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Question Nos.

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Q1) The change in the demand or quantity of goods by virtue of change in the price is called elasticity of demand. There are 5 types of elasticities of Demand:-

Formula?

1) Unitary elasticity

When the proportion of change in the demand is the same as the proportion of change in the price, it is called unitary elasticity.

Foreg:-

P	D
5	10
6	8

Here: Elasticity: $\frac{\Delta D}{\Delta P} = \frac{10-8}{10} = \frac{2}{10} \times \frac{5}{1}$

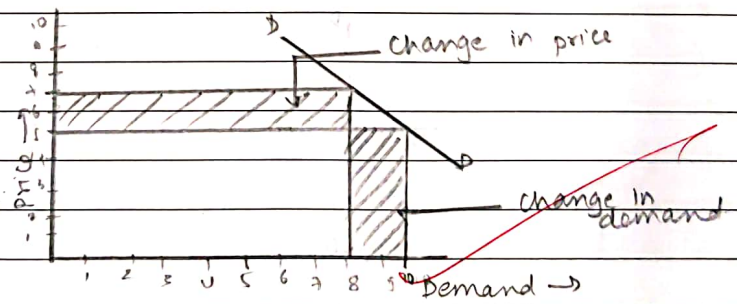
$\frac{6-5}{5} \quad \frac{1}{5}$

$= 1 \times 100 = 100\%$

The elasticity of price (E_p) here is 1.

$E_p = 1$

The graph will be:-



2) Perfectly elastic or Perfect elasticity of demand

When even though there is negligible change in price, there is major change in demand, it is said to be perfectly elastic.

Ar: The D-D curve in a perfectly elastic graph is a horizontal line parallel to the x-axis. Here, $E_p = \infty$

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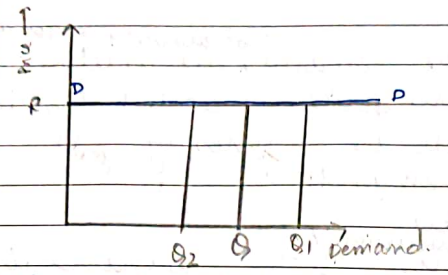
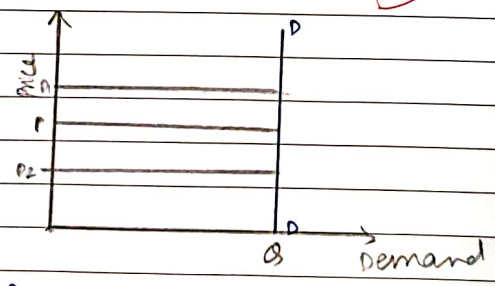


for eg: gold; if price of gold has an almost negligible drop, the demand increases and if price of gold has an almost negligible increase, the demand decreases.

3) Perfectly inelastic

When there is no change in the demand irrespective of the change in the price, it is said to be a perfectly inelastic. The D to D-D curve is vertical parallel to the y-axis and $e_p = 0$.



For eg: agricultural commodities even if the price changes, we will consume the same amount of commodities.

4) Relative elastic

When the proportion of change in the demand is much more than the proportion of change in the price. then the elasticity of price (E_p) ranges from 1 to ∞

Thus $[E_p > 1]$

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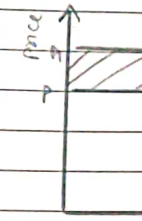

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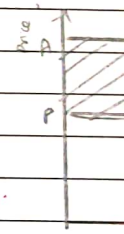

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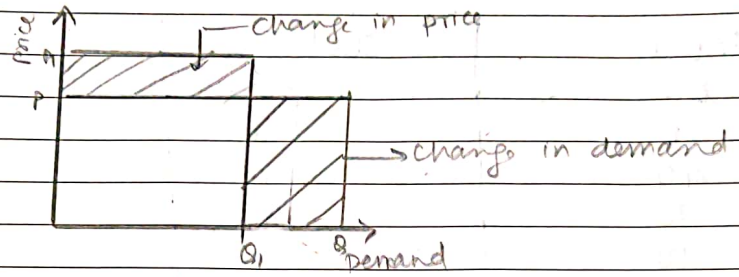
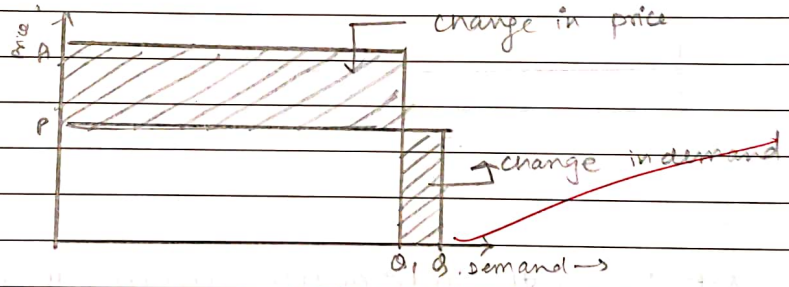


(3) Relatively inelastic

Here, the proportion of change in demand is less than the proportion of change in price. The elasticity of price (Ep) varies from 0 to 1 thus $\boxed{Ep < 1}$



5

Q2) A market basket is basically a list of 2 or more commodities.

An indifference curve is the graphical representation of market baskets of consumers. The indifference curve represents the combinations of market baskets for which the consumers will have the same level of satisfaction. The consumer will be indifferent to all the points on an indifference curve. For eg: lets take 2 commodities food (A) and clothing (B)

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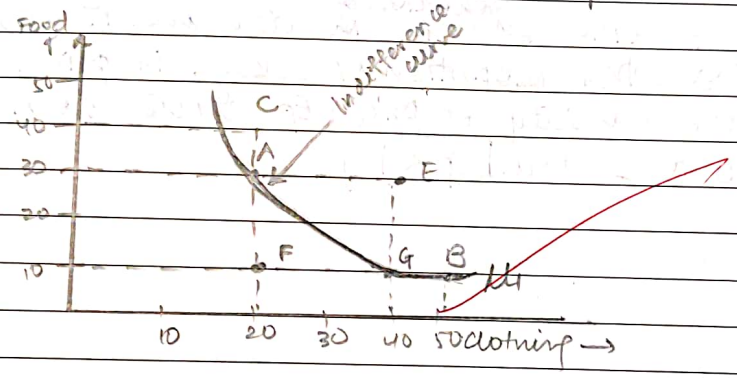
Question Nos. | Marks Awarded

Market Basket	Food	Clothing
A	20	30
B	10	50
C	40	20
E	30	40
F	10	20
G	10	40



Let M_1 be the indifference curve. Points A, B, G lie on the indifference curve and hence they are indifferent to one another. For eg:- The consumer doesnt mind giving up 10 units of food to gain 20 units of clothing. He doesnt feel either good or bad about it.

The indifference curve is almost sloping downwards from left to right. It cannot be sloping upwards since consumer always prefers more, and E has more clothing and food than A, thus, AE cant be an indifference curve.

Also, any point lying above and to the right of the indifference curve is preferred more than the indifference curve.

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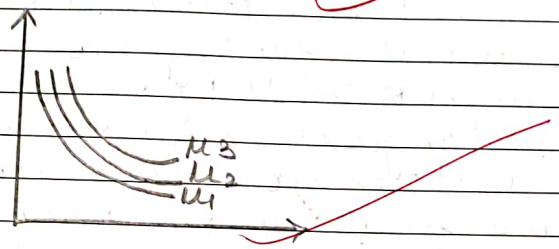
Indifference map:- The graphical representation of all combination of market baskets in a combination of indifference curves is called as indifference map.



Here U_1, U_2 and U_3 each are Indifference curves respectively joining to make an indifference map. Indifference curves are always parallel to each other. They cannot intersect each other.

Q3) Giffen goods are such goods that dont follow the first basic rule that 'demand is inversely proportional to price supply.' Giffen goods are such goods that with the increase of price the demand increases. Giffen goods have an upward slope since the income effect overpowers the substitution effect. These are a type of inferior goods. Lets take for eg: bread and lamb. Bread is a staple food which we require to eat on a daily basis. Now, if a consumer can spend Y economy on food, with the left over money, he buys luxury food like a lamb. But when the price of bread increases, since he requires minimum of that many breads, there is no

Question Nos.		Marks Awarded

money left for the lamb. Hence he increases the bread he buys. Thus as the price increases, the demand increases.

For negative income effect, in giffen goods, as the income increases, a consumer prefers goods of higher indifference curve (luxury goods) considering giffen goods are inferior goods. Thus the demand for eg. of these goods reduces and demand for luxury goods increases. This causes a negative income effect.

For eg. In india common men consume bajra and jawar. If their income will increase, they will rather consume wheat and rice, thus irrespective of increase in income, the demand of these goods (giffen goods) is decreasing.

3

Q4) a) True :- For a better utility, the consumer finds a bunch near the budget line where the ratio of the price change of the 2 commodities is equal to the marginal rate of substitution. Thus P_1 being price of good 1 and P_2 being price of good 2. $MRS = \frac{P_1}{P_2}$. When the price of good 1 decreases, the value of the ratio decreases and hence the value of the MRS decreases. Thus, the consumer doesn't mind giving up a few units of good 2 for another unit of good 1.

Thus, the MRS diminishes as an individual moves downward along the demand curve.

Question Nos.		Marks Awarded

Q4)b) True:

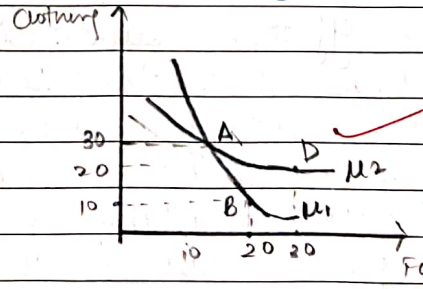
As the price increases, the budget line pivots towards the outside and hence the consumer moves towards the higher indifference curve. Hence the level of utility increases as an individual moves downwards along the demand curve.

Q4)c) False :-

Engel curve is a curve which gives the ratio between the demand or quantity of goods and the income of the consumer. For Inferior goods as the income increases, the demand decreases as people prefer better goods. Thus, in this case the engel curve doesnt slope upward. So its false that the engel curve always slopes upward.

3

Q5) Two indifference curves cannot intersect. Lets prove this by contradicting it and taking 2 intersecting indifference curves.



	Clothing	Food
A	30	15
B	10	20
D	20	30

Now here as we can see on indifference curve u_1, points A and B are indifferent. On indifference curve u_2, we can see points

Question Nos.		Marks Awarded

A and D are different. By the concept of transitivity points B and D should also be indifferent. Now, that is not possible as D has more clothing and more food than B, and according to the assumption that more units, the more preferable, it is not possible.

By looking at the graph also we can notice that B and D are not indifferent.

2

Hence, two indifference curves cannot intersect.

Q6) a) Salt:

Low income effect, low substitution effect.

The price of salt is not a major part or lot in our income. But there are substitutions available to salt, but consumers dont prefer that. Hence, the rise in price of salt will cause a little loss of income and very less changes reductions in consumptions of other commodities

b) Housing:

High income effect, no substitution effect.

We can all agree that the price of houses are very high and they consume a major part of our income. There is no substitutions available for houses. Hence, if the price of housing increases, there will be a substantial loss in the income and will have to reduce the consumption of other commodities.

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c) Theatre tickets

Low income effect, High substitution effect. The price of movie tickets is not a lot and ~~but~~ it doesn't consume a lot of our income. However, there are lot of substitutes available for theatre tickets like watching a movie at home, television, etc. even though, when the price of theatre tickets will rise, theatre tickets cause very low loss in income, the subitituion effect will cause a major difference in consumption of other commodities.

D) Food

High Income effect, no substitution effect. ~~Low~~ The price of food is a major part of our income and a major income is spent on food. There might be subsititutes for some kind of luxury food but there is no substitute of food as a whole. Thus, if the price of food increases, there will be a substantial loss in the income and it will lead to the reduced consumption of other commodities.

2