

OPEN STUDENT FOUNDATION

Chapters : 3

Std-12 Economics

Date : 22/02/24

Day - 3

Section A

- Choose correct answer from the given options. [Each carries 1 Mark] [7]
- 1. What is the type of inflation when demand increases? (March-2018, July-2022)
(A) Supply pull (B) Demand pull (C) Salary pull (D) Cost pull
- 2. "What is universally accepted for exchange of goods and services." Who gave this definition for money? (July-2018, Aug-2020, March-2022)
(A) Keyn (B) Marshall (C) Robertson (D) Pigou
- 3. "Inflation is said to occur when monetary income rises faster than real income." Who gave this definition? (March-2019)
(A) Lerner (B) Keynes (C) Pigou (D) Marshall
- 4. What is the name of inflation when Govt. controls and suppresses the rates by laws? (July-2019, May-2021)
(A) Suppressed inflation (B) Open inflation (C) Running inflation (D) Hidden inflation
- 5. The method of receiving clothes in exchange with rice known as (March-2020, May-2021, July-2022)
(A) Money system (B) Banking system (C) Barter system (D) Borrow system
- 6. Which type of problem is inflation? (March-2022)
(A) Monetary (B) Social (C) Psychological (D) Political
- 7. What is the value of money during constant and steady price increase?
(A) Decreases (B) Increases (C) Stable (D) Constant

Section B

- Write the answer of the following questions. [Each carries 2 Marks] [2]
- 8. "Storing Value is difficult in a barter system." Explain it.

Section C

- Write the answer of the following questions. [Each carries 3 Marks] [6]
- 9. Explain types of money. (July-2018)
- 10. Explain functions of money. (March-2019, July-2019, Aug-2020, May-2021)

Section D

- Write the answer of the following questions. [Each carries 4 Marks] [12]
- 11. Define inflation and state its causes. (March-2018, July-2018)
- 12. State the origin and development of money and explain its functions. (March-2018)
- 13. Define the barter system and state its limitations. (July-2019, Aug-2020, March-2022)

OPEN STUDENT FOUNDATION

Chapters : 3

Std-12 Economics Practice Sheet Day 5

Date : 22/02/24

Section A

● Choose correct answer from the given options. [Each carries 1 Mark] [7]

1. What is the type of inflation when demand increases? (March-2018, July-2022)

- (A) Supply pull (B) Demand pull (C) Salary pull (D) Cost pull

⇒ Ans : (B)

2. "What is universally accepted for exchange of goods and services." Who gave this definition for money? (July-2018, Aug-2020, March-2022)

- (A) Keyn (B) Marshall (C) Robertson (D) Pigou

⇒ Ans : (C)

3. "Inflation is said to occur when monetary income rises faster than real income." Who gave this definition? (March-2019)

- (A) Lerner (B) Keynes (C) Pigou (D) Marshall

⇒ Ans : (C)

4. What is the name of inflation when Govt. controls and suppresses the rates by laws? (July-2019, May-2021)

- (A) Suppressed inflation (B) Open inflation (C) Running inflation (D) Hidden inflation

⇒ Ans : (A)

5. The method of receiving clothes in exchange with rice known as (March-2020, May-2021, July-2022)

- (A) Money system (B) Banking system (C) Barter system (D) Borrow system

⇒ Ans : (C)

6. Which type of problem is inflation? (March-2022)

- (A) Monetary (B) Social (C) Psychological (D) Political

⇒ Ans : (A)

7. What is the value of money during constant and steady price increase?

- (A) Decreases (B) Increases (C) Stable (D) Constant

⇒ Ans : (A)

Section B

● Write the answer of the following questions. [Each carries 2 Marks] [2]

8. "Storing Value is difficult in a barter system." Explain it.

⇒ Barter system is a system of exchange where goods or services are directly exchanged for other goods or services without using a medium of exchange, such as money. But the goods are mortal and will decay and end after a certain time. So it is impossible to store goods for a long time.

⇒ As an example, milk, vegetables will decay. Animals can't be easily transferable. Animals are mortal and indivisible, they get sick and die, therefore the goods and animals were difficult to store and move. Thus we can say that storing value is difficult in a barter system.

Section C

[6]

● Write the answer of the following questions. [Each carries 3 Marks]

9. Explain types of money. (July-2018)

➡ After the time of barter system, metal coins came into existence which were followed by government regulated notes and currency coins.

➡ The types of money are:

- (1) Commodity money
- (2) Animals Money
- (3) Metal money
- (4) Paper money
- (5) Plastic money
- (6) Banking money (Invisible or e-money)

(1) Commodity money:

⇒ Since the time of the barter system in ancient times, animals or precious stones were used as the means of exchange and storage of value.

⇒ There are only two main utilities of commodity money are:

- (1) It can be used on need.
- (2) It can be exchanged with other goods and services.

⇒ The limitations of using commodities are: They are mortal and will decay and end after a certain time. So it can't be stored. So it inspired to introduce Metal money.

(2) Metal money:

⇒ The metals are generally used to make metal money. In those times, people were not aware of gold and silver like nowadays. So metals were used to make coins after proper and certain measurement of weight and valuation.

⇒ Due to exchange increment, metals were demanded so scarcity of metal was generated. These difficulties inspired to introduce paper money.

(3) Paper money:

⇒ Paper money was introduced after the invention of paper in China as believed in the 9th century.

⇒ Paper money is easy to use because of its flexibility to move anywhere due to negligible weight. This is the promissory note issued by the government. After this, Banking money (Invisible or e-money) is introduced.

(4) Banking money (Invisible or e-money):

⇒ In this digital era, bank money is very important. Bank provides this money in the form of credit card, debit card, e-banking, etc.

10. Explain functions of money. (March-2019, July-2019, Aug-2020, May-2021)

➡ Generally, money is what performs the functions of money. While Robertson defines money as "What is accepted universally in exchange of goods or services".

➡ According to Marshall "Money is that medium which is used as a means of exchange without any doubt or investigation regardless of time or place". This definition is more famous in economics.

➡ There are three functions of money:

- (1) Money as a Medium of Exchange
- (2) Money as a Store of Value
- (3) Money as a Measure of Value

(1) Money as a Medium of Exchange:

- ⇒ The most important function of money is to act as a medium of exchange and trade. It removes the limitation of the lack of 'double coincidence of wants' and makes exchanges easier. The farmer can get money in exchange for wheat and then from that money he can buy clothes, rice, ghee, etc.
- ⇒ An individual can spend money to satisfy his present demands of goods and services, and also save the money for future needs for goods and services. Basically money is used as a medium to satisfy the needs of an individual by buying goods or services.

(2) Money as a Store of Value:

- ⇒ Another function of money is "Money is a store of value".
- ⇒ If a person produced goods and services in exchange for other goods and services for future needs, it was difficult before the use of money as a means of exchange.
- ⇒ In the barter system, animals were mortal and grains would decay and so it was not possible to store them as a value for a long time.
- ⇒ Money makes these tasks easy. It is the most successful means of storage of value in terms of time. It is easy to have money as storage of value. It became possible to get money in exchange for crops and save the money for future needs to buy goods or services.
- ⇒ Another advantage of using money was that it could be used as a standard of deferred payment. This characteristic of money became an important basis for the entire systems of credit, hire-purchase and instalment payments. Thus, money is the best storage instrument for any value.

(3) Money as a Measure of Value:

- ⇒ Money plays an important role as a measure of value. In the Barter-exchange system it was difficult to remember the exchange rates and values of each of the goods or services like for 20 kg of wheat equals how much kg of rice? equals how much metre of cloth? equals to how much kg of ghee?
- ⇒ While on the other hand, money makes this easier allowing the values of different goods or services to be compared and assessed against each other. Money implies the price system, allowing the measure of price of each goods or services which can be compared to each other. It also allows faster decision making and exchanges.

Section D

- **Write the answer of the following questions. [Each carries 4 Marks] [12]**

11. Define inflation and state its causes. (March-2018, July-2018)

- ⇒ Inflation means a continuous rise in the price level of goods and services. The two major factors affecting the price of goods and services are : Demand and Supply. So the major factors affecting inflation are : (1) Increase in demand (2) Increase in production cost.

(1) Increase in Demand :

- ⇒ There is an increase in demand for a product which leads to the increase in its price. If the supply is not provided or if they are provided at a slower rate than the increasing demands, then there is an increase in price of the product. If there is inflation due to an increase in aggregate demand as compared to the aggregate supply, then it is called 'Demand-pull inflation'.
- ⇒ I.e. only 60 kg tomatoes are available against 100kg tomatoes demand so it is impossible to produce 40 kg tomatoes instantly. This causes the increase in the price level for 60 kg tomatoes that increase inflation.
- ⇒ The major reasons for increase in demand are following : Increase in Supply of Money, Increase in Public (Government) Expenditure, Over-population

(2) Increase in Supply of Money:

- ⇒ Monetarists consider inflation as a purely monetary phenomenon. According to them if there is an increase in money in a state, the individuals earn more income because of which the demands of necessities increase. Against the increasing demand the supply remains steady, leading to increase in price and inflation.

Machlup says that "Too much money chasing too few goods causes inflation"

(3) Increase in Public (Government) Expenditure:

- ⇒ The governments of developing countries like India are involved in the economic development of the country. Government incurs expenditure after installing infrastructures, provision of basic utilities or providing employment; which increases the supply of money in the economy. This increases the incomes and demands of the people which lead to a rise in the general price level. Thus, if the government circulates money in excess of the production of goods and services in the economy by increasing public expenditure then the rise of general price level gains momentum.
- ⇒ I.e. Due to the public expenditure by the government, people have more money and so public demand increases but supply is not enough to fulfil demands instantly cause increase in price level of the available supply that generates inflation.

(4) Over-population:

- ⇒ In India, there is 2 % annual increase in population, leading to an increase in demands of individuals. The increasing population causes an increase in the demands of basic requirements and when the supply is insufficient the price level increases.
- ⇒ When the population is constant but their purchasing power increases due to the rise of their income, price levels increase.
- ⇒ Thus, supply of money leads to increase in demands followed by increase in price levels of goods or services.

(5) Increase in Cost of Production :

- ⇒ The other major factor affecting the price is the supply of goods and services. Supply-oriented economists believe that when there is an increase in production cost there is an increase in its price.
- ⇒ If there is an increase in the cost of raw material, machines, electricity, water rates, worker's wages or transportation, price of goods or services increases. The inflation caused due to increase in production cost is called 'Cost-push inflation' or 'Supply shock inflation'.

(6) Other Reasons :

- ⇒ The major reasons for inflation are (1) increase in demand (2) increase in production cost. But practically there are also other factors which can affect inflation.
- ⇒ Basically there is an increase in demand and production cost that leads to inflation, but the other minor factors are : Taxation Policy, Increase in Price of Import, Scarcity

(i) Taxation Policy:

- ▶ The taxation policy of the government causes inflation. The high increase in tax rates increases the production cost of the products which leads to rise in inflation.

(ii) Increase in Price of Import:

- ▶ To fulfil the public demand, commodities are imported from the international market. These commodities are costly and depend on everyday price level fluctuations in the international market causing inflation.
- ▶ I.e. In India 70 % of petroleum products are supplied via import. If there is an increase in the price of crude oil in the international market then there will be an increase in rates of petrol and diesel which can also increase the price of other products.

(iii) Scarcity:

- ▶ If the production is not possible to produce against the public demand, supply decreases and so prices of the production instrument increases. These instruments are raw material, electricity or any requirement produces scarcity which leads to increase in price level of the goods or services. If scarcity prevails for a longer period during production or is extensive in nature, it can cause inflation.

12. State the origin and development of money and explain its functions. (March-2018)

⇒ The origin and evolution of money are as follows:

⇒ **Origin:**

⇒ In ancient times, under the barter system, commodities and animals were used as a medium of exchange

in India when money was not introduced. Animals were universally accepted as an exchange medium. Cow were valued as a wealth in India.

⇒ Agriculture being the major sector of the economy, there was a large production of crops, of which the required stock was stored. Rest of the crops were sold to buy animals. When required, the animals could also be sold to get goods, services or even the crops in return. In this way animals like horse, cow, and buffalo became the means of exchanging values for money and trade.

⇒ The use of animals as a standard measure and a common medium of trade also became a limitation and caused difficulties. Animals are mortal, they get sick and die, therefore the storage of wealth (in terms of value for money) in the form of animals was not advisable. Thus, valuable minerals-stones were used instead of animals. At the onset of imperialism the use of coins started, as a means of trade and exchange of goods and services in the kingdom. The only limitation was that they were used in limited societies and regions.

⇒ **Evolution :**

⇒ Democracy and Industrialization inspired the need for modern money as a means of exchange. With the support of the central government, the money became widely accepted as a means of exchange of goods and services. Money also succeeded in overcoming the limitation of storage of value for money. The advent of the banking system made it easier to transfer and store money. Thus, the origin and evolution of money is the major step.

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⇒ **There are three functions of money:**

(1) Money as a Medium of Exchange

(2) Money as a Store of Value

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(1) Money as a Medium of Exchange:

⇒ The most important function of money is to act as a medium of exchange and trade. It removes the limitation of the lack of ‘double coincidence of wants’ and makes exchanges easier. The farmer can get money in exchange for wheat and then from that money he can buy clothes, rice, ghee, etc.

⇒ An individual can spend money to satisfy his present demands of goods and services, and also save the money for future needs for goods and services. Basically money is used as a medium to satisfy the needs of an individual by buying goods or services.

(2) Money as a Store of Value:

⇒ Another function of money is “Money is a store of value”.

⇒ If a person produced goods and services in exchange for other goods and services for future needs, it was difficult before the use of money as a means of exchange.

⇒ In the barter system, animals were mortal and grains would decay and so it was not possible to store them as a value for a long time.

⇒ Money makes these tasks easy. It is the most successful means of storage of value in terms of time. It is easy to have money as storage of value. It became possible to get money in exchange for crops and save the money for future needs to buy goods or services.

⇒ Another advantage of using money was that it could be used as a standard of deferred payment. This characteristic of money became an important basis for the entire systems of credit, hire-purchase and instalment payments. Thus, money is the best storage instrument for any value.

(3) Money as a Measure of Value:

- ⇒ Money plays an important role as a measure of value. In the Barter-exchange system it was difficult to remember the exchange rates and values of each of the goods or services like for 20 kg of wheat equals how much kg of rice? equals how much metre of cloth? equals to how much kg of ghee?
- ⇒ While on the other hand, money makes this easier allowing the values of different goods or services to be compared and assessed against each other. Money implies the price system, allowing the measure of price of each goods or services which can be compared to each other. It also allows faster decision making and exchanges.

13. Define the barter system and state its limitations. (July-2019, Aug-2020, March-2022)

- ⇒ Barter system is a system of exchange where goods or services are directly exchanged for other goods or services without using a medium of exchange, such as money.
- ⇒ In the earlier years, individuals lived a simple village life, had less needs and carried out agricultural exchange, exchange of goods and service which was sufficient for their sustenance. For example, a farmer cultivating wheat would store the required stock, and would exchange the remaining wheat to get rice, clothes or shoes. Similarly the shoe maker would get clothes and food, ghee by exchanging the shoes he made. Teachers used to get food in exchange for knowledge and the artists would be patronised for their entertaining art.
- ⇒ Increasing population and socio-economic development resulted in an increase and change in demands, making them more specific. Industrialization, Urbanization, division of labour, and Specialization made the Barter system limited and less applicable. The mutual exchanges decreased and the personal needs increased.
- ⇒ **The prominent limitations of barter system are :**
 - (1) Problem of Mutual Adjustment of Wants.
 - (2) Difficulty in Storing Value.
 - (3) Problem of Measurement of Value.
 - (1) **Problem of Mutual Adjustment of Wants :**
 - ⇒ With socio-economic development, the needs of human beings increased and so the economic structure which was simpler in earlier times became more complicated.
 - ⇒ Now those who had rice to exchange for wheat did not need wheat but clothes under barter. While on the other hand one who had clothes did not want rice but wanted ghee in exchange for their clothes.
 - ⇒ Thus, there was a difficulty in establishing a need for each other's goods or services to make the barter possible. It was a challenge to establish a barter between indivisible and divisible goods.
 - (2) **Difficulty in Storing Value :**
 - ⇒ There was an increasing problem in storing value. Here value means exchange value.
 - ⇒ A farmer may exchange wheat for a pair of shoes or cloth, but when productivity rises and she/he produces more wheat there arises a problem of strong surplus wheat. If wheat can be stored for a long period then at a future date such stock of wheat can be exchanged for a new pair of shoes or cloths or rice. But the question arises, how to store wheat?
 - ⇒ When an individual produced on a large scale through one's own efforts, she/he had to exchange this produce instantaneously for other goods and services. It was otherwise difficult to store the surplus goods or store the exchange value of these goods.
 - (3) **Problem of Measurement of Value :**
 - ⇒ With the introduction of division of labour and specialisation in an industry driven economy, the issue of measuring the value of goods and services emerged. Exchanging wheat for rice was simpler but now a large number of goods became available for exchange against wheat and hence it became difficult to determine and maintain the exchange value of wheat.
 - ⇒ Some examples of exchanges are as for 20 kg. of wheat is equal to 40 kg. of rice, 10 metres of cloth and 1 kg. ghee, etc. In a modern structure the questions of measurement arise as, how much of textile can exchange for 1 kg. ghee? Or how much rice can exchange for 1 kg. ghee? It became difficult to determine such measures and hence arose a need for a universally acceptable measuring rod.

⇒ This led to the origin of money, which became a standard measure of value and a common denomination of trade.