CHAPTER 1 : DEMAND

Desire + ability to pay+Willing to buy = Demand

Determinants of demand

- Price of commodity(*P*T†-*D*†T)
- Price of related commodities:
  - Substitutes *(P*T†-*D*T†*)*
  - Complementaries *(P*T†-*D*†T*)*
- Income of consumers (IT†-*D*T†)
- Tastes & Preferences of Consumers*(Fav-D*T,*Unfav-D*†*)*
- Population*(Pop*T-*D*T,*Pop*†-*D*†*)*
- Climate & Weather *(Fav-D*T,*Unfav-D*†*)*
- Gov't Policies*(Fav-D*T,*Unfav-D*†*)*
- Expectations about future prices

Types of Demand

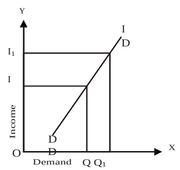
Price demand

Price	Demand
T †	T †

Income demand

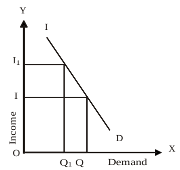
Superior goods

Income	Demand
T †	T †



Inferior goods

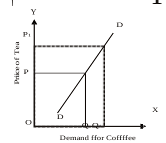
Income	Demand
T †	† T



Cross demand

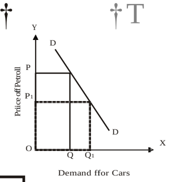
Substitutes

Price of Tea	Demand for coffee
T †	T †



Complementaries

Price of Petrol	Demand for car
T †	† T



Law of Demand

Assumptions

All the determinants of demand are assumed to be constant except price

Exceptions

- Giffen's paradox *(Generally inferior goods)* Demand curve-back ward bending
- Articles of distinction *(Veblen goods)*
- Demonstration effect
- Future expectations about prices
- Irrational consumer

Importance

Useful to:

- Farmers
- Finance Minister
- Consumer
- Monopolist *(In determination of Price)*

Reasons for downward sloping demand curve

- New Buyers
- Old Buyers
- Income effect
- Substitution effect

Changes in demand

Caused by Change in price

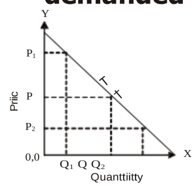
Extension & contraction

↓

Movement along the same demand curve

↓

Change in quantity demanded



Caused by Change in other factors

Increase & Decrease

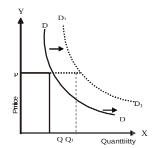
↓

Shift in the demand curve

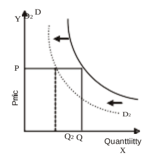
↓

Change in demand

Increase



Decrease

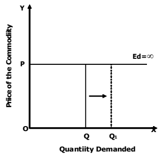


CHAPTER 2 : ELASTICITY OF DEMAND

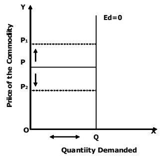
Price elasticity of demand

Degrees

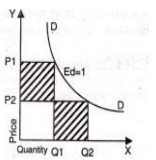
1) Perfectly elastic(∞)



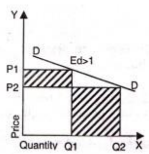
2) Perfectly inelastic (0)



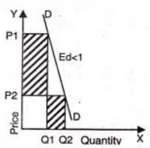
3) Unitary elastic (1)



4) Relatively elastic (>1)



5) Relatively In elastic (<1)

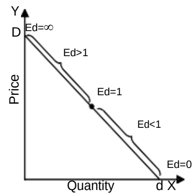


Methods

1) Point Method

$Ep = \frac{dq}{dp} \times \frac{p}{q}$ Or

$Ed = \frac{\text{lower segment}}{\text{Upper segment}}$



2) Percentage Method

$Ed = \frac{\text{\% Change In demand}}{\text{\% Change in price}}$

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

3) Arc Elasticity Method

$$Ed = \frac{q_2 - q_1}{p_2 - p_1} \times \frac{p_1 + p_2}{q_1 + q_2}$$

4) Total out lay Method

Price	-	T.Exp
T†		†T (Ed >1)
T†		T† (Ed <1)
T†		Same(Ed =1)

Factors

1) Availability of Substitutes
*[If Available - Elastic
If not Available - Inelastic]*

2) Type of want
*[Necessary - Inelastic
Comforts, luxuries - Elastic]*

3) Consumer habits
*[Habitual consumers - Inelastic
Others - Elastic]*

4) No of purposes (uses)
*[Can be used -elastic
Can't be used -inelastic]*

5) Price Range
*[Very high /low -inelastic
Middle range-elastic]*

6) Postponement
*[Yes- elastic
No -inelastic]*

7) Proportion of Expenditure
*[Small -inelastic
High -elastic]*

Importance/uses

- Useful to business firms
- Determination of Price & output
- Determination of prices
- Useful to super markets
- Useful to finance minister
- Pricing factors of production
- Explains the paradox of plain theory
- Useful in foreign exchange rates
- Nationalising an industry
- Granting protection to industry

Income elasticity of demand

Formula

$$E_I = \frac{\% \, Change \, in \, demand}{\% \, Change \, in \, income} = \frac{\Delta q}{\Delta y} \times \frac{y}{q}$$

Degrees

Negative (<0) -Inferior goods
Positive (>0) - Superior goods
0 to 1 - Necessaries
>1 - comforts/ luxuries

Cross elasticity of demand

Formula

$$E_C = \frac{\% \, Change \, in \, demand \, of \, x}{\% \, Change \, in \, price \, of \, y} = \frac{\Delta q_x}{\Delta p_y} \times \frac{p_y}{q_x}$$

Degrees

Negative (<0) - Complementaries
Positive (>0) - Substitutes
Zero - Unrelated goods/ Independent goods

CHAPTER 3: SUPPLY & ELASTICITY OF SUPPLY

SUPPLY

Determinants

- Prices of Products
- Prices of related commodities
- Prices of factor of production
- State of technology
- Government policy
- Business policy
- Time
- Agreement among producers

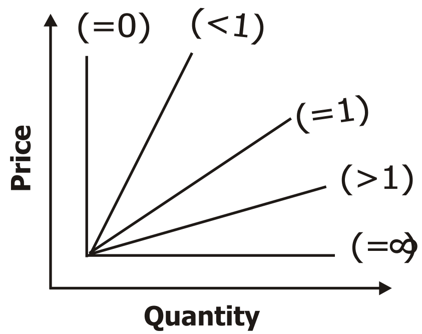
Exceptions to law of supply

- Auction sale
- Fear of fall in prices in future
- Rare commodities
- Land
- Supply of labour

Elasticity of supply

Degrees of price elasticity of supply

- Perfectly elastic supply (= ∞)
- Perfectly inelastic supply (=0)
- Relatively inelastic supply (<1)
- Relatively elastic supply (>1)
- Unit elastic supply (=1)



Determinants

- Nature of commodity
- Time
- Techniques of production
- Estimates of future

Importance

- Effect of price
- Quasi rent
- Better for

Measurements

- Point elasticity

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

- Arc elasticity

$$E_s = \frac{q_2 - q_1}{p_2 - p_1} \times \frac{p_1 + p_2}{q_1 + q_2}$$

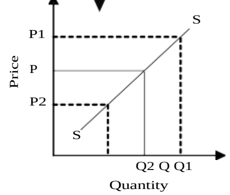
Changes in supply

Caused by change in price

Extension & contraction

Movement along the same supply curve

Change in quantity supplied



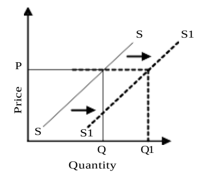
Caused by change in other factors

Increase & decrease

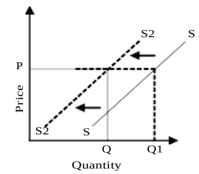
Shift in the supply curve

Change in supply

Increase



Decrease



CHAPTER 4: THEORY OF CONSUMER's BEHAVIOUR

UTILITY

Cardinal (1,2,3...) Marginal Utility analysis developed by Marshall

$$MU_n = TU_n - TU_{n-1} = TU_{n+1} - TU_n = \frac{\Delta TU}{\Delta Q}$$

Assumptions:
- Measurability of utility
- Marginal utility of money is constant
- Independent utility

Ordinal (I, II, III......) Indifference curve Analysis developed by Hicks & Allen

Assumptions
- Rational consumer
- Scale of preference
- Diminishing marginal rate of substitution
- Assumption of consistency
- More units, more preference
- Scale of preference is

Properties

Indifference curve:
- slopes downwards from left to right
- are always convex to origin
- can never intersect with each other
- do not meet the axes
- need not be parallel to each other
- higher indifference curve gives higher level of satisfaction than lower one

Superiority
- Assumptions are near to reality
- Non measurability of utility
- Marginal utility of money is not constant
- Explain cause for Giffen Goods
- Two commodity model
- Marginal rate of Substitution

Marginal Utility Analysis

Law of Diminishing Marginal Utility

Assumptions
- Standard Units
- Identical Units
- No time interval
- No change in tastes & habits
- Some goods of special Nature
- Availability of substitutes &

Importance
- Price determination
- Finance minister
- Explains paradox of value
- Basis for economic laws
- Advantage to

Law of Equi-Marginal Utility

$$\frac{MU_a}{P_a} = \frac{MU_b}{P_b} = \dots = \frac{MU_n}{P_n} = MU \ \ of \ \ money$$

Assumptions
- Indivisibility of goods
- Ignorance
- Unlimited resources
- Customs & fashions
- Measurability of Utility
- Constant utility of money

Importance
- Consumption
- Production
- Exchange
- Distribution
- Government

Theory of consumer's surplus

Consumers surplus=Willing price-Actual price

Criticisms
- Imaginary
- Measures mental satisfaction
- Difficult to calculate willing price
- Marginal utility of money is not constant
- Apply only in inflation
- Prestigious goods
- Changes from person to

Importance
- Price determination
- Useful to finance minister
- Price discrimination in discriminating monopoly
- Understanding the Water-diamond paradox
- Assessment of

CHAPTER 5: PRODUCTION

LAND

Features

- Free gift of nature
- No cost of production
- Limited in supply
- Permanent
- Land has no mobility
- Land is heterogenous
- Land has multiple uses
- Land is a specific factors of production
- Land is subject to law

CAPITAL

Features

Capital is

- result of labour
- result of savings
- productive
- temporary
- mobile factor
- a passive factor
- not a free gift

Functions

- Provides subsistence
- Provides employment
- Provides raw materials
- Provides means of transport
- Provides tools & machines
- Increases labour Productivity

Capital formation

Stages

- Savings
- Mobilization of savings
- Investment of savings

Factors

- Ability to save
- Willingness to save
  a) Family affection b) Prudence,
  c) Habit, d) Social status
- Facilities to save
- Security
- Rate of interest
- Taxation

Forms of Capital

- Real capital & human capital
- Individual capital & Social Capital
- Fixed capital & Circulating capital
- Tangible capital & Intangible capital
- Sunk capital & floating capital
- Internal capital & external capital

ORGANISER

Different possible objectives

- Organic
- Economic
- Social
- Human

Problems

Problems relating to

-objectives
-location & size of plant
-finance
-organization structure
-marketing
-legal formalities
-industrial relations
-selecting & organising physical activities

Qualities

- Far- sightedness
- courage
- leadership
- organising the labour
- experience
- Knowledge of business
- Moral quality
- knowledge of

Functions

- Initiating a business enterprise & resource co-ordination
- Risk bearing or uncertainty bearing
- Innovations
- Organizing the business
- Managing the business
- Allocation of income
- Decision making

Labour

Features

Labour-

- Means human exertion
- Power is co-extensive
- Is perishable
- Involves intelligence and judgement
- Is inseparable from labourer
- Has weak bargaining power
- Power differ's from labourer to labourer
- Efficiency of labour can increased
- Make choice between hours of labour & leisure
- Is less mobile than other factors

Mobility of Labour

Type

Occupational
(One job to another job in the same industry)

- **Horizontal**
  (In the same grade or at the same level)
- **Vertical**
  (Lower grade to higher grade)

Geographical
(One place to another place)

Factors

- Family-bond
- Information & knowledge
- means of transport & communication
- Level of literacy
- Poverty of labour

Factors affecting efficiency of Labour

- Racial qualities
- Health & strength of workers
- Standard of Living
- Education
- Personal qualities
- Social & political security
- Chances of promotion
- Trade unions
- Labour Laws

Division of Labour

Types

- Professional specialisation
  (Auditors, Doctors, Engineers, Teachers, Carpenters)
- Specialisation by process
  (Pins manufacturing)
- Territorial specialisation
  (Cotton Mills in Gujarat, Cycle

ADVANTAGES

- Increases production
- Employment opportunities
- Efficiency
- Saving in time
- Saving in tools
- Large scale production
- Best quality of product
- Possibility of Mechanization

DISADVANTAGES

- Monotony
- Loss of skill
- Mistake will multiply
- Loss of sense of responsibility
- Risk of job
- Hinders mobility of labour
- Difficulty in distribution of

LIMITATIONS

- Extent of market
- Nature of demand
- Inventions
- Capital availability
- Technical knowledge
- Nature of Industry
- Labour availability

CHAPTER 6: COST ANALYSIS

Determinants of cost

- Prices of factors of production
  (If high- cost T, If low-cost †)
- Technology
  (Advanced-cost†,If not-costT)
- Size of plant
  (Big-cost†, small-costT)
- Capacity Utilization or output level
  (Output levelT-costT, output level †-cost†)
- Period
  (Short run-costT, long run-cost†)
- Stability of output
  (If stable-cost†, If unstable-costT)
- Law of returns operating
  (Diminishing returns-costT, increasing returns-cost†)
- Managerial efficiency

Components of cost

- Prime cost
  (Direct material+direct wages+direct expenses)
- Production overheads
  (Indirect material+indirect wages+indirect expenses)
- Production cost
  (Prime cost+production over heads)
- Cost related to other functions
  (Administrative over heads+selling over heads+ distribution over heads)
- Total cost

Relation between Average cost & Marginal Cost

- Average cost and Marginal cost can be calculated from total cost
- When Average cost falls Marginal cost also falls
- When Average cost rises Marginal cost also raises
- Marginal cost cuts Average cost at its optimum

Different types of costs

- **Implicit costs**
  (Earnings of factors of production belonging to organizer himself)
- **Explicit costs**
  (Remuneration paid to outside factors of
- **Accounting costs**
  (All payments made by the entrepreneur to the suppliers of various factors of production)
- **Economic costs**
  (Accounting cost {explicit}
- **Outlay costs**
  (Actual outlay of funds like wages, material, rent)
- **opportunity costs**
  (Cost related to foregone
- **Direct costs**
  (Identified & traced to a particular product)
- **Indirect costs**
  (Can not be identified & traced to a particular
- **Shutdown costs**
  (Cost incurred after closing down of the business)
- **Abandonment costs**
  (Cost related to retirement of fixed asset from use)
- **Money costs**
  (Payment made to factors of production & other expenses)
- **Real costs**
  (Pains & sacrifices of labour or efforts &

CHAPTER7: PRODUCTION ANALYSIS

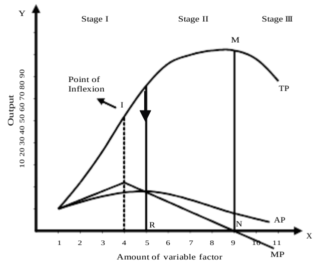
PRODUCTION FUNCTION

Short-Run
Law of variable proportions

[Fixed factors -constant
Variable factors-vary]

Assumptions

- State of technology is constant
- Some inputs are kept to be fixed
- Law does not apply if they



1st stage
Law of increasing returns
Reasons

- Invisibility of fixed Factor of production
- Division of work &

2nd stage
Law of diminishing returns
Reasons

- Distributing optimum proportion
- Imperfect substitutability

3rd stage
Law of negative returns
Reasons

- Too much of variable factors in relation to quantity of fixed Factor

Long Run

(All factors are variable)

Law of returns to scale

1st stage
output > Input
Reasons

- Indivisibility
- Specialization
- Dimensional

2nd stage
output = Input
Reasons

- Exists in short period only
- Balancing
- Increasing returns to scale will not continue

3rd stage
output < Input
Reasons

- Expansion
- Entrepreneur
- Decreasing returns

Diseconomies

Internal

- Inefficient management
- Technical difficulties
- Production
- Financial

External

- Pollution
- Strains on infrastructure
- High factor

Features

- Substitutability
- Complementary

Economies

Internal

- Technical :
  - -Big machines
  - -Bye- products
  - -Research
  - -Specilisation
  - -Linking process
  - -Workshops
- Managerial

External

- Cheaper source of raw materials & capital equipment
- Technical economies
- Development of skilled labour
- Growth of ancillary industries
- Better transportation &

Assumptions of production function

- Capital can be increased or decreased
- Production function implies to a given

CHAPTER8: MARKETS & CHAPTER 9 : PRICE &OUTPUT DETERMINATION

Features

- Every market have some commodities
- Competition
- Area

Types

On the basis of area

- Local market
  (buyers & sellers carry on business in a particular locality)
- National market
  (commodity is demanded and supplied all over the country)
- International market
  (commodity is demanded and supplied all over the

Basis of competition

- Perfectly competitive Market
  (large number of sellers selling homogeneous products)
- Monopoly
  (single seller of the Commodity having full control over the entire market)
- Imperfect Competition
  (It is a combination of monopoly & perfect competition)
- Oligopoly
  (only few sellers of a commodity each seller can influence the price-output policy of other

Basis of period of time

- Very short period Market
  (supply is more or less fixed)
- Short period market
  (one can change variable factors only but not fixed factors)
- Long period market
  (both fixed and variable factors can be changed)
- Secular period Market
  (changes can take place even in factors of

Factors effecting size of market

- Wide demand *(If - YesT, If -No†)*
- Adequate supply *(If - YesT, If -No†)*
- Durability *(If - YesT, If -No†)*
- Portability*(If - YesT, If -No†)*
- Grading and sampling
  (If - YesT, If -No†)
- Transport and communications
  (If - YesT, If -No†)
- Level of income*(If - highT, If -low†)*
- Development of financial institutions
  (If - YesT, If -No†)

-Availability of banks and other financial Institutions

-Credit and banking habits of people etc

CHAPTER 10: PRICE & OUTPUT DETERMINATION UNDER DIFFERENT MARKETS

Perfect Competition

Features

- Large number of buyers & Large number of sellers
- Products are homogeneous
- Free entry and free exist of firms
- Perfect knowledge of the market conditions
- Perfect mobility of factors of Production

Monopoly

Features

- Single seller of the product
- No close-substitutes
- Restrictions to entry
- Price maker
- Can't control supply & price
- Downward sloping demand

Sources

- Immobility of factors of production
- Ignorance
- Indivisibility
- Deliberate policy of

Monopolistic competition

Features

- Large number of Buyers and seller
- Product differentiation
- Control over price
- Freedom of entryor exit

Oligopoly

Features

- Interdependence
- Importance of advertising and selling costs
- Group behaviour
- Indeterminateness of demand curve

Discriminating Monopoly

Features

- Difference in elasticity of demand
- Market imperfections
- Legal sanction
- Existence of monopoly

Degrees

- **1st Degree**

  (In this the monopolist is able to sell each separate unit of his Product at different prices)

- **2nd degree**

  (In this buyers are divided into different groups and different price will be charged to different groups)

- **3rd degree**

  (In this seller divides his buyers into two or more than to sub markets & from each sub market a different price is charged)