

AL-AMEEN COLLEGE OF LAW

SUB: ECONOMICS MAJOR-1

PRINCIPLES OF ECONOMICS

MODEL ANSWER PAPER

UNIT-1-INTRODUCTION TO ECONOMICS

**Answer the following-any one**

**Q.1: Critically explain the wealth definition of economics?**

**Ans:** The credit of defining economics as a subject for the first time goes to Adam Smith. He is considered as the father of economics and in his book “An Enquiry into the nature and cause of wealth of nation” he defined economics as a science which enquires into the nature and which enquires into the nature and cause of wealth of nation. He emphasized the production and growth of wealth as the subject matter of economics. His followers like J.B Say, J.S Mill, Walker, Senior etc, gave similar definitions as follows.

**J.B Say:** Economics is the science which treats of wealth.

**Walker:** Economics is the body of knowledge that relates to wealth.

**J.S Mill:** Economics investigates the nature of wealth and the laws of its production and distribution.

**Senior:** The subject of political economy is not happiness but wealth.

Main features of the wealth definition

1. Economics is the study of wealth only. It deals with the consumption production, exchange and distribution of wealth.
2. Only such material commodities contribute wealth as are scarce and useful. Non material goods like services and free goods like air and water are not wealth.

3. Economics studies the cause of wealth changes which means economic development. To increase wealth, production of material goods will have to be increased.

**Criticism:**

1. Too much importance to wealth: - wealth has been given the primary place in economics. Many economists like Carlyle John Ruskin criticized.
2. Restricted meaning of wealth: - Material goods only are considered as wealth. Non material services are not taken as wealth. But modern economist uses the word wealth for both goods and services.
3. No mention of man's welfare:- This definition give no importance to the economic welfare of society. It emphasis only the accumulation of wealth.
4. No study of means:- This definition makes the earning of wealth an end itself. It does not tell us the propriety of means for earning wealth

OR

**Q.2: What is cost? Explain different types of cost?**

**Ans:** Cost refers to total money expenses incurred to produce a particular quality of output by the producer.

**The concepts of cost are:**

- a) Total Fixed cost: - TFC refers to total money expenses incurred on fixed inputs like plant, machinery, tools & equipments in the short run. TFC remains the same at all levels of output in the short run. It is the same when output is nil. It indicates that whatever may be the quantity of output whether 1 to 6 units, TFC remains constant.
- b) Total Variable cost: -TVC refers to total money expenses incurred on the variable factor inputs like raw materials, power fuel etc in the short run. TVC is obtained by summing up the production of qualities of variable inputs multiplied by their prices the formula to calculated TVC is  $TVC=f(Q)$ .

- c) Total cost: -The TC refers to the aggregate money expenditure incurred by a firm to produce a given quantity of output. The formula to calculate TC is  $TC = TFC + TVC$ .
- d) Average cost: -Ac is also known as the unit cost since it is the cost per unit of output produced. AC is the sum of AFC and AVC. According to Dooley, "the Average cost per production is the total cost per unit of output". In short run AC curve also tends to be U-shaped. It has 3 phases
- (1) Decreasing Phase
  - (2) Minimum Phase
  - (3) Increase Phase
- e) Marginal cost: - MC may be defined as the net addition to the total cost as one more unit of output is produced. In other words, it implies additional cost incurred to produce an additional unit. It is obtained by calculating the change in total cost as a result of a change in the total output.
- Hence  $MC = \frac{\Delta TC}{\Delta TQ}$
- f) Opportunity cost: - According to the Australian school of Economists opportunity cost also called the displacement cost is the value of the next best alternative sacrificed in order to obtain that commodity. So the opportunity cost of anything is the value of the next best alternative that has been foregone.

### **SHORT NOTE: ANY ONE**

#### **Q.1. CAPITALISM:**

It is a system of production for profit under which instruments and materials of production are privately owned and the work is done mainly by hired labour whose subsistence security and personal freedom seem dependent on the will of the owners, who control the organization of factors of production, the product belonging to the capitalist owner or owners.

The owners are free to use the factories and firm and other means of production with a view to making profit or not to use them, if it so suits them. Every producer is free to take up any line of production he likes and is free to enter in to any contract with others for his profit. They are free to use their

property in any manner they like, to start any business they think profitable to themselves. The free enterprise systems without any governmental interference is called laissez faire i.e. let things take their own course.

### **Features of capitalism**

1. Right of private property: everybody has a right to acquire private property, to keep it, and pass it on to his heirs or dispose it off.
2. Freedom of enterprise: every citizen has the freedom to form any firm or company and set up a factory anywhere he likes provided he has the required capital and ability.
3. Profit motive: the profit motive includes people to undertake any production activity. What to produce, how to produce and how much to produce is determined by individual profit rather than social benefit.
4. Competition: the producers compete with one another to get the consumers' choice. Similarly there is competition among workers for jobs.
5. Price system: it is the price which equates the demand and supply of commodities and factors of production in capitalism.
6. Key role of entrepreneur: the entire productive machinery of the commodity is under his direction and he is the key person
7. Risks: there are risks of losses. The person who risks his money can control the business.

### **Q.2. GROWTH DIFINITION**

Professor. Samuelson gave modern or growth definition in his book economics as follows. Economics is the study of how men and society choose, with or without the use of money to employ scarce productive resources which could have alternative uses, to produce varies commodities now and in the future among various people and groups of society.

Similar growth definition is given by other modern economists also like Spencer, Milton etc.

The main features of the definition are

1. Like Robbins, Samuel has stressed the problem of scarcity of means in relation to unlimited Ends.
2. Samuelson definition is not only dynamic in content; it is also wider in scope. It is applicable even to a barter economy where money is conspicuous by its absence.
3. The main thing about Samuelson definition is that it deals with the problem of choice in its dynamic setting.
4. It is an exhaustive, comprehensive and expansive of Robbins definition. Economics is considered as the study of the allocation of scarce resources and of the determinants of income, output, employment and economic growth.

## **UNIT-2- THEORIES OF CONSUMPTION**

**Q. 1. Define utility? Explain the law of equi- marginal utility?**

**Ans:** The concept of utility was introduced in economics by Prof. William Stanley Jevons an English economist.

Utility is an economic concept means desirability. It is the capacity of a commodity to satisfy human want.

The law is Equi -Marginal Utility is another fundamental law of consumption. This law is called as Gossen's second law of consumption.

**Assumption:**

1. Consumer is rational in his behavior and seeks maximum satisfaction.
2. Utility of a commodity can be exactly measured in both physical and monetary terms.
3. Marginal utility of money remains constant.
4. The law of DMU will operate.

5. Fashion, tastes, preferences, customs and habits customer remain constant.

### **Meaning and Definition of Law:**

A consumer has unlimited wants. His resources are strictly limited & they can be put to alternative uses. Hence, he should spend his money income in such a way as to get maximum satisfaction. The law of EMU states that “other things being equal consumer get maximum satisfaction when he allocates his limited income to the purchase of different goods in such a way that marginal utility desired from the last unit of money spent on each item of expenditure tends to be equal”.

This is known as proportionally rule which sets two condition for consumer equilibrium in case of two commodities.

1. Marginal utilities of all commodities should be equal to their prices

$$\text{i.e. } \frac{MUa}{Pa} = \frac{MUb}{Pb} = \frac{MUn}{Pn} = K$$

Where MU= Marginal Utility

P= Price

K= Marginal Utility of the given money

Income which is assumed to be constant & a,b,n refers to different goods. Law can be explained with the help of the following table.

### **Assumptions:**

1. Income of the consumer is Rs.10.00
2. Spend entire Rs.10.00 on both commodities A & B.
3. Price of A& B per unit is Rs. 2.00 each.

### Computation of the ratio of Marginal Utility to price.

Units	$\frac{MU_a}{P_a}$	$\frac{MU_b}{P_b}$
1	$\frac{35}{2}$	$\frac{30}{2}$
2	$\frac{30}{2}$	$\frac{25}{2}$
3	$\frac{25}{2}$	$\frac{20}{2}$
4	$\frac{20}{2}$	$\frac{15}{2}$
5	$\frac{15}{2}$	$\frac{10}{2}$

#### **Allocation of Income:**

Let us assume that the consumer will spend Rs. 4.00 on commodity A & Rs. 6.00 on commodity B. This helps him to buy 2 units of A and 3 units of B. The new combination of 2A+3B.

He will derive a total amount of 140 units of satisfaction i.e 2 units of A  $35+30=65$  units and 3 units of B  $30+25=55=75$  units.

#### **Reallocation of income:**

In order to desire more than 140 units of satisfaction, he will relocate his income so as to buy 3 units of A & 2 units of B. Thus he will substitute 1 unit of A. this new combination of 3A +2B proves to be his most ideal combination of 2 goods which helps him to get the highest total satisfaction of 145 units.

OR

**Q.2: Explain consumer Equilibrium under indifference curve analysis?**

**Ans:** The basic objective of the consumer is to desire highest level of satisfaction out of a given amount of money income. In order to achieve this objective, he will spend his limited income on combination of two commodities which yield highest total level of satisfaction. The consumer reaches the position of equilibrium when he enjoys the highest level of satisfaction by consuming the most ideal or best possible combination of two goods for a given amount of income. The position of equilibrium will be indicated by the point at which the budget line is tangential to the indifference curve.

**Assumptions:**

- a) Consumer is rational in his behavior. He seek maximum satisfaction.
- b) The consumer has a fixed amount of money income.
- c) Prices of two goods are constant.
- d) There is no change in taste and habits of the consumer
- e) Different unit of A and B commodities.

**Illustration: -**

- 1 Income of the consumer is Rs 4.00.
- 2 Price of commodity A per unit is 25 paisa
- 3 Price of commodity B per unit is 50 paisa

Summarizing that the given income of Rs 4.00 is spent on commodity A, the consumer gets 16 units of A. Similarly assuming that the same income of Rs.4.00 is spend on commodity B, the consumer gets 8 unit of B.

The budget line indicates the limited or a given income of the consumer with the help of which he can buy a particular combination of two goods A & B. The indifference map represents the subjective scale of preference of the consumer based on his tastes, habits and likes & dislikes. It is clear that both budget line and indifferences map are quite independent of one another. In order to explain the equilibrium position of the consumer. We have to super impose the budget line upon the consumers indifference map.

**Conditions for consumer equilibrium:**

1. The budget line should be tangential to the indifference curve.
2. The slope of the indifference curve and of the budget line should be same.
3. The indifference curve & budget line, we can explain consumer equilibrium.

Thus by integrating indifference curve & budget line we can explain consumer equilibrium.

## SHORT NOTE

### Q.1. CONSUMER SURPLUS

The concept of consumer surplus was first invented by a French Engineer Economist Dupuit in the year 1844. Further it was refined & popularized by Prof. Marshall in 1980. Hence it is called as Marshallian concept Prof. Boulding described it as “Buyer’s Surplus”.

In a Monetary economy we measure the utility of a commodity with the help of price. The price we pay for a commodity basically depends on its worthiness & utility. If a product possesses higher utility then it would command a higher price and vice-versa.

The excess or surplus satisfaction enjoyed by a consumer over and above the price he is paying for a product rather than go without it is technically described as consumer surplus.

In the words of Prof. Tanssing, consumer’s surplus is the difference between the potential price and actual price. It can be explained with the help of simple formula consumer’s surplus what we are prepared to pay- what we actually pay.

It is essential to know that there is an inverse relationship between price and consumer surplus. If price rises consumer surplus falls and vice-versa.

The concept of consumer surplus is derived from the law of diminishing marginal utility.

Units of commodities	MU of a commodities	Price Per commodity	Consumer’s Surplus
1	50	30	20
2	45	30	15

3	40	30	10
4	35	30	5
5	30	30	Nil
Total Units	Total Utility = 5	Price Paid	CS=50 Units

Consumer's Surplus= Total Utility – price\*Quantity

$$\begin{aligned}
 \text{Symbolically C.S} &= \text{TU}-(\text{P}*\text{Q}) \\
 &= 200-(30*5) \\
 &= 200-150 \\
 &= 50
 \end{aligned}$$

CS= what we are prepared to pay – what we actually pay

$$\text{CS} = 200-150=50$$

OR

## Q.2. Indifference curves.

**Ans.** Indifference curves may be defined as a locus or path indicating different combination of two commodities which yields equal or same level of satisfaction.

Properties:-

- a) An indifference curve always slopes downwards from left to right. In order to represent fall in the quantity of one commodity and increase in the quantity of another commodity the indifference curve must slope downwards from left to right.
- b) An indifference curve is lower to the origin of the axis:-This property is derived from the law of DMRS. In order to represent the fall in the rate of substitution the indifference curve must be lower to the origin of the axis. If the curve is concave in that case the DMRS cannot be represented.
- c) No two indifference curve intersects each other- Each indifference curve represents only one particular level of satisfaction. If two curves cut each other at one point, it indicates equal level of satisfaction at the interesting point. This is against the rules of the ICA.

- d) An indifference curve bearing higher number represent higher level of satisfaction & a lower number represent a lower level of satisfaction. A consumer moves on from one indifference curve to other, a lower to the higher as his income increases.
- e) An indifference curve should not touch either of the axis. If the indifference curve touches x-axis it indicates that the consumer is buying only commodity A and if the indifference curve touches y-axis, it indicates that he is buying only commodity B at the point where it touches the axis and vice- versa.
- f) Indifference curves are parallel to each other but it is not a rule. But the rate of substitution between the two commodities may not be the same in case of all indifferent curves. It depends upon changing economic position of a consumer.

### UNIT-3-PRODUCTION

In economics theory the law of variable proportion occupies an important place. It is describe the input output relation in a situation when the out is increased by increasing the quantity of one input and keeping the other inputs constant. It is also called returns to a factor well known as law of diminishing returns.

The law can be explained with the help of following schedule and stages

Suppose a farmer has some land to cultivate and the land has some fixed investment, i.e. tube well, a farm house. The amount of land & capital is fixed factor of production. The farmer can vary the member of men will change output also. The change in total product, average product & the marginal product are shown in the following table.

<b>Variable factors (no of men)</b>	<b>Total Product</b>	<b>Average Product</b>	<b>Marginal Product</b>	
1	3	3	3	
2	7	3.5	4	

3	12	4	5	1 <sup>st</sup> stage
4	16	4	4	2 <sup>nd</sup> stage
5	19	3.8	3	
6	21	3.5	2	
7	22	3.1	1	
8	22	2.75	0	
9	21	2.33	-1	3 <sup>rd</sup> stage
10	15	1.5	-6	

### **Three phases of the Law:**

**First Stage:** Total product is steeply increased with the increase of variables factor. It shows that the efficiency of land too is increasing. If we add more variable factors nits, marginal product first increased and starts falling after a point Q.

**Second Stage:** The total output goes on increasing but not so steeply as in the first stage. Average product and marginal product of labour decreases. Marginal product starts falling in first phase itself whereas the average product starts falling in second phase. The AP is higher than the marginal product. The second phase ends where the MP is zero.

**Third stage:** In the third stage all the products i.e. total average and marginal product decrease. The MP becomes negative where as AP is positive, it is called the stage of negative returns. In this stage both labour and land have been used inefficiently. The additional units of variable factors are harmful as they hinder the production B.

Correspond to the margin beyond which production will not take place.

### **SHORT NOTE**

#### **Q.1.PRODUCTION FUCTION**

The term production means transformation of physical inputs into physical outputs. The entire theory of production centres round the concept of production function. A production function expresses the technological or engineering relationship between quantity of physical inputs & physical outputs of a firm. It specifies a flow of output resulting from a flow of inputs during a specified period of time. It is a table, graph or an equation specifying maximum output rate from a given amount of inputs used. Since it relates inputs to outputs it is also called as input output relation.

A production function can be represented in the form of a mathematical model or equation as  $Q = f(L, N, K)$  etc. Where Q stands for quantity of output per unit of time and LNK etc are the various factor inputs like land, capital, labour etc which are used in the making of output. The rate of output Q is thus a function of factor inputs LNK etc employed by the firm per unit of time factor inputs are of two types.

a) Fixed Factor b) Variable Factors.

Due to the difference between the short run and long run time periods, we have two types of production functions.

1. Short run and long run production: under short run we study the effect of change the quantity of one input on the total output, keeping all other inputs fixed. The behavior of output when only one input changes are termed as returns to a factor or the law of variable proportion.

Under long run we study the changes in output when all the inputs are changed simultaneously and in the same proportion. The behavior of output when all factors change in the same proportion is termed as returns to scale or the law of constant proportions.

## Q:2, **Properties of land.**

Meaning of land

The term land means the surface of land or soil but in economics land means not only soil but also all other natural resources available to man for the production of wealth. In other words its reference to various natural resources such as land soil, water air, sun lights, minerals natural vegetation animals, fish etc available to man for producing man.

According to Marshall land means the materials and the forces which nature which gives freely, man's aid in land and water, in air and light and heat.

Land is a free gift of nature and its quantity is fixed. Land has no supply price of land prevailing in the market cannot affect its supply. From the view point of the whole economy, the supply of land is perfectly inelastic that is it can be increased by shifting of land from other uses or industries.

Properties of land.

1. Free gift of nature: land is a free gift of nature. It can't be created by man.
2. Limited in area: land is limited in area in other words the total land surfaces is fixed. It cannot be increase or decrease by man
3. Permanent: land is permanent That is it can't be destined by man even the fall in the productivity or fertility of land is only for some time.

Soon land gets back its fertility

4. Immobile: Land is immobile it can't be shifted or moved physically from one place to another example the surplus land of Australia can't be shifted to the great Brittan.
5. Varies in quality: land is not uniform in quality and fertility.

Two pieces of land or plots or not uniformed in fertility some lands are fertile while others are infertile.

## UNIT-4-MARKET STRUCTURE

**Q1:What is perfect competition? Explain the feature of perfect competition?**

**Ans:** A perfectly competitive market is one in which the number of buyers and sellers are very large, all engaged in buying and selling homogeneous product without any artificial restriction and possessing perfect knowledge of market at a time.

### **Features of the perfect competition:**

1. Existence of very large number of buyers and sellers: - A perfectly competitive market will have larger number of sellers and buyer. Output of a seller will be so small that it is a negligible fraction of the output of the industry. Hence changes in supply made by a particular firm will not affect the total output and price. Similarly, no one particular buyer can influence the price of commodity because the quantity purchased by him is small fraction of total quantity.
2. Homogeneous products: - Different firms constituting the industry produce homogenous goods. They are identical in character. Hence no firm can raise its price above the general level.
3. Free entry and exit of firms: - There is absolute freedom to firms to get in a get out of the industry. If the industry is making profits new firms are attracted into industry. Conversely firms will quit the industry if there are losses.
4. Existence of single price: - Each unit bought and sold in the market commands the same price since products are homogeneous.
5. Perfect knowledge of material: - All the sellers & buyers will have the perfect knowledge of the market. Sellers cannot influence buyers and buyers cannot influence the sellers.

6. Perfect Mobility of factors of production:- Factors of production are free to move into any use or occupation in order to earn higher rewards. Similarly they are also free to come out of the occupation or industry if they feel that they are under remunerated.
7. Full and unrestricted competition perfectly competitive market is free from all sorts of monopoly, oligopoly conditions. Since there are very large number of buyers and sellers it is difficult for them to join together and form other organizations. Hence each firm acts independently.

## **SHORT NOTE:**

### **1..Monopoly:-**

The word 'Monopoly' is made up of two syllables Mono means single and Poly means to sell. Thus Monopoly means existence of a single seller in the market. Monopoly is that market form in which a single producer controls the whole supply of a single commodity that has no close substitutes.

According to Prof. Watson "A monopolist is the only producer of a product that has no close substitutes.

### **Features of Monopoly:**

- a) Anti thesis of completion.
- b) Absence of competition in the market creates a situation of monopoly and hence the seller faces no threat of completion.
- c) Existence of a single seller.
- d) There will be only seller in the market who exercises single control over the market.
- e) Absence of substitute.
- f) There are no close substitutes for his product with a strong cross elasticity of demand. Hence buyers have no alternatives.
- g) Control oversupply
- h) He will have complete control over output and supply of commodity.
- i) Price Maker
- j) Entry of other firms is banned somehow. Hence monopolist will not direct competitors or direct rivals in the market.

- k) Firm & industry is same. There will be no difference between a firm and an industry.
- l) There will be a place for super normal profits under monopoly because market price greater than cost of production.
- m) The monopolist is the price maker. He is independent to fix a price of a commodity.

There are different kinds of monopolies private and public, pure monopoly, simple monopoly and discrimination monopoly. It is to be clearly understood that with the exception of public utilities or institutions of a similar nature whose price is set by regulatory bodies, monopolies rarely exist.

**OR**

## **Q.2. Price discrimination**

**Ans.** Generally speaking the monopolist will follow different methods under different circumstances. The policy of price discrimination refers to the practice of a seller to charge different prices for different customers for the same commodity produced under a single control without corresponding differences in cost when a monopoly firm adopts this policy it will become a discriminatory monopoly. According to Prof. Benham, "Monopolist may be able however to divide his sales among a number of different markets and to charge a different price in each market."

### **Kinds of Price Discrimination:-**

Prof. AC Pigou speaks of three kinds. They are

- a) Discrimination of the first degree:-** Under price discrimination of the first degree the producer exploits the consumers to the maximum possible extent by asking him to pay the maximum he is prepared to pay rather than go without the commodity. In this case the monopolist will not allow any consumer surplus to the consumer. This type of price discrimination is called perfect discrimination.

- b) Discrimination of this second degree:-** In case of second degree the monopolist charges different prices for different units of the same commodity but not a maximum possible rate. The monopolist will leave a certain amount of consumer's surplus with the consumers. This is done to keep the consumers happy and prevent the entry of potential rivals.
- c) Discrimination of third degree:-** In case of discrimination of third degree the markets are divided into many sub markets or sub groups. The price charged in each case roughly depends on the ability to pay of different subgroups in the market. This is the most common type of discrimination followed by a monopolist.

## **UNIT-5- THEORIES OF DISTRIBUTION**

**Q.1: What is rent? Explain the Ricardian theory of rent?**

**Ans:** Rent refers to that income which the owner of land gets and other natural assets get for using them in production. Ricardo was the first person who formulated a comprehensive theory of rent. He defined rent as "that portion of produce of the land in which is paid to the landlords for the use of original and indestructible powers of the soil."

### **Explanation of the Ricardian theory:**

According to this theory the cause for the emergency of rent is the difference in the fertility of land. The more fertile land or superior land would be cultivated first, followed by the next best superior land. The output produced by the most superior land is more than the output produced by the next superior land. The difference of the product of the first category of the land & that of second category of land is called rent. As successive inferior land are cultivated rent starts emerging on the superior lands and these further increases the rent on the superior land.

Suppose A,B,C& D are four pieces of land in the order of fertility. So quintals of rice are produced by cultivating land A. A is a marginal land, therefore there is no rent. But as the population increases, land B is also cultivated, which is inferior to land A as regards fertility and the produce from this land is 60 quintals. Now land A generates a rent of 20 quintals ( $80-60=20$ ). As population increases further, lands C and D are also cultivated & they produce 40 & 20 quintals respectively. Now land D is marginal land & therefore land D is marginal land & therefore land A generates rent of 60 quintals ( $80-20=60$ ). Land B generates rent of 40 quintals ( $60-20=40$ ) and land C, 20 quintals ( $40-20=20$ ). This can be shown with the help of the following table.

<b>Types of land</b>	<b>Produced of Rice</b>	<b>Rent in Quintals</b>
A	80	$80-20=60$
B	60	$60-20=40$
C	40	$40-20=20$
D	20	$40-40=0$ No rent land

Land D is the marginal land or no rent land. Excess of the portion over the produce of land. Ricardian theory applies to extensive cultivation more & more land is cultivated to produce more.

The above example of four types of land is an example relating to extensive cultivation.

Under intensive cultivation more & more doses of labour & capital are employed on the same land for increasing production. The marginal dose of labour and capital is no rent dose. As land is cultivated more intensively, additional doses of labour and capital applied to it would yield lesser returns than the previous doses.

## **Q.2 Explain briefly the Marginal productivity theory of Distribution?**

ANS: The concept of 'Marginal Productivity' is the heart of the theory David Ricardo and Edward West first developed this concept in the beginning the marginal productivity theory was used only to explain the determination of wages. Now the same theory respects an attempt on the part of different economist explain the determination of factors prices such as rent wages interest and profits. The central theme of this theory is that the reward paid to any factor input depends on its marginal productivity.

A producer while employing different factor inputs is guided by the law of substitution. While wincing out the most ideal factor inputs combination, he substitutes one factor input to another till the marginal productivity are equalized. Thus a producer would secure maximum profits when the marginal productivities of all the factor inputs are equalized.

Productivity of a factor inputs is of two types:

1. Physical Productivity
2. Revenue Productivity.

Physical Productivity refers to the amount of a commodity in terms of physical units which a factor helps to produce when physical productivity is expressed in terms of money, then we get the revenue productivity.

Physical Productivity classified into two types:

Average Physical Productivity (APP) & Marginal Physical Productivity (MPP).

APP is obtained by dividing total output by the number of units a factor input & employed.

MPP refers to the increase in total output resulting from the employment of an additional unit of factors inputs constant.

Similarly revenue productivity is divided into two types: Average Revenue

### **SHORT NOTE:**

**WAGES:** The payments made to a worker in return for his work is called wages. Work signifies both mental and physical work undertaken to earn money.

Economists like Benham have used the term wages in a narrow context.

According to them the payment which is paid to a worker in lieu of his work is called wages. In the broader context wages is not confined only to wages paid in cash but it also includes facilities and extra benefits available in kind.

Nominal and Real wages: nominal wages the amount which a worker gets in cash in exchange for the services rendered by him. Real wages means the purchasing power with the help which a worker can buy various goods and services. Real wages include money wages and also those facilities and incidental gains which are available to a worker such as rent free accommodation, free medical facilities, free education, etc. it is possible that nominal wages may be very high but real wages may be considerably low. Nominal wages are also called money wages. Nominal wages may be equal in two industries in to regions but real wages may differ considerably. Thus, in calculating the real value of a workers earnings we must consider not only the money value of his wages but also the factors on which the real wages depend.

Labour is a peculiar factor of production, its demand depends on the productivity to the employer. labour has a weak bargaining power as against the powerful employer. Thus, the actual wage is less than what a worker may be entitled to by his productivity. Generally, it

is the demand and the supply the factors of the production. But this is not fully applicable for the determination of wages because of the peculiar characteristics of labour .the human element present in labour deserves special consideration. From time to time various attempts had been made explain the determination of wages. The various theories of wages only differ in the assumptions regarding the basic conditions of demand and supply.

## **Q.2. LONABLE FUNDS THEORY:**

According to classical economists, the rate of interest is the price paid for the use of capital. Loanable funds theory is an improved form of classical theory. According to this theory rate of interest depends upon the supply of and demand for loanable funds. Thus, the equilibrium rate of interest would be at the level where quantity supplied and quantity demanded of loanable funds would be equal.

Demand for loanable funds comes from investors, consumers and holders.

Demand from investors is the most important constituent of the total demand for loanable funds and it is guided by profit motive. Demand from consumers arises due to low levels of current income but this demand is very less. Some times people demand loanable funds for hoarding purposes also.

Supply of loanable funds comes from savings, bank credit, disinvestment and dishoarding. The largest source of supply of loanable funds is savings. Banks generate supply of loanable funds through credit creation. Dishoarding means that when past accumulated savings and idle cash balances which were hoarding earlier are now offered in the capital for loan purpose.

Think that the capital invested in machines and factories is not profitable and  
Brings it to capital market for giving loans is called disinvestment.

This theory is an improvement over the classical theory because it takes in to  
Account the bank credit and also regognises the role of loaning or liquidity  
Preference as a factor influencing the denand for funds.