law.

3. Less Important Uses of Additional Quantities:

Furthermore, marginal utility diminishes because a person, having several units of a commodity capable of alternative uses, puts one unit to its most important use and the additional units to the successively less important uses.

3) Define Isoquant curve. What are the characteristics of isoquant curves?

Ans. **Iso-Quant Curve: Definitions, Assumptions and Properties!**

The term Iso-quant or Iso-product is composed of two words, Iso = equal, quant = quantity or product = output.

Thus it means equal quantity or equal product. Different factors are needed to produce a good. These factors may be substituted for one another.

an Iso-product or Iso-quant curve is that curve which shows the different combinations of two factors yielding the same total product. Like, indifference curves, Iso-quant curves also slope downward from left to right. The slope of an Iso-quant curve expresses the marginal rate of technical substitution (MRTS).

Assumptions:

The main assumptions of Iso-quant curves are as follows:

1. Two Factors of Production:

Only two factors are used to produce a commodity.

2. Divisible Factor:

Factors of production can be divided into small parts.

3. Constant Technique:

Technique of production is constant or is known before hand.

4. Possibility of Technical Substitution:

The substitution between the two factors is technically possible. That is, production function is of 'variable proportion' type rather than fixed proportion.

5. Efficient Combinations:

Under the given technique, factors of production can be used with maximum efficiency.

Iso-Product Schedule:

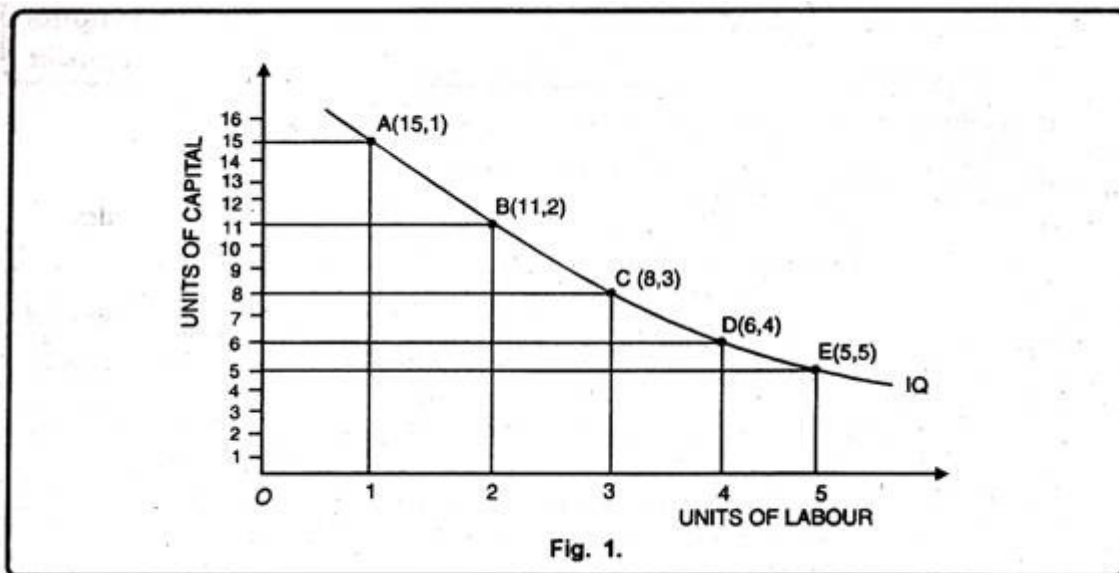
Let us suppose that there are two factor inputs—labour and capital. An Iso-product schedule shows the different combination of these two inputs that yield the same level of output as shown in table 1.

Table 1. Iso-Product Schedule.

Combination	Units of labour	Units of capital	Output of cloth (metres)
A	1	15	200
B	2	11	200
C	3	8	200
D	4	6	200
E	5	5	200

The table 1 shows that the five combinations of labour units and units of capital yield the same level of output, i.e., 200 metres of cloth. Thus, 200 metre cloth can be produced by combining.

- (a) 1 units of labour and 15 units of capital
- (b) 2 units of labour and 11 units of capital
- (c) 3 units of labour and 8 units of capital
- (d) 4 units of labour and 6 units of capital
- (e) 5 units of labour and 5 units of capital



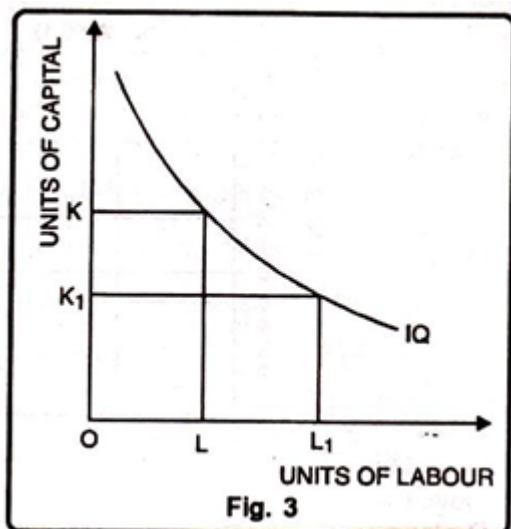
Properties of Iso-Product Curves:

The properties of Iso-product curves are summarized below:

1. Iso-Product Curves Slope Downward from Left to Right:

They slope downward because MTRS of labour for capital diminishes. When we increase labour, we have to decrease capital to produce a given level of output.

The downward sloping iso-product curve can be explained with the help of the following figure:



2. Isoquants are Convex to the Origin:

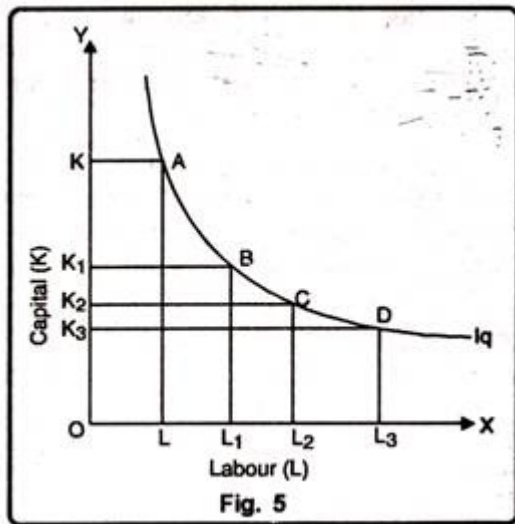
Like indifference curves, isoquants are convex to the origin. In order to understand this fact, we have to understand the concept of diminishing marginal rate of technical substitution (MRTS), because convexity of an isoquant implies that the MRTS diminishes along the isoquant. The marginal rate of technical substitution between L and K is defined as the quantity of K which can be given up in exchange for an additional unit of L. It can also be defined as the slope of an isoquant.

It can be expressed as:

$$MRTS_{LK} = - \Delta K / \Delta L = dK / dL$$

Where ΔK is the change in capital and ΔL is the change in labour.

Equation (1) states that for an increase in the use of labour, fewer units of capital will be used. In other words, a declining MRTS refers to the falling marginal product of labour in relation to capital. To put it differently, as more units of labour are used, and as certain units of capital are given up, the marginal productivity of labour in relation to capital will decline.

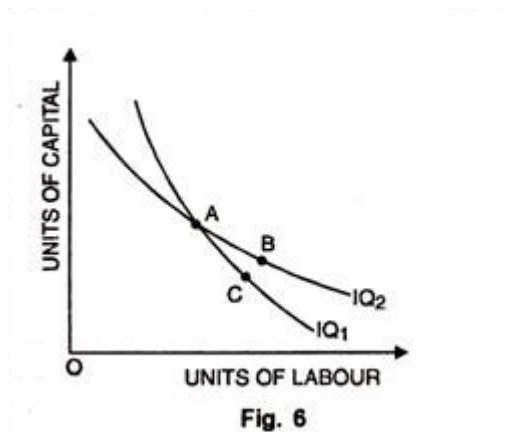


This fact can be explained in Fig. 5. As we move from point A to B, from B to C and from C to D along an isoquant, the marginal rate of technical substitution (MRTS) of capital for labour diminishes. Everytime labour units are increasing by an equal amount (AL) but the corresponding decrease in the units of capital (AK) decreases.

Thus it may be observed that due to falling MRTS, the isoquant is always convex to the origin.

3. Two Iso-Product Curves Never Cut Each Other:

As two indifference curves cannot cut each other, two iso-product curves cannot cut each other. In Fig. 6, two Iso-product curves intersect each other. Both curves IQ1 and IQ2 represent two levels of output. But they intersect each other at point A. Then combination A = B and combination A = C. Therefore B must be equal to C. This is absurd. B and C lie on two different iso-product curves. Therefore two curves which represent two levels of output cannot intersect each other.



4. Higher Iso-Product Curves Represent Higher Level of Output:

A higher iso-product curve represents a higher level of output as shown in the figure 7 given below:

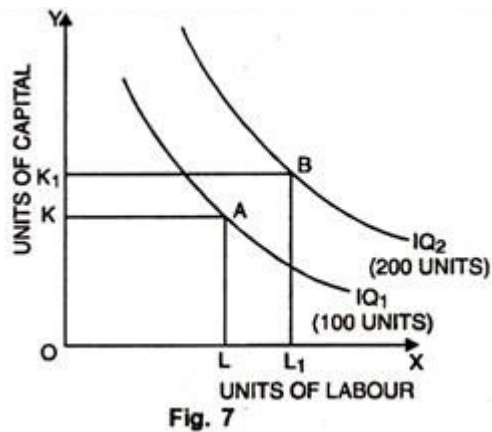


Fig. 7

In the Fig. 7, units of labour have been taken on OX axis while on OY, units of capital. IQ_1 represents an output level of 100 units whereas IQ_2 represents 200 units of output.

5. Isoquants Need Not be Parallel to Each Other:

It so happens because the rate of substitution in different isoquant schedules need not be necessarily equal. Usually they are found different and, therefore, isoquants may not be parallel as shown in Fig. 8. We may note that the isoquants Iq_1 and Iq_2 are parallel but the isoquants Iq_3 and Iq_4 are not parallel to each other.

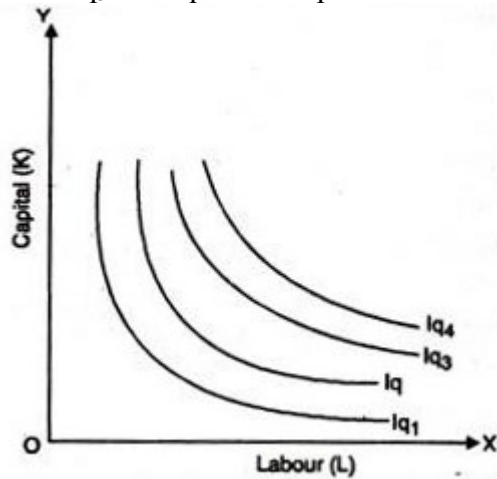


Fig. 8

6. No Isoquant can Touch Either Axis:

If an isoquant touches X-axis, it would mean that the product is being produced with the help of labour alone without using capital at all. These logical absurdities for OL units of labour alone are unable to produce anything. Similarly, OC units of capital alone cannot produce anything without the use of labour. Therefore as seen in figure 9, IQ and IQ_1 cannot be isoquants.

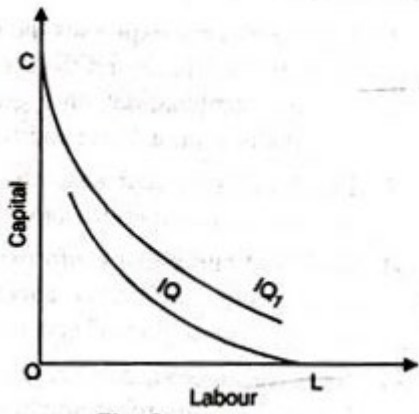


Fig. 9