

# Chapter-1

## Introduction to Economics

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### Very Short Answer Type Questions(1 Mark)

1. **With the help of an example, define micro economics.**

**Ans.** Micro Economics is that branch of economics in which economic problems are studied at individual level e.g. the behaviour of consumer, firms, etc.

2. **Define macro economics with the help of an example.**

**Ans.** Macro economics is that branch of economics which studies the economy as a whole and its aggregates e.g. National income, the level of employment.

3. **Define opportunity cost.**

**Ans.** For the selection of an opportunity, the sacrifice of next best alternative use is called opportunity cost.

4. **Why does an economic problem arise?**

**Ans.** An economic problem arises due to scarcity of resources having alternative uses in relation to unlimited wants.

5. **Write two characteristics of resources.**

**Ans.** Resources are scarce (limited) and they have alternative uses.

6. **What do you mean by scarcity?**

**Ans.** Scarcity refers to a situation in which demand is more than supply

7. **What do you mean by marginal opportunity cost?**

**Ans.** Marginal rate of transformation (MRT) is the ratio of one good sacrificed to increase one more unit of the other good.

8. **What do you mean by an economy?**

**Ans.** An economy is an economic organisation which provides sources to earn livelihood.

9. **Why is there a need for economizing of resources?**

**Ans.** Because resources are limited.

10. **Why does economic problem arise?**

**Ans.** It arises mainly because of scarcity of resources.

11. **Why is PPC downward sloping from left to right?**

**Ans.** Because in situation of full employment of resources, production of one good can be

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increased only with less of other good.

12. **What does a rightward shift of PPC indicate?**

**Ans.** The rightward shift of PPC indicates growth of resources or technological progress.

13. **Why does the problem of choice arise?**

**Ans.** Relative scarcity of resources having alternative uses in relation to unlimited wants, gives rise to an economic problem.

14. **Why does PPC look concave to the origin?**

**Ans.** PPC is concave to the origin because of increasing marginal rate of transformation (or increasing marginal opportunity cost).

15. **Which factor lead to a shift of PPC towards right hand side?**

**Ans.** Growth of resources or technological progress leads to a shift of PPC towards right-hand side.

16. **What does a point below PPC indicate?**

**Ans.** It shows inefficient/under utilization of resources.

17. **What does slope of PPC show?**

**Ans.** Negative slope of PPC shows that in order to produce more units of one good, some units of the other good must be sacrificed.

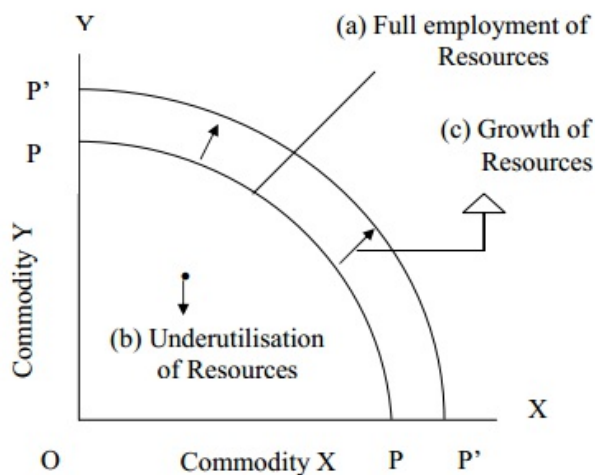
18. **When allocation of resources is considered as inefficient?**

**Ans.** Allocation of resources is considered as inefficient when economy performs below the PPC curve.

## Short Answer Type Questions(3-4 Marks)

1. Draw PPC and show the followings:-

- Full employment of resources,
- Underutilisation of resources, and
- Growth of resources.



**Ans.**

- Full employment of resources - A point anywhere on the PPC, shows the efficient use or full employment of resources.
- Underutilisation of resources - A point anywhere inside of the curve, shows inefficient/under utilisation of resources.
- Growth of resources – It refers to the shift in PPC. If more resources are generated, the level of production will increase. In the figure it is represented by a shift in PPC from PP to P'P'.

2. Why does PPC look concave to the origin? Explain.

**Ans.** PPC looks concave to the origin because of increasing marginal rate of transformation/substitution (or increasing marginal opportunity cost). It means that more and more units of commodity 'y' are to be sacrificed, to get each additional unit of commodity 'x'.

3. **What does a PPC show? When will it shift to the right?**

**Ans.** Production Possibility Curve shows the different combinations of two goods which an economy can produce with available technology and resources.

It would shift towards right-hand side in case of growth of resources or technological progress.

4. **Does production take place only on the PP curve?**

**Ans.** Yes and no, both. Yes, if the given resources are fully and efficiently utilized. No, if the resources are underutilized or inefficiently utilized or both.

Refer to the above figure; on a point anywhere on the PPC the resources are fully and efficiently employed. On point U, below the PPC or any other point but below the PPC, the resources are either underutilized or inefficiently utilised or both. Any point below the PP curve thus highlights the problem of unemployment and inefficiency in the economy.

5. **Why does an economic problem arise? Explain.**

**Ans.** Reasons-

1. Unlimited wants - Human wants go on multiplying with the expansion of education, knowledge, scientific advancement and economic growth. A man can not satisfy all of his wants and therefore he has to make a choice in order of urgency.
2. Limited resources - The resources are limited in relation to need for them. It is the main cause of economic problem.
3. Alternative use of resources - A resource can be utilized in a different way and for different purposes. Therefore choice has to be made among different uses of resources.

6. **Calculate MRTXY at different production possibilities from the following hypothetical data. Draw a PPC on the basis of the schedule.**

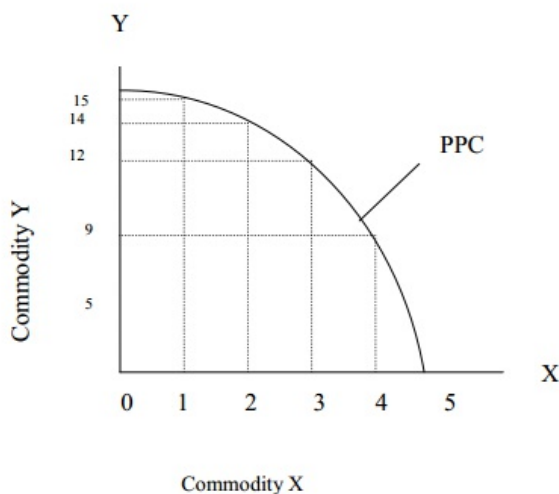
Production possibilities	Commodity X	Commodity Y
A	0	15
B	1	14
C	2	12
D	3	9
E	4	5
F	5	0

**Ans.**

Production possibility Schedule

Production possibilities	Commodity X	Commodity Y	Marginal Rate of Transformation (MRT) = $\Delta Y / \Delta X$
A	0	15	-----
B	1	14	1 X : 1 Y
C	2	12	2 X : 1 Y
D	3	9	3 X : 1 Y
E	4	5	4 X : 1 Y
F	5	0	5 X : 1 Y

Production possibility Curve



**7. Why is a production possibilities curve concave? Explain.**

**Ans.** The production possibility curve being concave means that MRT increases as we move downward along the curve. MRT increases because it is assumed that no resource is equally efficient in production of all goods. As resources are transferred from one good to another, less & less efficient resources have to be employed. This raises cost and raises MRT.

**8. Explain properties of a production possibilities curve.**

**Ans.** There are two properties of a production possibilities curve.

a. **Downward sloping** : It is because as more quantity of one good is produced some

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quantity of the other good must be sacrificed.

- b. **Concave to the origin** : It is because the marginal rate of transformation increases as more of one good is produced.

9. **Explain the problem of 'what to produce'.**

**Ans.** An economy can produce different possible combinations of goods & services with given resources. The problem is that, out of these different combinations, which combination is produced. If production of one good increases then less resources will be available for other goods.

10. **What is 'Marginal Rate of transformation'? Explain with the help of an example.**

**Ans.** MRT is the rate at which the units of one good have to be sacrificed to produce one more unit of the other good in a two goods economy. Suppose an economy produces only two goods X and Y. Further suppose that by employing these resources fully and efficiently, the economy produces 1X + 10Y. If the economy decides to produce 2X, it has to cut down production of Y by 2 units. Then 2Y is the opportunity cost of producing 1X. Then 2Y:1X is the MRT.

11. **Explain the problem 'How to produce'.**

**Ans.** Broadly, there are two techniques of production.

- a. **Labour intensive Technique** : Under this technique, production depends more on the use of labour.
- b. **Capital Intensive Technique** : Under this technique, production depends more on the use of machines (called capital). Efficient technique of production is that which uses minimum possible inputs for a given amount of output. So that, cost per unit of output is minimised.

## Long Answer Type Questions (6 Marks)

### 1. Explain the three properties of indifference curves.

**Ans.** Three properties of indifference curves are as follow.

1. **Slopes downward from left to right** : To consume more of one good the consumer must give up some quantity of the other good so that total utility remains the same.
2. **Convex towards the origin** : MRS declines continuously due to the operation of the law of diminishing marginal utility.
3. **Higher indifference curves represents higher utility** : Higher indifference curve represent large bundle of goods. Which means more utility because of monotonic preference.

### 2. Explain the conditions of consumer's equilibrium using indifference curve analysis.

**Use diagram.**

**Ans.** There are two conditions for consumer's equilibrium.

(i)  $MRS = \frac{P_X}{P_Y}$

(ii) MRS is continuously falling.

**Explanation:** Suppose there are two goods X and Y. the first condition of consumer's

equilibrium is  $MRS = \frac{P_X}{P_Y}$

If  $MRS = \frac{P_X}{P_Y}$  . It means consumer values X more than what market values & willing to

give more price than market price he will purchase more of X this cause fall in MRS and it

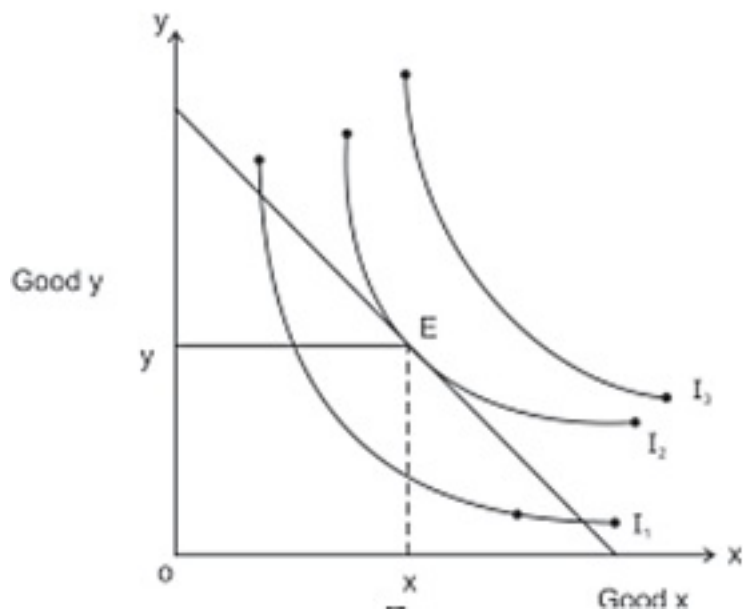
will continue up to that when  $MRS = \frac{P_X}{P_Y}$

If  $MRS = \frac{P_X}{P_Y}$  . It means consumer values X less than what market values. Consumer is

willing to give less price as market price & he will purchase less of X, by this MRS will

increase and it will continue till  $MRS = \frac{P_X}{P_Y}$

(ii) Unless the MRS is continuously falling the equality between the MRS and  $\frac{P_X}{P_Y}$  will not be achieved.



Consumer is in equilibrium at point E



## Value Based Questions

1. **Massive unemployment will shift the PPF to the left. Defend or refute.**

**Ans.** The given statement is refuted. Massive unemployment does not decrease the capacity of economy to produce. So, there will be no shift of PPF. However, 1 economy will operate at some point inside the PPF, due to un utilisation of human resources.

2. **What is the opportunity cost of an input which has no alternative use?**

**Ans.** The opportunity cost of such input is zero.

3. **Utility is directly linked with the usefulness of a commodity. Is it true or false? Give reason.**

**Ans.** False. A commodity may not be useful, yet it may have utility for a particular person. For example, chewing tobacco is harmful for health, yet many people derive high degree of utility from it.

4. **In order to encourage tourism in Goa, Indian Airlines reduces the air fare to Goa. How will it affect market demand curve for air travel to Goa?**

**Ans.** There will be a downward movement along the same market demand curve for air travel to Goa. It happens because of decrease in the air fare.

5. **At certain level of output, the marginal cost of a firm is above its marginal revenue. Can this be its equilibrium output?**

**Ans.** No, it cannot be its equilibrium output because the marginal cost exceeds the marginal revenue. The firm is running at a loss.

6. **Trendz produces both jeans and shirts. How will an increase in the price of jeans affect the supply curve of shirts?**

**Ans.** An increase in the price of jeans will make the production of jeans more attractive. As a result Trendz will shift its resources from shirts to jeans. It will shift the supply curve of shirts towards left.

7. **A severe drought results in a drastic fall in the output of wheat. Analyze how it will affect the market price of wheat.**

**Ans.** Market price of wheat will increase (due to decrease in supply).

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8. **What will be the effect on equilibrium price and equilibrium quantity of telephone instruments, if China exports a large number of telephone instruments to India.**

**Ans.** Equilibrium price will fall and equilibrium quantity will rise (due to increase in supply).

9. **‘Both, microeconomics and macroeconomics have same degree of aggregation’.  
Defend or refute.**

**Ans.** The given statement is refuted.

- Micro economics involves limited degree of aggregation. For example, market demand (micro concept) is derived by aggregating individual demands of all the buyers in particular market.
- On the other hand, macroeconomics involves the highest degree of aggregation. For example, aggregate demand (macro concept) is derived for the entire economy. It means, micro economics and macroeconomics differ in degree of aggregation.

10. **“Law of demand is a quantitative statement”. Comment.**

**Ans.** Law of demand is only an indicative and not a quantitative statement. It indicates only the direction, in which the demand will change with a change in price. It says nothing about the magnitude of such a change. For example price of Pepsi rises from Rs 10 to Rs 12 per bottle, then, as per law of demand, we can say that the demand for Pepsi will fall. But the law does not give the actual amount by which the demand for Pepsi will decline.

11. **“MC can be calculated both from total cost and total variable cost and is not affected by total fixed cost.” Discuss.**

**Ans.** The given statement is correct. MC is not at all affected by total fixed cost (TFC). MC is addition to TC or TVC when one more unit of output is produced. As TFC remains same with increase in output, MC is independent of fixed cost and is affected just by change in variable costs.

12. **Why AR curve under monopolistic competition is more elastic than AR curve under monopoly?**

**Ans.** The AR curve under monopolistic competition is more elastic because there exists close substitutes of the product sold by the monopolistic firm whereas under monopoly the AR curve is less elastic because there is non availability of close substitutes of the product sold by the monopoly firm.

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**13. How does a firm under monopolistic competition exercise partial control over price?**

**Ans.** A monopolistic competitive firm enjoys partial control over price. It happens because by incurring heavy selling costs, the firm is able to create a differentiated image of its product in the minds of consumers. Products are differentiated on the basis of brand, size, color, shape, etc. Buyers are attracted to buy a particular product even at a relatively higher price.

**14. Why is number of firms small in an oligopoly market?**

**Ans.** The main reason for small number of firms under Oligopoly is the Barriers to entry, which prevent entry of new firms into the industry. Patents, requirement of large capital, control over crucial raw materials, etc, are some of the other reasons, which prevent new firms from entering into industry. As a result, there are few firms in an Oligopoly market.

**15. "Demand and supply are like two blades of a pair of scissors". Comment.**

**Ans.** The given statement is correct. Both the blades of pair of scissors are equally important to cut a piece of cloth. Similarly, both demand and supply are needed for determining price in the market. There is no use for demand for a product if there is no supply for the product and supply is not needed if there is no demand for the product. One of the two may play more active role in price determination in the short run. But, both are needed to determine the price in the long run.

### **Higher Order Thinking Skills**

**1. What is meant by economizing the use of resources?**

**Ans.** Economising the resources means that resources are to be used in a manner such that maximum output is realised per unit of output. It also means optimum utilisation of resources.

**2. What do you mean by alternative uses of resources?**

**Ans.** Alternate use of resources mean, more than 1 uses to which a resource can be put.

**3. What will be the shape of PPF when MRT is constant?**

**Ans.** Shape of PPF will be a straight line sloping down ward.

**4. Unemployment in India is a subject matter of Micro or Macro eco., give reason.**

**Ans.** Unemployment in India is a subject matter of macroeconomics because it relates to economy as whole.