CD CAT1 QB – Answers

1) What do you understand by Industrial Economics? Differentiate between Micro and Macroeconomics.

Ans 1)

Industrial Economics

Industrial Economics is the study of firms, industries, and markets. It is a distinctive branch of economics which deals with the economic problems of the firms and the industries and their relationship with the society. It looks at firms of all sizes – from local corner shops to multinational giants such as Walmart or Tesco and also considers a range of industries, such as electricity generation, car production, and restaurants. It has both micro and macro aspect.

Difference between Microeconomics and Macroeconomics

S.No	Microeconomics	Macroeconomics
1.	Microeconomics studies individual economic units	Macroeconomics studies a nation's economy, as well as its various aggregates.
2.	Microeconomics primarily deals with individual income, output, price of goods, etc.	Macroeconomics is the study of aggregates such as national output, income, as well as general price levels.
3.	Microeconomics focuses on overcoming issues concerning the allocation of resources and price discrimination.	Macroeconomics focuses on upholding issues like employment and national household income.
4.	Microeconomics accounts for factors like the demand and supply of a particular commodity.	Macroeconomics account for the aggregate demand and supply of a nation's economy.
5.	Microeconomics offers a picture of the goods and services that are required for an efficient economy. It also shows the goods and services that might grow in demand in the future.	Macroeconomics helps ensure optimum utilization of the resources available to a country.
6.	Microeconomics helps to point out how equilibrium can be achieved at a small scale.	Macroeconomics help determine the equilibrium levels of employment and income of the nation.
7.	Microeconomics also focuses on issues arising due to price variation and income levels.	The primary component of macroeconomic problems is income.

2) State the Law of Demand and Supply and explain various factors on which Demand depends.

Ans 2)

The law of supply and demand refers to one of the core concepts in economics explaining the relationship between demand, supply, and price of products and services. It integrates the concepts of the law of demand and the law of supply.

In simple terms, while all other factors remain constant, the law of demand holds that when the price rises, demand falls.

At the same time, the law of supply states that when the price increases supply increases. The direct relationship between the price and supply creates an upward sloping supply curve.

At the same time, the inverse relationship between price and demand results in a downward sloping demand curve.

Demand increases, and supply remains the same:

In a competitive market, this will cause an increase in the price. The shortage of products increases the value of the product.

Demand decreases, and supply remains the same:

In this situation, the price reduces. If the demand continues to decline, there will be a surplus of the product in the market, subsequently dampening the product's value.

Supply increases and demand remains unchanged:

The easy availability of a product causes a decrease in its price, manifesting an oversupply scenario if the demand remains intact for long.

Supply decreases and demand remains unchanged:

When supply decreases, and there is no increase or decrease in demand, the price will increase.

3) What do you understand by Deflation? Describe its impact on Economy.

Ans 3)

Deflation is the opposite of inflation. Deflation refers to situation, where there is decline in general price levels. Thus, deflation occurs when the inflation rate falls below 0%. Deflation increases the real value of money and allows one to buy more goods with the same amount of money over time. Deflation can occur owing to reduction in the supply of money or credit. Deflation increases unemployment in an economy. Deflation allows one to buy more goods and services than before with the same amount of money. Deflation is an indication that economic conditions are deteriorating. Deflation is usually associated with significant unemployment.

Causes of Deflation

1. Increased Productivity
2. Decrease in Currency Supply
3. Reduction in government expenditure
4. Deflationary Spiral

Impact of Deflation on Economy:

Deflation can be compared to a terrible winter: The damage can be intense and be experienced for many seasons afterwards. Unfortunately, some nations never fully recover from the damage caused by deflation. Hong Kong, for example, never recovered from the deflationary effects that gripped the Asian economy in 2002. Deflation may have any of the following impacts on an economy:

1. Reduced Business Revenues:

Businesses must significantly reduce the prices of their products in order to stay competitive. Obviously, as they reduce their prices, their revenues start to drop. Business revenues frequently fall and recover, but deflationary cycles tend to repeat themselves multiple times.

2. Wage Cutbacks and unemployment:

When revenues start to drop, companies need to find ways to reduce their expenses to meet their bottom line. They can make these cuts by reducing wages and cutting positions. If businesses face more loss, they remove the employees and this leads to unemployment.

3. Changes in Customer Spending:

When the economy undergoes a period of deflation, customers often take advantage of the substantially lower prices. Initially, consumer spending may increase greatly; however, once businesses start looking for ways to meet their supply, consumers who have lost their jobs or taken pay cuts must start reducing their spending as well. Of course, when they reduce their spending, the cycle of deflation worsens.

4. Reduced Stake in Investments:

When the economy goes through a series of deflation, investors tend to view cash as one of their best possible investments. Investors will watch their money grow simply by holding onto it. Additionally, the interest rates investors earn often decrease significantly as central banks attempt to fight deflation by reducing interest rates, which in turn reduces the amount of money they have available for spending.

5. Reduced Credit:

When deflation rears its head, financial lenders quickly start to pull the plugs on many of their lending operations. As assets such as houses decline in value, customers cannot back their debt with the same value.

4) Explain the term Recession. Illustrate in detail its impact on Economy.

Ans 4)

A recession is a significant, widespread, and prolonged downturn in economic activity. A common rule of thumb is that two consecutive quarters of negative gross domestic product (GDP) growth mean recession, although more complex formulas are also used.

What Causes Recessions?

Numerous economic theories attempt to explain why and how an economy goes into recession. These theories can be broadly categorized as economic, financial, psychological, or a combination of these factors.

Some economists focus on economic changes, including structural shifts in industries, as most important.

For example, a sharp, sustained surge in oil prices can raise costs across the economy, leading to recession.

Some theories say financial factors cause recessions.

These theories focus on credit growth and the accumulation of financial risks during good economic times, the contraction of credit and money supply when recession starts, or both. Monetarism, which says recessions are caused by insufficient growth in money supply, is a good example of this type of theory.

Impact of Recession on Economy:

1. **Unemployment**
2. **Fall in income – shorter working week.**
3. **Rise in poverty**
4. **Fall in asset prices (e.g., fall in house prices/stock market)**
5. **Increased inequality and an increase in relative poverty**
6. **Higher government borrowing (less tax revenue)**
7. **Permanently lost output.**
8. **Firms go out of business.**

5) Analyse the significance of generation of healthy aggregate demand for the economic growth of the country.

Ans 5)

Aggregate Demand

Aggregate demand is a measurement of the total amount of demand for all finished goods and services produced in an economy. Aggregate demand is commonly expressed as the total amount of money exchanged for those goods and services at a specific price level and point in time.

An increase or decrease in the components of aggregate demand will have an effect on economic growth.

If there is an increase in the components of aggregate demand such as higher consumption levels, more investments of firms in projects, more government spending on infrastructure, or increased exports in trade, then there will be increased economic growth.

Conversely, a decrease in these components will lead to a decrease in aggregate demand and hence a fall in economic growth.

6) State concept and types of elasticity of demand, and describe the various types of Elasticity of demand.

Ans 6)

Elasticity of Demand

Elasticity of Demand, or Demand Elasticity, is the measure of change in quantity demanded of a product in response to a change in any of the market variables, like price, income etc. It measures the shift in demand when other economic factors change.

In other words, the elasticity of demand is the percentage change in quantity demanded divided by the percentage change in another economic variable.

The demand for a commodity is affected by different economic variables:
1.Price of the commodity
2.Price of related commodities
3.Income level of consumers

Elasticity:

Elasticity plays a key role in determining the effect of changing prices on business revenue, the analysis of tax burden, the benefits of trade, and the effects of advertising. (For related reading, see Economic Basics: Elasticity.) Price elasticity of demand describes how changes in the cost of a product or service affect a company's revenue.

For some products, a small change in price will dramatically influence how many units the customer will buy. In other cases, price movements have little effect on demand. Therefore, understanding the price elasticity of each offering is crucial to maximizing profit.

Several factors can affect the price elasticity of products. For example, if substitute goods are readily available, the customer will immediately curtail purchases when the price rises. And if the good represents a major part of the buyer's total spending, he or she will be more likely to shop based on price.

Understanding how consumers value a product can be vital for any company. Raising prices can be one of the easiest ways to boost profits, but only if consumers are willing to accept the added cost.

1. Perfectly Elastic Demand:
When a small change in price of a product causes a major change in its demand, it is said to be perfectly elastic demand. In perfectly elastic demand, a small rise in price results in fall in demand to zero, while a small fall in price causes increase in demand to infinity. In such a case, the demand is perfectly elastic or ep = 00.

2. Perfectly Inelastic Demand:
A perfectly inelastic demand is one when there is no change produced in the demand of a product with change in its price. The numerical value for perfectly inelastic demand is zero (ep=0).

3. Relatively Elastic Demand:
Relatively elastic demand refers to the demand when the proportionate change produced in demand is greater than the proportionate change in price of a product. The numerical value of relatively elastic demand ranges between one to infinity.

4. Relatively Inelastic Demand:
Relatively inelastic demand is one when the percentage change produced in demand is less than the percentage change in the price of a product. For example, if the price of a product increases by 30% and the demand for the product decreases only by 10%, then the demand would be called relatively inelastic.

5. Unitary Elastic Demand:
When the proportionate change in demand produces the same change in the price of the product, the demand is referred as unitary elastic demand. The numerical value for unitary elastic demand is equal to one (ep=1).

7) Evaluate IT industry as the Driver of Economic Growth.

Ans 7)

Significance of IT Industry

1. IT-based services are vital for any organization to increase productivity, makes business process flow easily.

2. The IT industry has not only impacted the economic growth of India, but it also has made the government more accessible and competent.

3. Information Technology has made access to government-related services and information easier and inexpensive.

4. IT has made the management and delivery of government services like health care services, education information, consumer rights, and services, etc. seamless with enhanced transparency.

5. The industry has attracted significant investment from other countries. The computer software and hardware sector in India attracted cumulative foreign direct investment (FDI) inflows worth US$ 74.12 billion between April 2000 and June 2021.

6. The IT industry mainly involves IT services, IT-enabled services (ITES), e-commerce (online business), and Software and Hardware products. This industry is also instrumental in developing infrastructure to store, process, and exchange information for necessary business operations and other organizations.

7. Also, several other government initiatives like setting up Software Technology Parks (STP), Special Economic Zones (SEZ), Export Oriented Units (EOU), and Foreign Direct Investment (FDI) have facilitated this industry in attaining a dominant position in the world IT industry.

8) Differentiate between Labour Intensive & Capital Intensive Industry.

Ans 8)

Labour Intensive

- **Labour intensive is where most of the production is carried by workers or employees.**
- **It means that the levels of output would be at a much smaller scale than a labour intensive industry.**
- **The costs involved in a labour intensive production unit would be the costs of training and educating employees.**
- **However, in comparison to capital intensive, in labour intensive production, increasing the volume of output is easier as it does not require a large investment.**
- **Instead, hiring more workers, asking workers to work extra hours and hiring temporary staff can increase production in the short term.**

Capital intensive

- **Capital intensive production requires more machinery, equipment and sophisticated technological production systems in the production process.**
- **Capital intensive production requires a higher level of investment and larger amount of funds and financial resources.**
- **A capital intensive production process is mostly automated and able to generate a large output of goods and services.**
- **Since capital intensive production relies largely on machinery and equipment, such industries require long term investment, with a high cost involved in maintaining and depreciating equipment.**
- **In such a capital intensive production process, it could be very costly to increase output levels as this would require higher investment in such machinery and equipment.**

Labour intensive Vs Capital intensive!

Labour-intensive!

Manufactures use workforce because:

- Labour supply is cheap and always available.
- Products sometimes require craftsmanship or special expertise if the product has detail.
- Businesses may be small and do not have finance to have expensive machinery.
- COSTS:
- Labour force can be expensive to buy.
- If staff are ill the production of the product may have to stop.

Capital intensive!

Manufactures use machinery because:

- Labour supply can scarce or expensive.
- Consistency of product is required and with machines it is always consistent.
- Continuous production is required by machines.
- COSTS:
- Set u p costs and installation costs are expensive.
- Worker motivation can be low due to repetitive nature of tasks.