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Economics.

→ Free Goods : supply > demand. Ex air

→ Economic Goods :- supply < demand
- they have an exchange value.

→ scope of Economics revolves around activities of rational human being as well as production, distribution and consumption of economic goods

→ Normative economics is based on ethical, moral, philosophical & religious beliefs of the people.

→ Positive economics involves explanation and prediction of economic behaviour. as it is not what it ought to be.

- Goods: Commodity or service which gives satisfaction to humans on consumption is called good.

Criterias for differentiating goods:

① Free Goods	Economic Goods.
→ They do not bear a price	→ They bear a price.
→ supply > Demand	→ supply < Demand
→ They are not exchanged	→ They are exchanged.
→ Ex: Air, sunlight.	→ Ex: Bread, Grinder.

(*) Some goods become economic or free depending on person, place or situation. Ex. mother taking care of baby & nanny taking care of baby.

mother taking care of baby: non-economic

nanny taking care of baby: Economic good

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② Capital Goods	Consumer Goods
→ They help in production of other goods.	→ They are directly consumed by humans.
→ Ex: Machine & raw materials	→ Ex: bread & milk.

(*) A particular good can become capital / consumer good depending on type of use
Ex. $\underbrace{\text{Milk to drink}}_{\text{consumer}}$ & $\underbrace{\text{Milk to produce milk products}}_{\text{capital}}$

(*) Consumer Goods
classification { ↳ Perishable Goods — short shelf life. Ex. vegetables
↳ Non-perishable

classification { ↳ Durable : long working life
↳ Non-durable :

(*) Veblen Goods: A type of consumer good which violate the law of demand. i.e demand increases as price increases.

③ Transferrable Goods	Non-transferrable Goods.
→ Land / Building of a person.	→ Beauty of a model, teacher's knowledge
→ can be transferred to another person	→ cannot be transferred

④ **Complimentary**
→ When 2 or more goods are reqd. together to satisfy 1 want.
→ Ex. Ink & Pen

Substitute.
→ When 2 or more goods satisfy similar wants.
→ Ex. Wheat & Rice
Tea & Coffee.

⑤ **Material Goods**
→ Are tangible & have physical existence.
→ Ex. Land, water, building, machinery etc.

Non-Material Goods
→ Are intangible. Like one's own qualities
→ Muscular strength, beneficial relations

⑥ **Normal Goods** :- Demand increases ~~as~~ with increase in income.
-Ex. clothes & pencils.

price elasticity is negative.

Inferior Goods
→ Demand decreases ~~as~~ with increase in income
→ Price elasticity is positive
→ Substitution effect is more prominent.

Giffen Goods.
→ Paradoxically, demand increases with increase in price.
→ Price elasticity is positive
→ Income effect is more prominent.

⑦ **Private Goods**
→ Owned by one person who benefits from it & prevents others from using it.
→ Excludable & Rivalrous

Public Goods
→ No individual can be excluded from its use.
→ Non-excludable & non-rivalrous

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(*) Public goods may at times be subject to excessive use resulting in negative extaralities affecting all users like, air pollution & traffic

(*)

	Excludable	Non-excludable
Rivalrous :	Private goods : food, house, property.	Common goods : timber, mineral
Non rivalrous :	Club goods : Library, theatre	Public goods : Air, road, river.

- Indifference Curve Analysis :

↳ It is the locus of points which represent combination of two commodities M & N which yields equal satisfaction.

→ Characteristics :

↳ Is negatively sloped & convex to the origin.

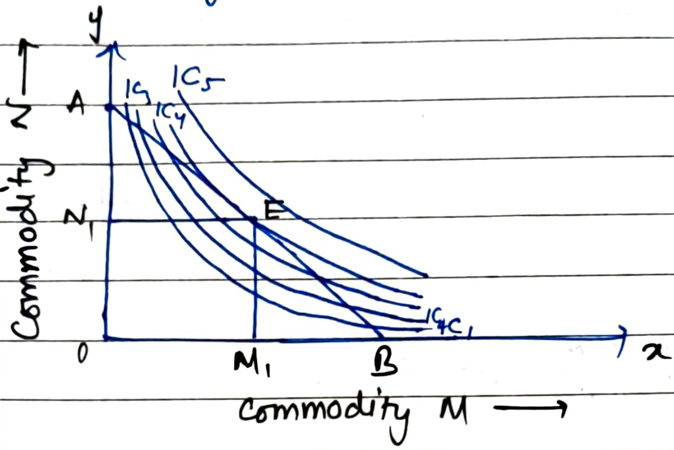
↳ 2 indiff. curves do not intersect & are usually parallel to each other.

↳ Indiff. curve towards right means higher level of satisfaction.

→ Marginal Rate of Substitution : (MRS_{MN})

↳ refers to the amount of N that a user is willing to forego in order to gain 1 additional unit of M (and still have same level of satisfaction).

↳ On moving down the indiff. curve, MRS_{MN} diminishes.



→ Budget Constraint Line:

↳ Shows the different combinations of commodities a consumer can purchase given ~~the~~ his money, income & prices of the commodities. (AB is the budget line)

→ Consumer Equilibrium:

↳ When his budget line reaches the highest possible curve.

↳ In the above example, consumer equilib^m is reached at E on IC_4.

→ Price Effect:

↳ Impact of change in price of M on consumer's demand & consumption while keeping the price of N, consumer's taste & money income constant.

(✱) PCC: Price consumption curve, is the locus of points of consumer's equilib^m resulting when only price of M is varied.

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- Consumer's Demand Curve: Shows amount of M a consumer would purchase at various prices of M.

- Price Effect = Income effect + Substitution effect.

→ Application of Indifference curve:

↳ used to calculate price elasticity of demand for the product which has numerous close substitutes. It will have Large substitution effect.

↳ used to differentiate goods as luxury & necessity. Luxury goods will have strong income effect

↳ used to differentiate substitute & complimentary goods. substitution effect will be very high for substitute goods. & not so high for complimentary goods.

- Wish becomes a want if it is supported by the ability to fulfil it.

→ WANTS

↳ Necessities: - Basic for our existence
- Are of 3 types:
(i) necessities for existence
(ii) " for efficiency
(iii) conventional necessities.

→ Comforts: wants that enhance comfort ultimately enhance efficiency

→ Luxuries: They are wanted for pleasure. They are neither must for our existence nor enhance productivity/efficiency.

(*) One will like to fulfil want with higher intensity of consumption first.
One will like to have more of a good if price is less & less if price is more.

(*) If a wish is supported by ability & willingness to fulfil, it, becomes a demand.

- LAW OF DEMAND:

→ If income of household, fashion, season etc remain constant, demand is inversely proportional to price.

$$\boxed{D \propto \frac{1}{P}} \rightarrow \text{Law of Demand}$$

→ Demand curve has negative slope & the sum total of demand by all individuals (or household) is called market demand.

→ When price of a good remains same but demand increases or decreases due to other factors, it is known as expansion or contraction in demand respectively.

EXCEPTIONS :

→ Giffen goods : when price falls, demand also falls & vice versa.

This happens because when price falls, purchasing power of the consumer increases & they switch to superior substitutes.

→ Prestige goods / conspicuous consumption / Veblen effect :

Some luxury goods are bought because they are high priced & can be shown off to boast.

→ Price expectation: If prices are expected to rise further, the initial demand increases.

- Price elasticity of Demand

Ratio of proportionate change in demand with proportionate changes in price is called price elasticity of demand.

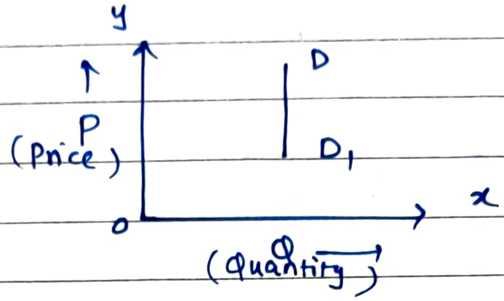
Price elasticity coefficient ← $e_d = \frac{dQ}{dP} \times \frac{P}{Q} = \frac{dQ/Q}{dP/P}$

change in demand (dQ); change in price (dP); original price (P); original demand (Q)

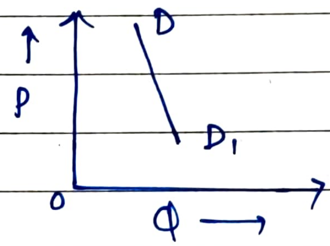
$$0 \leq e_d < \infty$$

Elasticity	Type of elasticity	Implications
1. $e_d = 0$ →	Perfectly inelastic →	Change in price doesn't affect demand

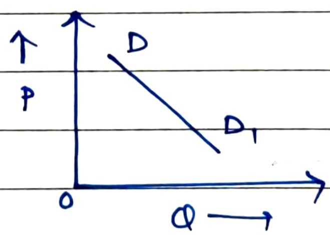
Graph:



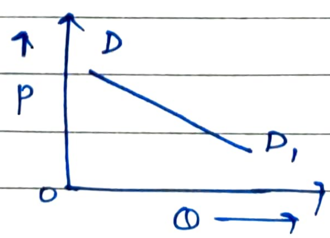
2. $|e_d| < 1$ → Less than unit elastic → % change in demand is less than % change in price.



3. $|e_d| = 1$ → Unit elastic → % change in demand = % change in price.



4. $|e_d| > 1$ → More than unit elastic → % change in demand > % change in price.



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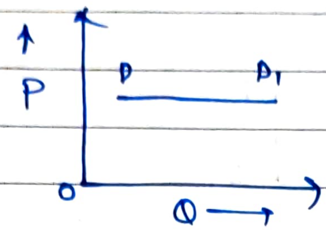
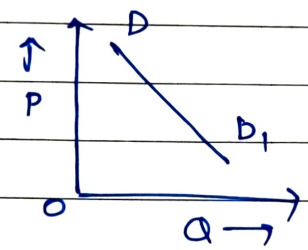
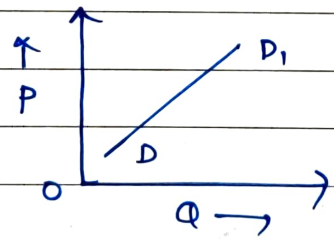
5. $e_d = \infty$ → Perfectly elastic → Any change in price causes infinite change in demand.



6. $e_d < 0$ → Normal good → $D \propto \frac{1}{P}$



7. $e_d > 0$ → Giffen good → $D \propto P$



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→ **Determinants of Price Elasticity:**

① **Sustainability:** – If more substitutes are available, the demand will be more elastic

– Producers with multiple uses have higher price elasticity than single-use goods.

② **Relative size of expenditure on product concerned:**

If small amount of total expenditure is spent on the commodity, then relative effect on demand is less.

③ **Necessity v/s Luxury:** – Consumer's perception of the product as a necessity or luxury.

④ **Time period of demand curve:**

A substitute may be found in the long run. Thus, in short run, it may be price inelastic but in the long run it might become price elastic.

→ **APPLICATIONS:**

① **As a guide for setting prices:** If ed > 1 then dQ > dP. Then it is advisable to keep the price low as, ultimately lower prices garner higher turnovers for such product.

② **As a guide of shifting tax burden (indirect tax):**

If $ed < 1$, then $dQ < dP$. Thus, if an indirect tax is levied on the product, producer can shift larger burden of tax to customer & vice versa.

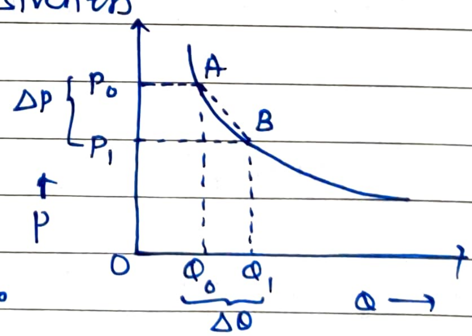
③ **Discount Sales:**
Firms take into consideration, ed while giving discounts so as to determine whether discounts would attract enough additional customers to offset the lower revenues per unit.

→ **MEASUREMENT:**

① **Total Outlay / Expenditure Method:**

	Nature of change in expenditure	ed	Nature of ed
Effect of increase in price	Increases	$\lvert ed\rvert > 1$	Elastic
	Decreases	$\lvert ed\rvert < 1$	Inelastic
	Constant	$\lvert ed\rvert = 1$	Unit Elastic

② **Arc Method:**
Measure of the avg. responsiveness of price change ~~to~~ exhibited by demand curve over a finite stretch.



Absolute changes: $\Delta P = P_1 - P_0$, $\Delta Q = Q_1 - Q_0$

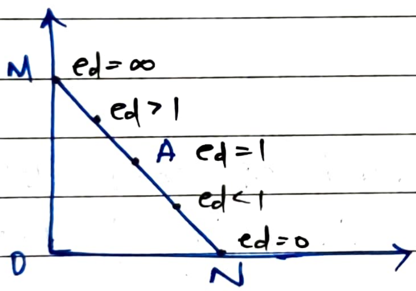
$P = \dfrac{P_1 + P_0}{2}$, $Q = \dfrac{Q_1 + Q_0}{2}$ } Any value of P & Q may occur between P_1, P_0 & Q_1, Q_0 respectively.

$$e_d = \frac{-\Delta Q}{\Delta P} \cdot \frac{P}{Q} = -\frac{Q_1 - Q_0}{P_1 - P_0}\left(\frac{P_1 + P_0/\cancel{2}}{Q_1 + Q_0/\cancel{2}}\right)$$

$$\boxed{e_d = -\frac{Q_1 - Q_0}{Q_1 + Q_0} \cdot \frac{P_1 + P_0}{P_1 - P_0}}$$

③ Point Method :- Points where $dP = 0$ ~~&~~ or $dQ = 0$ should not be taken into consideration.

- arc AB is made smaller & smaller using lim.



$$\boxed{e_d = -\frac{AN}{MA}}$$

- Income Elasticity of Demand:

Ratio of proportionate change in demand with proportionate change in income. (e_y)

$$e_y = \frac{dQ}{dY} \cdot \frac{Y}{Q}$$ → original income.

$e_y < 0 \longrightarrow$ Inferior Good
$e_y > 0 \longrightarrow$ Normal Good
$e_y < 1 \longrightarrow$ Necessity
$e_y > 1 \longrightarrow$ Luxury.

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SIGNIFICANCE:

1. Goods with low e_y are recession proof. i.e their sales are stable in economic downturn.

2. If $e_y < 0$ then the firm must expect decline in demand as economy grows.

3. e_y info. is also considered for planning location, & expansion of firm & advertising & promotion of product.

- **Cross Elasticity of Demand:**

Proportionate change in demand of commodity M due to proportionate change in price of commodity N.

$$e_d^* = \frac{dQ_M}{dP_N} \cdot \frac{P_N}{Q_M}$$

$e_d^* = +ve \rightarrow$ commodities are substitutes
$e_d^* = -ve \rightarrow$ commodities are complimentary.
$e_d^* = 0 \rightarrow$ Unrelated commodities.

SIGNIFICANCE:

1. Firm Level: helps in formulation of marketing strategy.

2. Industry Level: indicates whether or not as substitute exists.

- **Price elasticity of supply:**

Proportionate change in supply due to proportionate change in price.

$$e_s = \frac{ds}{dp} \cdot \frac{p}{s} \rightarrow \text{original supply}$$

DETERMINANTS:

1. **Nature of commodity:** – Perishable goods have less shelf life → supply is relatively INELASTIC.
   – Durable goods have more shelf life → supply is relatively MORE ELASTIC.

2. **Chances of increasing output:**
   Availability of inputs & at which stage of return-to-scale, production is being carried out.

3. **Techniques of Production:** – Easy & less time consuming techniques → Elastic supply
   – Complex, more time consuming technique requiring heavy investment → Less elastic supply

- **Monopolistic Competition:**
  As no. of sellers are large, they do not have knowledge of market share of their rivals. So, they concentrate on their own market and try to enhance it.

No. of firms	Nature of Product	
	Homogenous	Heterogenous / Differentiated
(i) Many.	Perfect competition	Monopolistic competition.
(ii) Few	—	Oligopoly
(iii) One	Monopoly	—

- MONEY:

→ Barter system was inconvenient so money was introduced as a medium of exchange

→ Earlier it used to be cattle, then pebbles, precious stones, metals were eventually preferred because of their convenient size.

- INFLATION:

→ refers to monetary phenomenon where prices rise due to increase of money in circulation & is not accompanied by ~~the~~ such an increase in output.

→ In a developed economy, inflation generally occurs after stage of full employment of resources

→ In a developing economy, inflation may co-exist with under-employment of resources.
This may be on account of shortage of capital, equipment, poor power facilities etc.

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→ Classifications:

1. Cause: (i) Demand Pull Inflation
   (ii) Supply Push Inflation.

2. Rate: (i) Creeping Inflation
   (ii) Running "
   (iii) Galloping/ "
   Hyper.

✱ Demand Pull Inflation:

- Most common
- ever rising demand on a stagnant or slowly increasing supply.

- Process:

(i) Increase in money supply.
(ii) Fall in interest rate.
(iii) Increase in investment in the economy.
(iv) Increase in money income of factors of production.
(v) Inevitable increase in expenditure on consumption goods.
(vi) Further increase in money income of f.o.p.

(vii) Since, the economy is already operating at the level of full employment or the output cannot be increased due to unavoidable reasons, an increase in investment expenditure will lead to demand inflation.

- Indicators:
(i) General shortage (of goods & services)
(ii) Lengthening queues.
(iii) Increased imports.
(iv) Rising wages
(v) Rising profit margin.

(*) Cost-Pull Inflation:
- caused due to increase in production cost which maybe due to :
(i) Increase in wages.
(ii) Increase in profit-margin.
(iii) Imposition of heavy commodity taxes.

- It is contagious to other industries, if cost-inflation arises in one industry, because various economic sectors are closely linked to each other

On basis of Rate of Inflation:

- Creeping Inflation: upto 3% per annum.
- Walking Inflation: 3–9% per annum.

Moderate inflation = Creeping + walking

- A single digit inflation is considered good for an economy.
- Running Inflation : 10 – 20% per annum.
- Galloping / Hyper Inflation : > 20% per annum.
- Inflation of higher denomination is not desirable. It causes economic distortions & disturbances.
- Indian inflation was < 25%.
- Argentina, Brazil, Israll have experienced > 100% infl.

Q. What happens when price rise is alarmingly high during hyper-inflation?

Ans: In such situation, value of national currency reduces to almost 0. Paper money becomes worthless & people start trading either gold or silver.

Ex. Hungary – 1996 & Zimbabwe 2004–09.

→ CONTROL OF INFLATION:

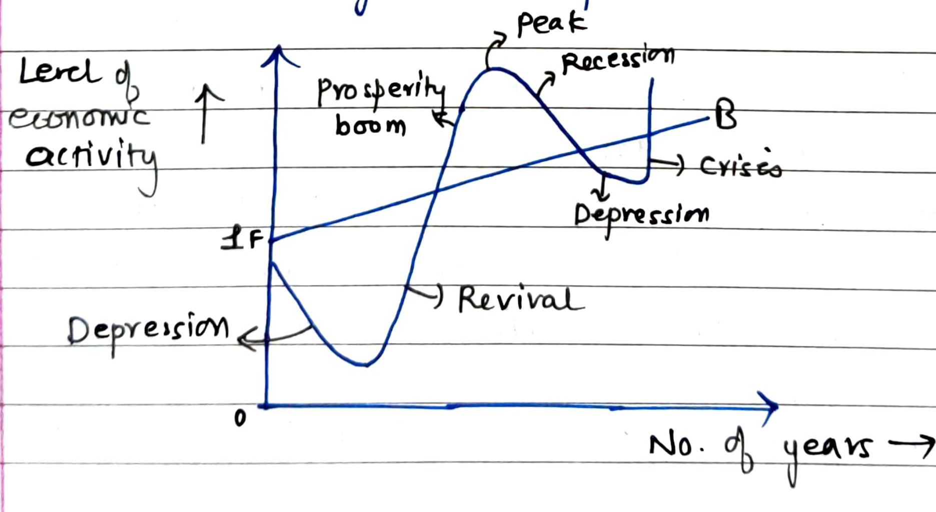
① To control demand-pull inflation, the target is to mop up surplus purchasing power from the hands of the public.
This can be achieved by increasing taxes & decreasing subsidies.

② Cost-push inflation is difficult to control because any attempt to cut down wages by authorities will be met by strong resistance from workers.

- **Business Cycle:**

→ Rhythmic fluctuations of an economy i.e periods of prosperity followed by periods of depression.

→ Waves of prosperity & depression need not be of the same length & amplitude.



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→ Five phases of trade cycle:

① Depression:
(i) There is a persistent lack of demand.
(ii) Management introduces economic measures like stoppage of waste, greater efficiency, wage cutting & retrenchment of staff. (reducing cost of production/unit)
(iii) Reduction in prices, which leads to low profit margin
(iv) Retrenched workers do not have salary & cannot demand same products & services they were demanding earlier.
(v) Cascading effect on other sectors, which also have a lack of demand now.

* Total o/p & employment fluctuate more in durable & capital goods industries. This is passed on to non-durable & consumer goods industries.

② Recovery phase:
(i) To create demand, technological innovations in existing products are made which thereby increase value.
(ii) Gradually, there is greater demand for goods & services and consequently increased production.
(iii) Prices start rising & with it, wages, interest & profits too.
(iv) Employment & incomes increase which increases national income.
(v) Increase in investment, bank loans and advances.

③ Full Employment phase: Recovery continues till there is full employment of resources. Wages, interests & profits are high, output and employment are highest under given technological circumstances. There may be some voluntary unemployment.

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④ Inflation Phase:
(i) Beyond full employment, rise in Investment leads to increased pressure on resources.
(ii) If any resource asks for higher money, it distorts the cost-calculations, which leads to recession

⑤ Recession:
(i) Crash of boom is sudden & sharp.
(ii) Business expansions stop, orders are cancelled & workers are laid off
(iii) Widespread unemployment is there.

- BANK: Financial institution that deals in money & credit.

→ Main functions are:
(i) accept deposits (for people to keep their money safe)
(ii) Lend money to the needy in form of loans.

→ Commercial Banks: earn from the difference between what they pay & take as interest.

→ Central Bank: - Apex monetary & banking institution.
- Forms banking policies

→ Types of Bank Accounts:

① Savings Account: - To save a part of customer's income to meet their future needs & also earn an income on their savings (bank interest).

- No. of withdrawals over a period of time and amount of money are limited.

② Current Account:

- A running account which can be operated upon any no. of times a day.
- No restriction on the number & amount of withdrawal
- Bank does not pay interest. In some cases it takes incidental charges.

③ ~~Fixed~~ Fixed Deposit:

- Made for a fixed period of time from 45 days onwards.
- Higher rate of interest
- Rate of interest $\propto$ period of deposition.
- Banks lend this money to the needy as loan.

→ Subsidiary Bank activities:

1. Collection of cheques drawn from other banks.
2. Acceptance & collection of bills of exchange.
3. Dealing in foreign exchange to assist settlement of overseas debt.
4. Stock exchange trustee & executor of business.
5. Bank locker facilities.
6. Making standing order payments.
7. Supplying change & assisting local bank in keeping the note issue in good condition.
8. Selling of application forms of several national exams.
9. Collection of bills on behalf of any org.

Commercial Bank	Central Bank
1. Objective is to earn profit	Objective is to stimulate economic growth.
2. There can be several commercial banks.	There is only one central bank in a country.
3. There can be private & nationalized commercialised banks	It is an autonomous institution.
4. Perform general banking & agency services for gen. public	Performs general banking & agency services for the govt.
5. They deal with public directly.	They deal with comm. banks, other financial institutions & govt.
6. PNB, SBI, ICICI in India	RBI in India

- MONETARY POLICY:

→ Refers to measures taken ~~by~~ to control & regulate money & credit supply in the economy.

→ Rate of interest is a very important factor here.

→ To control volume of money in circulation:

1. Bank loan interest rate is increased.
2. This reduces demand of bank loan.
3. Ultimately, this reduces volume of money in circulation.

→ If there is large scale unemployment in the economy:

1. Bank loan interest rates are decreased.
2. This creates demand for bank loans & advances
3. This ultimately eradicates unemployment upto a certain extent.

- **INTERNATIONAL TRADE:**

→ Takes place due to difference in efficiency. due to following reasons:

1. Climatic & Geographical conditions:
They differ widely across regions which results into difference in efficiency in production of goods & services.

2. Human Capabilities:
- are different in diff. countries.
- some possess great dexterity & organizational skill, some are physically sturdy & others intelectually alert

3. Difference in Accumulated capital:
Developed countries are richer in capital endowments compared to developing countries.

→ Intl. Trade is different from national/interregional trade:

1. Degree of difficulty in movement is more.
2. National policies like taxation, labour standards etc differ among countries.
3. Access to national markets is easier than intl. markets

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Gain from International Trade :

→ It enables a country to export commodities to other countries and thus, secure a better market for them.

→ Countries are able to import commodities they cannot produce at all or whose production cost is very high.

→ International specialization leads to best utilisation of resources among countries of the world.

→ It also helps to equalise prices between all countries.

→ In absence of trade, price will be low in producing country & high where it is not produced.

→ Through trade, prices increase in producing country & decrease ~~in the~~ where it is not produced.

Terms of Trade :

→ refers to the prices at which a trade is made.

→ They depend on the demand and supply forces (collectively called reciprocal demand) :

1. elasticity of a country's demand for imports
2. " " foreign demand for country's exports.
3. " " supply of exports.
4. " " supply of imports.

- **Free Trade & Protection:**

→ Under free trade, entry & exit of any foreign firm is free in the domestic market.

→ Presence of cheap imported goods affect the domestic producers adversely.

→ To protect the domestic producers from international ~~trade~~ competition, countries impose restrictions.:

(1) **Tariffs / Custom Duties:**
- most widely used method.
- of 3 types:

(i) **Uni-Linear / Single column:**
- preferential tariff system
- exclusive trade privileges to nations with political relations, racial or regional negotiations etc.

(ii) **Specific duty & Ad valorem duty:**
- if tariff is imposed & calculated on basis of physical units → specific duty.
- if duty is imposed based on value of goods → Ad valorem duty.

(iii) **Custom & Countervailing duty:**
- tariff imposed to raise prices of imported goods & help the domestic producer → custom
- tariff in addition to original custom duty to ensure degree of protection originally intended → countervailing.

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② Quantitative Restrictions:
- limitation upon physical amounts of certain goods.
- licensing / quota are used to implicate.

③ Exchange Restrictions:
- classification of goods acc. to importance & assign priority of import.
- Leads to distortion in production & trade and administrative corruption & arbitrariness.

④ Other Methods:

(i) Multiple Exchange Rates: (for different types of goods)
(ii) Sanitary Regulations: (prevent import on basis of health & welfare)
(iii) Import Surcharge: (special taxes on dutiable import)
(iv) Linked Purchase Regulations: (require a fixed proportionate purchase of domestic articles for every import)

→ Arguments In Favour & Against Protection.

① Required for young & newly started industries to help them establish

② consumer suffers due to ~~denial~~ denied access to foreign goods at a cheaper rate

③ It results in decrease of exports.

④ Countries with richer strata of people, avoids import of cheaper goods from poorer countries

(5) It equalizes the cost of production of home & foreign countries.

(6) ICT (Info. & Comm. Tech.) has made it possible to shift part of the production process, which can be digitally transferred to place where it can be performed in a cost-effective manner.

- Balance Of Payment:

→ systematic record of all economic transactions between residents & foreign countries during a given time period (usually 1 year)

→ It includes invisible trade as shipping, banking insurance, tourist & traffic along with visible items which can be counted at port.

→ Advantages:

(1) provides info. regarding intl. transactional status of the country to the govt.

(2) Helps govt. in making decisions regarding monetary & fiscal policy.

→ Structure:

Consists of two sections:

↳ Current acc.

↳ Capital acc.

Current Account	Capital Account.
① Deals with payments of currently produced goods & services.	Deals with debts & claims.
② Includes interest earned or paid on claims & also on gifts and donations.	Includes payments on claims only.
③ Directly affects national income & level of income in country.	No direct effect on level of income. Affects volume of assets held by a country.

→ Balance of Payment depends upon current acc. as follows:

① will be balanced if export = import
② Is adverse if export < import
③ Is favourable if export > import

→ Country ~~meets~~ meets BOP deficits through:

① Drawing on past accumulated balance, kept as reserve in a foreign country. Ex India holds in England.
② Drawing from the IMF (Intl. Monetary Fund)
③ Loans / Grants from other countries.

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- **Dumping** : is the sale of a good abroad at a lower price than its domestic selling price under same circumstances & at the same time

→ 2 types:

1. International Dumping:

- occasional foreign sales below home price or even below cost price with some specific objectives:

(i) Recession (temporary low prices)
(ii) to establish a foothold
(iii) to drive out an existing foreign competition or force it to join a cartel.
(iv) to dispose of occasional domestic surplus which might result from a decline in demand.
(v) to dispose off remnants at the end of season.
(vi) to obtain badly needed foreign exchange.

2. Persistent Dumping :

- means continuous sales abroad at a lower price than home price.
- may be due to difference in demand curves in different countries for a product.