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PART- I

Chapter 1

INTRODUCTION TO ECONOMICS

1.1 Meanings of Economics

The word 'economics' is derived from a Greek word "Oikonomos", which means 'Household Management'. In the beginning, the subject of economics was related to the efforts of an individual household management in which man tried to fulfill unlimited wants with limited resources. Human material welfare is always the basic motive for these efforts.

By nature, a person is surrounded by many different kinds of wishes. Some wishes are those which are necessary for human existence such as; food, shelter and clothing. These basic needs are called necessities. Some wishes are not necessary for living but essential for an easy life. In economics, we call them 'comforts'. For example, television, telephone, refrigerator, air conditioners, one's own conveyance.

All resources are scarce in the sense that they are not enough to satisfy all human wants. Individuals need to make choices in order to get maximum satisfaction with limited resources. In short, we can say that the basic economic problem faced by human beings is, "unlimited wants and limited resources".

Because resources are scarce, choices have to be made. Individuals have to choose the most important wants and leave behind the less important ones. Individuals have to seek many ways to achieve the highest level of satisfaction by fulfilling maximum wants with limited available resources. The study of this human behavior in ordinary business of life is called 'economics'. Economics has two branches.

(1) Micro-economics

Micro-economics is concerned with the small individual parts of the economy. It deals with the study of the behaviour of buyers and sellers in the market for particular goods or services. For example, a study of consumer behaviour, price determination of one good, analysis of one firm, etc.

(2) Macro-economics

Macro-economics is the study of economic system as a whole instead of small units. It develops relationship between major economic aggregates and averages. For example, it considers income of a country instead of an individual, unemployment of a country instead of an individual, etc.

The study of economics plays a significant role in today's modern age. Economic growth and development can be achieved by following theories and golden rules of this subject.

1.2 Definition of Economics

The subject of economics is very old. At different times, economists defined it differently on the basis of individual observations under different economic situations or circumstances. Different definitions of economics as defined by different economists are given below.

1.3 Definition of Adam Smith

Adam Smith is called the founder of economics. According to him, **"Economics is a science of wealth"**. He wrote a book in 1776 named, "An Enquiry into the Nature and Causes of Wealth of Nations". In his book, Adam Smith explained economics as:

> **"A study of wealth concerning with the production, consumption, distribution and exchange of wealth in the human society".**

(1) Production of wealth

Wealth is produced with the combined efforts of four factors of production which are, land, labour, capital and organization. It is called production of wealth.

(2) Consumption of wealth

It is that part of wealth which we spend on necessities of life.

(3) Distribution of wealth

Wealth is distributed among four factors of production in the form of rent, wages, interest and profits. Rent is paid for land, wages for labour, interest to capital and profits to organization.

(4) Exchange of wealth

It means an exchange of wealth from one hand to another. When factors of production engaged themselves in an economic activity, individually or collectively, the consumption of one becomes income of another. Thus, wealth moves among individuals pursuing their own self-interests.

Adam Smith considered 'economics' as a study of wealth. He stressed that people un-intentionally contribute towards national income, while satisfying their own personal desires. Therefore, people benefit others at the time of meeting their own wants and needs thus creating wealth of nations.

Many other economists also termed economics as a science of wealth. Among them, J.B. Say, N.W. Senior, and J.S. Mill are the most important. All these economists belong to the classical school of thought, which regards wealth as a center point of all economic human activities.

Taking positively, wealth assists human beings to satisfy a number of desires and wants. Wealth does not include gold and silver alone but all sorts of goods and services, which are needed for increasing the volume of production.

1.4 Definition of Alfred Marshall

Alfred Marshall introduced neoclassical economics, so, he is considered to be the founder of neo-classical school of thought. He re-vitalized economics by terming it a study of material welfare. He changed the concept of economics from dismal science to a science of material welfare. This was his great success. He wrote the book on "Principles of Economics" in 1890. According to him,

> **"Economics is the study of mankind in the ordinary business of life; it examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well being."**

According to Marshall, economics studies those efforts which enable human beings to live a happy life. Marshall stated that economics on the one end, is a study of wealth, and on the other end, it is a part of a study of man. It does'not only deal with wealth but also explains how to achieve material welfare with the help of wealth.

Important features of the definition are given below:

(1) Economics is the study of daily activities of mankind.

(2) Economics deals with the making of material goods either individually or collectively. It ignores non -material things.

(3) Economics is linked with only those economic activities, which generate material requisites of well-being.

(4) Economics studies the wealth of nations only because it helps to gain human welfare.

Economics is the study of human behaviour that helps to gain wealth. It also helps individuals to explore different ways and means to achieve a highest level of standard of living. This positive concept of economics increased the value of economics. Moreover, Marshall called economics a social science. It does not study the behaviour of an isolated individual but the actions of persons living in a society as a whole.

Although Marshall presented a comprehensive and purposeful definition of economics but the concept of 'Attainment of wealth for the sake of material welfare' limited the scope and nature of economics. The critics soon raised voice against the use of vague term of 'welfare'. As a result, a better definition of economics came forward by Professor Lionel Robbins.

1.5 Definition of Professor Robbins

Lionel Robbins wrote the book named, "The Nature and Significance of Economic Science" in 1932. According to him,

> **"Economics is the science which studies human behaviour as a relationship between multiple ends and scarce means which have alternative uses".**

In the definition, 'multiple ends' refers to unlimited wants and 'scarce means' refers to 'limited resources'.

Important features of Robbins's definition are as follows.

(1) Human efforts to fulfill unlimited wants with limited resources.

(2) Economic problem arises because resources are scarce.

(3) Problem of choice arises because resources have alternative uses.

Robbins extended the scope of economics by using words like, 'unlimited wants' and 'scarce resources'. His definition of economics is true for all times. Basically, economic problem is the outcome of scarcity of resources. Human beings are faced with the problem of meeting unlimited wants with limited available resources. Had there been abundance of resources for satisfaction of all desires, there might have not been any economic problem, nor should be subject of economics have come in to existence.

Moreover, resources are not only scarce but they have alternative uses. The economic problem is to choose between the best resources available to get maximum human welfare. This view marked the boundaries of the economics in the line of production as what, where, how and for whom to be produced.

Definition of economics given by Robbins is superior to the earlier definitions of economics because it is comprehensive and closest to the realities of life. It has broadened the subject matter of economics by introducing the idea of multiplicity of wants and scarcity of means.

Exercise

Q.1 Each question has four possible answers. Tick (√) the letter that corresponds to the best answer.

1. Definition of Marshall is related to:
   - (a) Non-material things. (b) Scarcity of means.
   - (c) Acquiring of wealth. (d) Material welfare.
2. The most clear and comprehensive definition of economics is given by:
   - (a) Adam Smith. (b) Alfred Marshall.
   - (c) Robbins. (d) A.C. Pigou.
3. Economics refers to those goods which are:
   - (a) Limited. (b) Scarce.
   - (c) Have prices. (d) a, b, and c.
4. The book by Adam Smith was published in the year:
   - (a) 1870. (b) 1890.
   - (c) 1776. (d) 1876.

5. Economic resources include:

(a) Land. (b) Labour.

(c) Capital. (d) a, b, and c

Q.2 Complete the following statements by filling in the missing words or phrases:

1. Economic problem arises because resources are ___________.
2. Robbins criticized the definition given by ____________.
3. According to Robbins means have _____________ uses.
4. The founder of economics was _______________.
5. The classical school of thought regarded economics as the study of ___________.

Q.3 Match the statement in column A with column B. Choose the correct answer from column B and write in column C.

A	B	C
Scarcity is	The study of an individual or a firm	
Material welfare	The study of economic aggregates as a whole	
Micro economics deals with	The study of human behaviour	
Macro economics deals with	Less than required	
Social science deals with	Measurement is not possible	

Q.4 Answer the following questions in three sentences.

1. What does economics mean?
2. Write the definition of Alfred Marshall.
3. Write the definition of Adam Smith.
4. What is the difference between Micro and Macro Economics?
5. What does 'material welfare' mean?

Q.5 Answer the following questions in detail.

1. "Economics is a study of wealth". Which economist said this? Explain the statement also.
2. Explain in detail the definition of economics given by Alfred Marshall.
3. Explain the definition of economics given by Lionel Robbins.
4. Explain the meaning of economics in detail.

Chapter 2

SUBJECT MATTER OF ECONOMICS

2.1 Wants

Wants mean desires and needs for goods and services which provide utility.

People indulge themselves in various economic activities till the time of death in order to fulfill their ever emerging wants. These economic activities produce goods and services which give some level of satisfaction.

2.2 Characteristics of Wants

1. Human wants are endless which cannot be listed.
2. Wants if satisfied appear again after sometime.
3. They compete with each other. With limited income people have to choose among wants with order of their importance.
4. Wants may be satisfied by various alternative means.
5. Their importance depends on the degree of intensity.
6. Wants complement each other. When we buy a car we need to buy petrol also.
7. Wants may become a habit. Sometimes it becomes a habit to smoke a cigarette.

2.3 Kinds of Wants

There are two kinds of wants which are given below:-

1. Economic Wants

These are wants which can be satisfied only by paying for them. If we need a haircut we have to pay for it. If hunger strikes us at school, we have to pay for eatables.

2. Non- Economic Wants

These wants can be fulfilled without paying in money terms. We want and get love, air and light without any payment. Such goods for which we do not have to pay are called free goods; For example, the air we breathe in, the sunshine, rain water, water in ocean, etc.

2.4 Degrees of Wants

The degree of wants depends on their intensity. These are given below:-

1. Necessities

These are first degree wants which are most important because these are essentials for our existence. These are food, clothing and shelter.

2. Comforts

These are second degree wants because we can live without them but their presence makes our life easier; for example, a cycle for transport, use of a fan in hot weather.

3. Luxuries

These are third degree wants which are less important for a simpler life.

These goods are expensive and have a strong element of demonstration. They make life very luxurious and comfortable. For example, a big and expensive car for transportation, a big house to live in, use of air-conditioners in hot weather.

2.5 Labour

Struggle is the main key to fulfill our wants. In order to satisfy innumerable wants, continuous effort is needed throughout our lifetime.

2.6 Kinds of Labour

There are two kinds of struggle:

1. Mental Labour

It is the struggle done with brain. We make plans to launch any economic activity to satisfy our needs and requirements through all stages of life.

2. Physical Labour

It is the struggle which is applied physically. Struggle is needed to produce any good. Although a struggle cannot be measured but profit of a producer is the outcome of his mental and physical struggle. A labourer also gets wages as a result of his physical struggle.

2.7 Goods and Services

Let us explain goods at first.

Goods

Goods are all material things that are needed by man. The common feature of all the goods is that they satisfy human wants. Utility and productivity are the general features of all the goods.

There are two kinds of goods in economics.

1. Consumer Goods

Consumer goods are those which can satisfy human wants directly. These are things such as a chair, a car, a pen, a book, etc. These goods have some utility. The more a person has consumer goods, the more he feels wealthier. The demand for consumer goods leads to the demand for producer goods.

2. Producer or Capital Goods

Producer goods are used for the production of other goods. Demand for producer goods is a derived demand, because the demand for consumer goods leads to the demand for producer goods. This is the reason that they are called capital goods also.

There are three kinds of producer goods:-

1. Raw-material.
2. Semi-manufactured goods.
3. Manufactured goods or final goods.

There are two kinds of goods according to scarcity:-

1. Free Goods

Free goods are those, the supply of which is unlimited and are available free of cost. For example, fresh air and sunshine in winter season. This is because they do not require resources to produce them. They are the free gift of nature.

2. Economic Goods

Economic goods are those, the supply of which is limited and are not free of cost. Resources are needed to produce these goods. So these goods are available at some price.

Services

Services are indivisible goods which are in direct use by the people. Teaching by a teacher, medical treatment by a doctor and people's work for the welfare of a community, all are termed as services. Services are the actions of individuals that make possible to satisfy one another's wants. Services have values so they are bought and sold like goods.

Services may be technical and non-technical. Services of a sweeper are non-technical but services of a clerk are technical.

It is to be noted that the difference between consumer and producer goods does not depend on their nature but on their use. A good may be a consumer good at one point of time and producer good at another point of time. A car remains a consumer good until it is used as a taxi.

2.8 Utility

Generally speaking, utility means the advantage from the use of goods and services. It shows the usefulness of the commodity in use. But in economics it means the pleasure or satisfaction obtained from a good or a service. In economics utility and usefulness have different meanings. Any thing which is medically harmful may have a utility. Drugs kill a person but it gives satisfaction to the addict. Such goods have a utility but they are not useful. Therefore, goods which have utility may not be useful.

In consumer behaviour analysis we use the terms total utility, marginal utility and diminishing utility.

Let us explain these terms.

1. Total Utility

It is the total amount of satisfaction derived from consuming any given quantity of a good or a service.

2. Marginal Utility

It is equal to the amount by which total utility changes when consumption of a good or a service changes by one unit. It is calculated by dividing the change in total utility by the change in quantity consumed.

3. Diminishing Utility

It is equal to a decline in utility when an extra unit of a commodity is consumed.

2.9 Characteristics of Utility

1. Utility depends upon the intensity of a human desire. Thus it varies from an individual to individual.
2. Utility of a commodity increases with its multiple uses. Electricity and natural gas have great utility because they are used for many purposes.
3. Utility depends on the use of a good by a particular consumer. For an uneducated person, a pen has no utility whereas for a student it has utility.
4. Utility of good changes with the changed nature of that good. The log of a wood in a jungle has no utility but when it changes into furniture it has utility.
5. Utility changes with the change in the environment or weather. In summer season, woolen clothes have no utility whereas in winter season they have utility.
6. Utility arises with a shift of a commodity from a useless place to a useful place. Sand beside the river has no utility but when it is transferred to cities for construction purposes it has utility.
7. Utility is a subjective term which cannot be measured directly from brain. It is a relative term and estimated measure.
8. Utility depends on information and technology. When Sui-gas was not found it had no utility.
9. Utility provides a base for demand. Only that good or service is demanded which has a utility.
10. Although all useful things possess utility but all things that have utility may not be useful.

2.10 Scarcity

Scarcity arises due to the lack of available human and non-human resources to produce all goods and services that are desired by all human beings. Scarcity does not mean that available goods are small in quantity. It means that it is less to meet all the demands of human beings. It is a relative term. It relates to the extent of people's wants to their ability to satisfy those wants. Scarcity is the basic reason for any economic problem. Human wants are unlimited but resources are limited which causes economic problem.

A person has to make a choice among various wants in order to achieve maximum satisfaction out of his limited income.

Economic resources and the output of goods and services are limited. Therefore, production of each good and service involves cost. Thus, each good and service is supplied at a price. So, scarcity is directly related to the price of a commodity. The scarcer is a good the higher the price it has. Scarcity is also related to economic goods. Non- economic good (like air) is never scarce. Scarcity gives importance to economics.

In fact, scarcity is a fundamental problem for every one; poor or rich. Scarcity implies that people have to make choice to achieve a higher level of satisfaction.

2.11 Value and Price

The word 'value' is a relative term and used in two ways:-

1. Value-in-use

It means ability of a thing to satisfy human wants. It is similar to the meaning of utility.

2. Value-in-exchange

It is the purchasing power of a thing which makes exchange of things possible. It is the value of a good with which other goods can be exchanged. All things which possess the features of providing satisfaction have value-in-exchange. But they have value-in-exchange only when they are transferable and scarce.

2.12 Determinants of Value

1. If a good has utility it has a value. Utility and value are positively related. The higher the utility, the higher is the value.
2. Free goods have no value,only scarce goods have value. Diamonds are scarcer than gold so they are more valuable than gold. Gold is scarcer than silver so gold is more valuable than silver.
3. Those goods that have mobility are valuable. They must be able to transfer from one person to another. Any thing that cannot be transferred to another person may have utility but no value.

Price of a thing represents its value. When money was not invented, goods were exchanged for goods in a barter economy. In the modern society, now money serves the function of medium of exchange. Changes in the level of prices bring changes in the economy.

2.13 Relationship between Price and Value

A good with higher value will have higher price. In fact, utility of anything represents its value. Therefore, in economics there is a close relationship among utility, value, and price.

2.14 Wealth

In economics 'wealth' is used in a broader sense. It means all those things which have a capacity to satisfy human wants and which are limited in supply.

It includes the following features:-

1. It has utility.
2. It is scarce.
3. It is transferable.

There are four kinds of wealth. These are given below:-

1. Individual Wealth

It includes all material things that a person possesses. For example, a person's car, clothes, house, etc.

2. Public Wealth

It is the property of a country, such as, government buildings, roads, railways, etc.

3. National Wealth

These are the natural resources, which include rivers, mountains, minerals, natural gas, etc.

4. International Wealth

These are air, ocean, space, etc.

Exercise

Q.1. Each question has four possible answers. Tick (√) the best answer.

1. Due to scarcity society is forced to:
   (a) Make roads. (b) Save resources.
   (c) Make choices. (d) Stop operating.
2. Scarcity exists in every society because:
   (a) Wants are limited and resources are unlimited.
   (b) Wants are unlimited and resources are unlimited.
   (c) Wants are unlimited and resources are limited.
   (d) Limited information and technology.
3. The word 'economics' refers to something that:
   (a) is scarce. (b) is limited.

(c) commands a price. (d) all of the above.

4. An economic good is one which:

(a) is sold at profit. (b) has a price.

(c) has high quality. (d) is produced efficiently.

5. The term 'marginal' in economics means:

(a) more. (b) the minimum unit.

(c) additional (d) None of the above.

Q.2. Complete the following statements by filling in the missing words or phrases.

1. Marginal utility of a good _______ with an additional unit.
2. Economic ___________ produces goods and services.
3. If value of a good is high its __________ is also high.
4. Food, clothing and shelter are ___________ goods.
5. Demand for producer's goods is called _________ demand.

Q.3. Match the statement in column A with column B. Choose the correct answer from column B and write in column C.

A	B	C
For economic goods	Expenditures are undertaken	
For non-economic goods	It must have a feature of satisfaction	
For goods and services	Money is spent	
For consumer goods	Money is not needed	
For demand of a good	Producer goods are needed	

Q.4. Answer the following questions in three sentences:

1. What are economic goods?
2. What does 'free goods' mean?
3. What is the meaning of utility?
4. What is the meaning of scarcity?
5. Write four kinds of wealth.

Q.5. Answer the following questions in detail:

1. Define human wants. Also explain their degrees and kinds.
2. Explain the meaning of utility in economics and write a note on its importance.
3. What is the meaning of value? Explain the factors that determine it.
4. Relate value with price.

Chapter 3

DEMAND

3.1 Meanings of Demand

A desire which is accompanied by willingness and power to purchase is called demand. Purchasing power of certain goods means rupee. We have many desires but these desires can be changed into demand if we have money to buy them. Therefore, demand has two necessary conditions to fulfill:-

1. Will to purchase **2. Power to purchase**

As demand is always at a specific price so a strong relationship develops between demand and price. If we go in the market, we will buy more at low price and buy less at high price. So, demand can be defined as follows:-

"Demand is the quantity of goods that buyers want to purchase at different prices".

3.2 Law of Demand

"Other things remaining the same, if price of certain goods rises, then quantity demanded falls and if price falls, then the quantity demanded increases". It shows that the quantity demanded is the function of price.

In terms of functional equation it will be written as follows:-

$Q_d = f(P)$ (Quantity demanded is the function of price)

In the law of demand, "Other things remaining constant", means that the certain factors are assumed to be constant. These are called assumptions of the law of demand.

3.3 Assumptions of The Law of Demand

(i) Consumer's income must not change

If there is an increase in income people may buy more even if price increases. If your pocket money increases you will buy more CDs even at higher price.

(ii) Prices of related goods do not change

Related goods can either be substituted or complement. Even if the price of chicken does not fall people buy it more because of increase in mutton price.

(iii) Taste and fashion remain the same

If there is a change in taste and fashion, people will keep on buying the same quantity of the commodity irrespective of any change in price. If taste of a consumer increases for a particular good, its demand will not decrease inspite of an increase in price.

(iv) Composition of population remains the same

The demand of goods will change at same price with an increase or decrease in the composition of population. If there is an increase in the population then demand will increase without a decrease in price.

(v) No change in future expectations

If people believe that prices of certain goods are going to change in near future, the law of demand will not hold true. If prices are falling, people will not increase their demand because they expect a further fall in price. Or if people expect the shortage of certain goods in future they will increase their demand at the same price.

(vi) No change in money supply

Demand is changed with an increase or decrease in the money supply.

3.4 Diagrammatic Presentation of Law of Demand

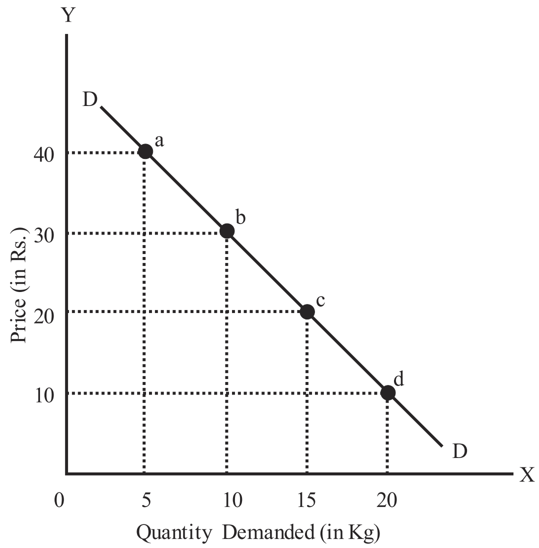
Let us explain the law of demand with the help of a demand schedule and a diagram.

Demand Schedule 3.1

Price of Sugar	**Demand for Sugar**
Rupees	Kilograms
40	5
30	10
20	15
10	20

The demand schedule is a table showing the quantities of a good at alternative prices in a given time period. At the price of Rupees 40 per kilogram, only 5 kilogram of sugar is demanded. If the price of the sugar falls to Rupees 30 per kilogram, then the demand of sugar increases to 10 kilogram. It means that when sugar becomes cheaper, more is demanded. In other words, a fall in the price of the sugar increases the demand for the sugar. This is law of demand, which develops an inverse relationship between price and demand.

Demand Curve 3.1



1. Demand curve, DD, slopes down to right. So, it has negative slope.
2. A fall in price increases the quantity demanded, so it shows inverse relationship between price and quantity demanded.

Demand curve (DD) is a graphic representation of the quantities of goods that a consumer is willing and able to buy at all possible prices. In the diagram 3.1, DD is the demand curve. At OX axis quantity demanded is taken in kilograms, whereas, price is taken at OY axis. OX axis is horizontal axis whereas OY is vertical axis. In economics price is always measured by the vertical axis and quantity is always measured by the horizontal axis.

If market price of any good is known then one quick look at the demand curve will tell us how much quantity a consumer will buy. Each point on the curve refers to a specific quantity that will be demanded at a given price. This curve falls from left to right downwards. This confirms that when price falls quantity demanded increases. At point ‘a’ price is Rupees 40 and the quantity demanded is 5 kilograms. At point ‘b’ the price falls to Rupees 30 and the quantity demanded increases to 10 kilograms. Similarly, at point ‘c’ price is Rupees 20 and quantity demanded is 15 kilograms and at point ‘d’ price is Rupees 10 and quantity demanded is 20 kilograms. By joining the points a, b, c and d, we get a demand curve.

Elasticity of Demand

The elasticity of demand represents the extent of change in demand in response to the change in price. There are three types of elasticity of demand:-

(i) **More elastic demand**: When a smaller change in price leads to a greater change in quantity demanded then demand is more elastic.

(ii) **Less elastic demand:** When a greater change in price leads to a smaller change in quantity demanded, then demand is less elastic.

(iii) **Inelastic demand:** When price changes but the quantity demanded remains the same then demand is inelastic.

3.5 Limitations of The Law of Demand

(i) Inferior goods

In case of inferior goods, people do not buy more even if its price decreases. So the law of demand will not apply in such cases.

(ii) Scarce goods

If a shortage of supply of certain goods is expected, people will increase their demand even if its price increases. This is against the definition of the law so the law will not hold.

(iii) Giffen goods

Professor Giffen gave the concept of 'Giffen goods'. These are special kinds of inferior goods. When price increases more is demanded and less of it is demanded if price is lower. It goes against the law of demand. For example, barley is inferior to wheat. However, if price of barley falls, people will buy some quantity of wheat more, instead of barley and its demand will not increase.

(iv) Precious goods.

If possession of any good is thought to be a matter of prestige or distinction, people will buy that commodity even at higher price. It means that rising prices will not lower the demand of such precious goods. Example of such goods is diamonds and antiques etc.

3.6 Factors Affecting Demand, other than Price

There are numerous other factors than the price of a commodity which affect its demand.

1. Liking or disliking

If you like chocolate, your friend may like ice cream. Preferences or tastes are important in determining our willingness to buy different types of goods. The demand for many goods, such as clothing and hairstyle, changes frequently as fashion changes. People plan to buy more at same price, if these are in fashion.

2. Income

An increase in income will also cause an increase in our demand for most of the goods. For example, an increase in income will increase the demand for clothing. If higher income causes an increase in the demand for a good, the product is a normal good. But in some cases, the opposite will happen. If an increase in income causes a decrease in the demand for a particular good, it is because it does not come at the standard of the income group and can be called an inferior good.

3. Population

Since people are potential buyers, therefore, the demand for most goods will increase with the rise in population. For example, migration of people from rural to urban areas increases the demand for housing, restaurants and transport in urban areas.

4. Prices of other goods

In this regard we will classify products in three major categories.

i. Substitute goods

In case of substitute goods, products are related with each other in such a way that a rise in the price of one will increase the demand for the other. Similarly, decrease in the price of one will decrease the demand for the other. For example, sharp increase in the price of mutton will increase the demand for its substitute (chicken)

ii. Complementary goods

In case of complementary goods, products are related with each other in such a manner that an increase in the price of one will decrease the demand for the other or a decrease in the price of one will increase the demand for the other. For example, an increase in the price of tennis ball will decrease the demand for tennis racket.

iii. Independent goods

If price of one good changes it will not have any effect on the demand for the other (independent) good. For example, an increase in the price of computer does not affect the demand for a car.

5. Expectations

If the price of a particular good is expected to increase in the future, consumers will rush to markets and demand will increase. For example, if people expect that the price of mutton will increase sharply they will purchase more mutton and store it for future consumption.

6. Quantity of money

An increase in the money supply will increase the demand and a decrease in the money supply will decrease the demand

7. Climate conditions

During the summer season, the demand for ice will increase while it will decrease in winter. Similarly, the demand for air conditions increases in summer but decreases in winter.

8. Standard of a goods

An improvement in quality of a good increases its demand. For example, if ice is added to any soft drink during summer, its quality improves and its demand will rise.

The change in quality of 'Coca-Cola' will change its demand without a change in its price.

9. Innovation and Inventions

Sometimes demand for a good is changed without any change in price level. For example, demand for computers will go up for publishing books if it is quicker and easier to compose books on computer rather than manually.

Exercise

Q. 1 Each statement has four possible answers. Tick (✓) the best option:

1. If the price of a good decreases the quantity demanded
   (a) increases. (b) decreases.
   (c) remains constant. (d) a, b ,and c.

2. The demand curve slopes
   (a) downward to the right. (b) upward to the right.
   (c) vertical. (d) horizontal.

3. The law of demand does not hold if goods are
   (a) inferior. (b) precious.
   (c) scarce. (d) all of the above.

4. With an increase in the price of a good, its substitutes will have
   (a) a fall in its price. (b) an increase in its price.
   (c) an increase in its demand. (d) a decrease in its demand.

Q. 2 Complete the following statements by filling in missing words or phrases:

1. When price of a good __________ its quantity demanded decreases.
2. With a decrease in the price of inferior goods __________ decreases.
3. With an increase in the price of a prestigious goods its demand ___________.
4. A change in quantity demanded due to a change in price is called _________.

Q 3 Match the statement in column A with column B, Choose the correct answer from column B and write in column C.

A	B	C
Complementary goods	is a good whose quantity demanded decreases with a decrease in price.	
Inferior goods	An increase in the price of one good decreases the demand for another good.	
Normal goods	is a good whose quantity demanded increases with an increase in price.	
Scarce goods	An increase in the price of a particular good increases the demand of another good.	
Substitute goods	A decrease in the price of certain goods increases the quantity demanded.	

Q. 4 Answer the following questions in three sentences.

1. Define demand.
2. Write the functional equation of demand.
3. What does elasticity of demand mean?
4. What is the slope of a demand curve?
5. What does 'other things remain constant' mean in the law of demand?

Q. 5 Answer the following questions in detail:

1. Law of demand and its assumptions.
2. Law of demand with the help of schedule and diagram.
3. What does the law of demand mean? Give its limitations also.
4. What factors other than price bring changes in the quantity demanded?

Chapter 4

SUPPLY

4.1 Meaning of Supply

"Supply is the quantity of a good; sellers wish to sell in the market at a specific time and price". Two points are important here.

(1) Specific Price

As good is demanded at a certain price similarly supply cannot be explained without price. Quantity is always supplied at some specific price.

(2) Specific Time

Time period is also very important with reference to supply, for example, whether it is daily, weekly, or monthly. It means that quantity supplied is not determined within some time frame.

4.2 Difference between Supply and Stock

Supply means the quantity that will come into the market over a range of prices while stock means the total quantity of the commodity which exists in a market but not offered for sale by the sellers. The stock becomes supply when a seller expects reasonable profit at a given price. The seller increases the quantity supplied when price increases in order to earn more profit. Similarly, with a decrease in price quantity supplied also decreases so as to avoid losses.

4.3 Law of Supply

The relationship between price and quantity can best be explained with the law of supply.

Definition:

"Other things remain constant, an increase in price, increases the quantity supplied and a decrease in price decreases the quantity supplied".

Assumptions of the law:

The law of supply holds true if the following factors are assumed to remain constant.

a. Cost of production

b. Technology

c. Country's natural resources

4.4 Graphic Presentation of the Law of Supply

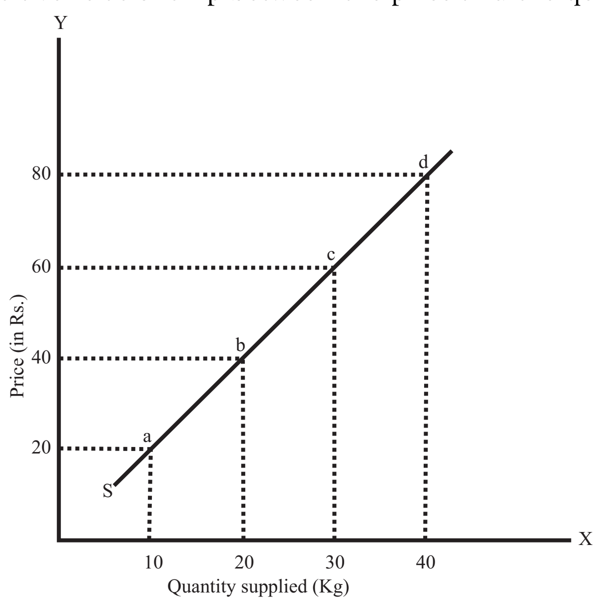
A supply schedule:

A supply schedule 4.1 is given below. Prices of onion are taken at rupees per kilogram.

4.1 Schedule of Supply

Price of onions (in rupees)	Quantity of onions supplied (in kilogram)
20	10
40	20
60	30
80	40

When price of onions increases from Rs. 20 to Rs.40, quantity supplied also increases from 10 kg to 20 kg. This shows that when the price increases quantity supplied also increases and when price decreases quantity supplied also decreases. Thus, there is a positive relationship between the price and the quantity supplied.



1. The supply curve slopes upward from left to right.
2. With a decrease/ increase in price, quantity supplied decreases/ increases, therefore, it develops positive relationship between the price and the quantity.

Diagram 4.1 The supply curve

In the diagram 4.1, the supply curve SS moves upward from left to right, indicating that larger quantities will be supplied at higher prices. The supply curve is drawn on the basis of the given values in the supply schedule. The quantity supplied is taken at the x-axis and the price is taken at y-axis At the price of Rs.20 , the quantity of onion supplied is 10 kg. When price increases to Rs.40, the quantity supplied also increases to 20 kg. At price Rs.60, the quantity increases to 30 Kg. Thus, as price increases quantity supplied also keeps on increasing. By joining points a, b, c, and d, we get the supply curve. The positive slope of the curve shows that the quantity supplied increases with an increase in price.

$$Qs = f(P)$$

It is read, as "The quantity supplied is the function of price".

4.5 Elasticity of Supply

In economics, the concept of elasticity is also important just like the elasticity of demand. The change in quantity supplied due to a change in price is called elasticity. Elasticity of all the goods differs from one another. The elasticity of supply has many degrees. Such as:

1. **More elastic supply**: When a small change in price brings a large change in quantity then the supply is more elastic.
2. **Less elastic supply**: When a larger change in price brings a small change in quantity then the supply is less elastic
3. **Inelastic supply**: When a change in price brings no change in quantity then the supply is inelastic

4.6 Factors Affecting Supply other than Price

1. Cost of production

Changes in the cost of production bring a change in the quantity supplied. When the cost of production increases, then the quantity supplied decreases and when the cost of production decreases, then the quantity supplied increases.

2. Methods of production

The changes in the methods of production also change the cost of production so the quantity supplied changes.

3. Climatic conditions

Bad weather may affect agriculture and related industries that may decrease the supply. Where as the good weather may increase the supply.

4. Means of transportation

A good transportation system increases the supply, which increases the extent of a market.

5. Rate of taxes on producers

If the rate of taxes increases it decreases the supply because the profit margin of producers decreases.

6. Political and economic system of a country

The instability of political and economic system decreases the supply.

Exercise

Q. 1 Each question has four possible answers. Tick (✓) the best answer:

1. Supply means.
   - a. Total supply of a specific producer.
   - b. Number of sellers
   - c. Quantity of goods offered for sale at alternative prices.
   - d. Purchasing power of quantity supplied.
2. Slope of a supply curve is:
   - a. Negative   b. Positive
   - c. Vertical   d. Horizontal
3. More elastic supply means:
   - a. A small change in quantity supplied without a change in price.
   - b. A small change in price brings a large change in quantity supplied.
   - c. A large change in price brings a small change in quantity supplied.
   - d. When price changes but quantity supplied does not change.
4. Which of the following factors do not change supply:
   - a. Cost of production   b. Political system of a country
   - b. Climatic conditions   d. Level of income.
5. Which of the following statement is not true?
   - a. Generally supply is a part of stock.
   - b. Supply curve has negative slope.
   - c. Supply is the function of price
   - d. Quantity supplied changes due to change in elasticity

Q. 2 Complete the following statements by filling in missing words or phrases.

1. With an increase in tax on a good its production _________.
2. The supply curve has _________ slope.
3. Supply is a part of _________.
4. Quantity supplied is a _________ of price.
5. With an increase in price quantity supplied _________.

Q. 3 Match the statement in column A with column B. Choose the correct answer from column B and write in column C.

A	B	C
Elasticity of supply	Small change in price but significant change in quantity	
If price is higher then producer	Decreases supply	
Tax on goods	Change in quantity supplied due to a change in price	
More elastic supply	Larger change in price but small change in quantity supplied	
Less elastic supply	Increases supply	

Q. 4 Answer the following questions in three sentences.

1. What does supply mean?
2. What is the difference between stock and supply?
3. What does a supply schedule represent?

Q. 5 Answer the following questions in detail.

1. Define the law of supply and explain it with a schedule and a diagram.
2. What are the factors that affect the quantity supplied?

Chapter 5

EQUILIBRIUM AND PRICE DETERMINATION

5.1 Equilibrium

A situation in which economic forces, as they exist at their times have no tendency to change. The concept of equilibrium is used in both physical and social sciences and it is of central importance in economic analysis. In economics, a market is said to be in equilibrium when all sellers and buyers are satisfied with one price and there is no tendency for production or price in that market to change.

In this chapter, we will work together on supply and demand to understand how market forces work to establish a particular price and quantity to establish a state of equilibrium.

5.2 Economic Equilibrium

All other things being equal, a buyer will always choose a seller with the lowest price, whereas a seller will choose, if possible, to sell at higher price. Only one price is possible where both seller and buyer agree and this is the state of equilibrium. When price is determined at equilibrium then it is called equilibrium price.

5.3 Perfect Competition

In our analysis of market equilibrium, we assume perfect competition in the market. A market is perfect in which there are enough buyers and sellers that no single buyer or seller can influence price of quantity by his or her individual actions.

5.4 One Price

In the perfect market, a law of one price holds. After the market forces of supply and demand of buyers and sellers, are at rest or in equilibrium, a single price for a good will prevail. The self interested, competitive forces of buyers and sellers acting through supply and demand guarantee this important result.

5.4 Market Equilibrium

At equilibrium price, consumers get precisely the quantity of the good they are willing to buy at that price, and producers sell precisely the quantity they are willing to sell at that price. When supply of a good is equal to the demand of that good then only one price is determined. This is called market equilibrium. At equilibrium, price is called equilibrium price and quantity is called equilibrium quantity.

5.5 Equilibrium and Price Determination

Price and quantity determine the market equilibrium. This can be explained with the help of following supply and demand schedule and diagram.

5.6 Explanation of Equilibrium with a Schedule

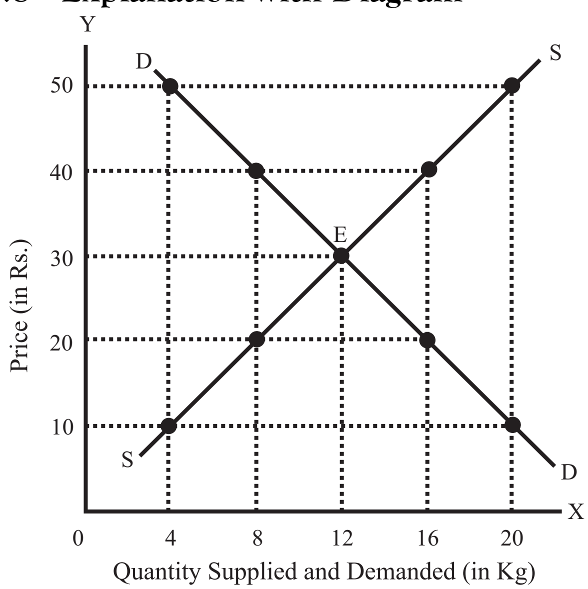
Price in the schedule moves from the highest level of Rs.50 to the lowest, level of Rs.10.The schedule shows the inverse relationship between price and quantity, which means less quantity is demanded at higher price and more quantity is demanded at lower price. This is according to the law of demand.

See the schedule 5.7. We can see that the equilibrium condition is met at a price of Rs.30 since sellers are planning to sell 12kg of sugar, which is the amount that buyers plan to buy at this price. Therefore, Rs.30 is the equilibrium price and 12 kg is the equilibrium quantity. This gives us the condition of market equilibrium.

Schedule 5.7 Determination of Market Equilibrium

Price of sugar in Rs. (Per Kg) P	Quantity demanded (Kg) (Inverse relation between price and quantity) Q_d	Quantity supplied (Kg) (Direct relation between price and quantity) Q_s
50	4	20
40	8	16
30	12	12
20	16	8
10	20	4

5.8 Explanation with Diagram



1. The intersection of demand curve, DD and the supply curve, SS gives the equilibrium point, E.
2. At equilibrium, price is Rs.30 and quantity demanded is equal to quantity supplied, that is, 12 kg.

The diagram is drawn on the basis of schedule 5.7. The demand curve DD, moves downward from left to right, which shows that it has negative slope. This confirms that price and quantity are inversely related. On the other hand, supply curve, SS, moves from left to right upward, which has positive slope. This confirms that price and quantity supplied are directly related.

Exercise

Q.1 Each question has four possible answers. Tick (✓) the best answer.

1. The intersection of demand and supply curves show:
   - (a) Equilibrium price.
   - (b) Equilibrium quantity.
   - (c) Market equilibrium.
   - (d) All above.
2. Market is in equilibrium when:
   - (a) The cost of production remains the same.
   - (b) The cost of production is decreasing.
   - (c) Desires of buyers are fulfilled.
   - (d) Demand of a good is equal to its supply.
3. Equilibrium means:
   - (a) The condition that is not possible.
   - (b) An unstable condition.
   - (c) A condition that cannot change.
   - (d) Stable position.

Q.2 Complete the following statements by filling in the missing words or phrases:

1. Market_______is determined with demand and supply.
2. When demand is equal to _________________ then market is in equilibrium.
3. Market price is also called _________________ .
4. In perfect competition no one can influence price and quantity by his ______________ .
5. Demand curve has _________________ slope.

Q.3 Match the statement in column A with column B. Choose the correct answer from column B and write in column C.

A	B	C
Market	Where supply and demand are equal	
Perfect competition	Negative slope	
Equilibrium price	Positive slope	
Demand curve	A place where sellers and buyers are present	
Supply curve	Where no one can fix price with his individual action	

Q.4 Answer the following questions in three sentences.

1. What does market equilibrium mean?
2. What is equilibrium price?
3. What is determined by the intersection of supply and demand?

Q.5 Answer the following questions in detail.

1. Explain market equilibrium with the help of a schedule and a diagram.
2. What is meant by equilibrium price and quantity? Explain with the help of a diagram.

Chapter 6

MARKET AND PRODUCTION

6.1 Meanings of Market

Generally, market means a place where things are sold and bought. But in economics it has a vast meaning. It is a place or region where sellers and buyers very easily come in contact with one another directly or indirectly in order to mature their transactions. The main function of a market is to enable an exchange of goods and services to take place. It is not necessary that these contacts are made personally. The communication in the market may be by telephone, telegraph, telex, Internet etc.

Definitions:

According to Professor Benham, **"A market is a place where buyers and sellers are in such a close contact with each other, either directly or through dealers, that the prices obtainable in one place of the market affect the prices paid in other places".**

According to Lipsey, **"A market is an area over which buyers and sellers negotiate for the exchange of a well-defined commodity"**.

6.2 Kinds of Markets

There are two kinds of markets according to the nature of competition.

6.3 Perfect Competition Market

In perfect competition market, the law of one price holds and this requires certain conditions to be fulfilled.

(1) Large number of buyers and sellers

There are a large number of buyers and sellers and none of them can influence the market price. All the firms are price takers.

(2) Homogeneity of Products

All the firms produce identical products. The product is homogenous. So, there is no difference in shape or packing. On this basis, the cost of production is the same so price is also the same.

(3) Free entry and exit

New producers are free to enter the market and old ones are free to exit the market at any time.

(4) Perfect knowledge of the market

This means that sellers and buyers have complete information about the market. The sellers have the knowledge of price and cost of production whereas the buyers have the knowledge of price and quality of the products. On these basis, one price is determined by the law of supply and demand and the law of one price prevails.

(5) Perfect mobility of factors of production

This means that the factors of production have complete freedom to move from one place to another in pursuit of better returns. This factor of perfect mobility makes returns equal in all production sectors and thus one price holds in the market.

6.4 Imperfect Market

In this kind of market, the law of one price does not hold. Therefore, if conditions of perfect market do not hold then it becomes imperfect market. In such a market, individual firm is capable of influencing the price of a product. The features of imperfect market are as follows:

1. Sellers are a few in number.
2. Goods are heterogeneous; therefore, different goods have different prices.
3. There is no perfect mobility in factors of production. Returns are different for each factor of production so cost of production is also different. This results in difference in prices.
4. Consumers have imperfect knowledge about the market conditions. Therefore, they are unable to buy at minimum price or sometimes buy lower quality product. This is why the imperfect market is not beneficial for the consumers.

6.5 Short Period Market

There are two kinds of short period market.

1. Daily Market.

This is also called market period. In this kind of market, price changes daily. It consists of those agricultural products that are perishable and cannot be stored, such as, cucumbers spinach, tomatoes, etc. The market period begins at the moment farmers place their ready goods in the market to sell. Supply is fixed and cannot be increased according to the demand. The supply curve is perfectly inelastic which means it is vertical to the x-axis. Therefore, price is only determined with the help of demand curve.

2. Short Period Market

In this kind of market, goods can be stored. This time period is longer than the market period since firms have some ability to adjust production to changes in the market conditions. However, the period is not long enough to install new machinery and equipment. This means that fixed inputs (land) remain the same, only variable inputs like labour and raw material can be changed. The supply curve of short period market is less elastic, which means that change in price is more than the change in quantity.

6.6 Long Period Market

The time period of this kind of market is quite long and fixed factors of production can be changed according to an increase in demand. Here, the supply curve is more elastic than in the short period. This means that due to a change in price, the increase in the quantity supplied is more in the long period than the increase in the quantity supplied in the short period. The main reason being that in the long period, the fixed factors of production also become variable and installing new and modern machinery can produce more. In this period, supply plays an important role to determine the price. In short period, there may be an increase in price due to increase in demand but in the long run, the price again settles at normal level due to an increase in supply.

6.7 Production

Production not only means making or creating things but also creating utility. Any kind of labour, which creates utility in one form or the other, is a part of the production process. In addition to utility, a thing must have a value also. To produce a thing having utility but not having value is no production in terms of economics. Production includes not only goods but services also. Transformation of one thing to another means production; for example, a log of wood changed into a table is production.

6.8 Importance of Factors of Production

Production cannot take place unless the necessary resources are available. These resources include factories, farms, mines, human skills, offices and shops. Resources can also be called factors of production or inputs.

There are four kinds of factors of production. These are land, labour, capital and organization. Let us explain the main characteristics and importance of these factors.

6.9 Land

This is the first basic factor of production. Land does not mean only the surface on which we move around but it includes all the things in it which are gift of nature. Land comprises all kinds of natural resources. The natural fertility of land, climate, sea, mountains, and mineral wealth, all are natural resources.

David Ricardo gave three important features of land, which made it distinct from the other factors of production. These are:

1. Land is a gift of nature.
2. Land is limited in supply.
3. Production in industries primarily depends on land.

The main characteristic of land is its use as a site where some form of economic activity can be carried out. In the words of Marshall, **"Earth surface is a primary condition of anything that a man can do; it gives him room for his action."**

Importance of Land:

(1) It is a foremost factor of production without which any economic activity is impossible.

(2) It provides food to the human beings. It supplies fruits and vegetables.

(3) It makes possible the construction of huge buildings and houses for living.

(4) Fertile and productive land helps in economic development of a country.

(5) Agricultural development depends on the best qualities of land.

(6) Industrial development depends on the raw material provided by the agriculture sector.

(7) Land provides natural resources such as minerals, lakes mountains, forest, rivers and canals, etc.

6.10 Labour

Labour is the second factor of production. It is called the physical and mental human effort which helps one to earn livelihood. Labour is not only a factor of production but it is also the reason why economic activity takes place. The people who take part in production are also consumers. The sum of consumers demand provides businessperson with the incentive to undertake production. So, labour is considered to be special. It is important to note that it is the services of labour which are bought and sold, and not labour itself.

Importance of Labour

Labour is very important in production.

(1) Labour is an active factor of production without which the presence of land becomes meaningless. Productive capacity of land is evident from the efforts of labour.

(2) All the goods used are fruits of labour. From necessities of life to luxuries items all are the result of human effort.

(3) Increase in national income of industrial countries, like Great Britain, Japan, America, is due to the labour of workers.

(4) In agricultural countries, like Pakistan, India, and Bangladesh, Agricultural production is due to the labour of workers.

6.11 Capital

It is a man made resource. It is used in the production of other goods and services. In the words of Chapman, **"Capital is the wealth which yields an income or aids in the production of an income or is intended to do so"**.

Adam smith states that "**capital is that part of a person's wealth, which further helps in producing income.**" Thus, it is evident that capital is that part of wealth, which helps in producing additional income.

Importance of Capital

(1) Capital is as much important as any other factor of production. Without capital other economic resources cannot be utilized.

(2) Capital is an essential input in big firms.

(3) Larger amount of capital increases the efficiency of the firms.

(4) Modern equipment and advance machinery increases production and rapid economic development is possible.

(5) A greater use of capital increases the pace of agriculture and industrial development.

(6) Capital helps in payment of wages.

(7) Firms try their best to increase their sales through advertisement that is possible only with the help of capital.

6.12 Entrepreneur

It is the term used to denote the organizing factor in production. The entrepreneur organizes land, labour and capital to produce goods. The entrepreneur not only earns profit for himself but he also makes payments to other factors of production. Risks are present in almost every business so sometimes he has to face the losses also.

According to Professor Newin, "Entrepreneur is a person who makes an organized link with land, labour and capital and decides about the number of units of each factor of production to be used and what goods to be produced."

In the words of Stonier and Hague, **"The difference between the entrepreneur and other factors of production is that land, labour and capital can be hired but the entrepreneur cannot be hired."**

Importance of an Entrepreneur

(1) The entrepreneur decides what, where, how and for whom to be produced.

(2) The entrepreneur can combine factors of production without which a good cannot be produced.

(3) Good management of the entrepreneur helps to utilize country's resources most efficiently.

(4) A capable entrepreneur not only increases his profit by optimum combination of factors of production but also plays an important role in economic development of his country.

(5) The entrepreneur helps in wealth distribution. He distributes the share of income to land, labour and capital according to the agreement.

(6) The entrepreneur keeps seeking new ways of production with advanced technology. This helps him to keep cost of production as minimum as possible so as to increase his profits.

Exercise

Q.1 Each question has four possible answers, Tick (✓) the best answer.

1. The duty of a market is not
   (a) To make exchange of goods and services possible
   (b) To contact buyers and sellers
   (c) To determine price
   (d) To give maximum output
2. Which of the following is not a factor of production?
   (a) land (b) labour
   (c) capital (d) output
3. Kinds of market according to competition are
   (a) four (b) six
   (c) two (d) three
4. It is not a characteristic of perfect competition that
   (a) Large number of sellers
   (b) Homogeneity of goods
   (c) Mobility of factors of production
   (d) Price of the same commodity is different

Q.2 Complete the following statements by filling in the missing words or phrases.

1. In the long run land becomes a ____________ factor.
2. Supply curve of daily market is ___________________.
3. All factors of production become variable in the ___________.
4. In the long run with an increase in ______ price settles at normal level.
5. Capital is that part of a person's wealth which helps in producing more _____________ .

Q.3 Match the statement in column A with statement in column B; choose the best answer to write in column C.

A	B	C
In imperfect market	Price changes daily	
In long run market	Prices of goods are different	
In daily market	Land is a variable factor of production	
In perfect market	There is a rule of one price	
In short run market	Land is a fixed factor of production	

Q.4 Answer the following questions in three sentences.

1. What does land mean?
2. What does labour mean?
3. What does capital mean?
4. What does organization mean?
5. Why does price change in daily market?

Q.5 Answer the following questions in detail.

1. What does a market mean? Give kinds of market with regard to the nature of competition.
2. Explain the difference between perfect and imperfect markets.
3. Explain the characteristics of short and long period markets.
4. Write a note on importance of factors of production.
5. Explain the role of capital in production.

Chapter 7

ECONOMIC PROBLEMS OF PAKISTAN AND THEIR REMEDIAL MEASURES

7.1 Poverty

Poverty is the major basic economic problem of Pakistan. In any country, poverty depends upon two factors:

a. Average level of national income

b. Degree of distribution of income

Poverty is inversely proportional to the level of national income; it means lower the national income, higher shall be the level of poverty. Similarly, poverty increases with rise in inequal distribution of wealth or concentration of wealth in fewer hands. There are many dimensions of poverty in Pakistan. Poor people in Pakistan do not have access, even, to basic necessities of life. Majority of people have low or less access basic facilities like education, healthcare, clean drinking water and proper sanitation. The situation is worse in rural areas than in the urban localities.

7.2 Causes of poverty in Pakistan

Some major reasons of poverty in Pakistan are:

1. Unemployment

There are limited employment opportunities in Pakistan and only a handful number of people get employment. According to Economic Survey of Pakistan 2021-22 , unemployment in Pakistan has reached to 5.9 %.

2. Low Productivity

Productivity of various sectors has been quite low in Pakistan. Due to low productivity, GNP growth rate of Pakistan decreased to 5.5% in 2001-02 during 1980's. Pakistan's GNP has gone up to 6.7% according to Pakistan Economic Survey of Pakistan 2006-07 but according to Economic Survey 2021-22 this ratio has reduced to 5.88%.

3. Low Per Capita Income

Per capita income is very low in Pakistan. Its main causes include high population growth and low productivity. According to Pakistan Economic Survey 2003-4, per capita income in Pakistan was 1051 US Dollar which has now been increased to1658.36US Dollar in 2021-22. However, it is still very low as compared to other countries.

4. Unequal Distribution of Wealth

In Pakistan, the poor is becoming poorer, while wealthy class is accumulating more wealth. It means that a handful class of people pockets major share in the national income while the poor get only a very small portion of it.

5. Poor Health

People in Pakistan lack basic health facilities. It adversely affects their productive capacity and efficiency.

7.3 Remedial Measures

Following steps are needed to address the grave problem of poverty in Pakistan:

1. Effective and efficient use of all available natural, human and capital resources should be made.
2. Better medical and healthcare facilities should be provided to the people for their physical and mental health. It shall ultimately increase people's capabilities.
3. Increase in production capacity raises level of national income which is a key to improve standard of living of the people. Therefore, necessary steps should be taken to increase per acre yield in the field of agriculture.
4. Well coordinated development plans should be implemented for promoting social wellbeing, providing employment opportunities and developing manpower. The plan should be made so as to provide equal opportunities to all segments of the society for a balanced economic growth.
5. Government should make policies based on public-private partnership so that maximum number of people may be benefited. Such policies shall disseminate fruits of progress to the common man.

7.4 Illiteracy

Education is a basic element for continuous and sustainable economic development of any country. Unfortunately, education facilities in our country are very little. Education occupies a lower priority in our budget and only 2.2% of our GDP is spent on it. It is quite inadequate as compared to our fast growing population. It is the main cause that literacy percentage in our country hardly reached to 58.9% in 2021-22.

1. Access to schools is very limited, especially in rural areas. Quality of education, where it is available, is very poor.
2. Slow economic growth and increase in poverty resulted decrease in enrollment in educational institutions, especially at primary level.
3. Drop-out/withdrawal ratio at educational institutes, especially at primary level, has increased due to rise in poverty.
4. Education to female population is neglected especially in rural areas, which affects overall level of education in the country.

7.5 Remedial Measures of Illiteracy

1. Access to education should be made easy, especially in rural localities.
2. Education should be given status of an industry and be provided with all such facilities that are given to other industries.
3. Government should provide lucrative incentives to the private education sector to promote investment in education.
4. Share of education in budget should be raised to at least 4% of GNP, according to the UNESCO guidelines.
5. Efforts should be made to lower poverty level and increase per capita income. It is necessary to improve literacy level in the country.
6. Curriculum/syllabus should be constantly reviewed to keep it updated on modern lines, modified to local environment. Practical aspect of real life should also be made part of study material.
7. Teaching should be administered on modern and interesting techniques and methods, such as use of audio/video equipment etc. Boring and old teaching methods should be done away with. Teaching faculty should be educated to make education interesting, especially for the beginners.
8. Female education should be promoted, since it means educating the whole family.

7.6 Agricultural Backwardness

Agriculture is backbone of Pakistan's economy. It contributes 19.1% to the national income. Majority of the population of the country depends on agriculture to earn livelihood. However, this important segment of economy could not, unfortunately mode progress.

7.7 Causes of agricultural backwardness

Some reasons for its backwardness are as under:

1. Low Income of Farmers

Due to low income level, farmers could not afford improved seed, quality fertilizer and modern agricultural implements/technology, necessary to increase agricultural production.

2. Water Logging and Salinity

According to an estimate, almost 17% of land is affected by water logging and 33% by salinity. This has rendered about one fifth (20%) of our agricultural land useless.

3. Inadequate Irrigation Facilities

There was a time when Pakistan's irrigation system used to be referred to as the best in the world. However, it has become less efficient and water losses have increased with the passage of time. It causes water shortage at the time of need. It is one major cause of low per acre yield of agriculture produce.

4. Primitive Methods of Cultivation

Majority of our farmers are either not conversant with the modern agriculture technology/methods or not able to efficiently make use of it due to lack of proper information, education and training. It causes underutilization of production capacity of the land and therefore per care yield remains low.

5. Market Imperfection

Due to imperfect markets, majority of farmers can not sell their produce at proper price and earn less income than they could get under perfect market conditions. Therefore, their income remains low. It affects farmers' capacity for optimum utilization of land for maximizing production.

6. Lack of Agricultural Research

Agriculture sector of Pakistan lacks adequate research and development facilities. Farmers do not use seeds which are the best according to nature of land and weather conditions. Normally, farmers use seed from previous crop and therefore production level remains low. The World Bank has recommended that Pakistan should spend at least 2.0% of GDP approximately on agricultural research and development activities.

7. Defective Land Tenure System

Pakistan inherited feudal system that permits a person to hold as much land as he desires. Thousands of acres of land are owned by a few landlords who do not care for their lands/tenants. The Government introduced land reforms in 1959, 1972 and 1977 to do away with the feudal system but could not succeed.

8. Illiteracy and Poor Health

Normally, farmers are too poor to get necessary education and training in their field of agriculture. Further, most of the farmers lack strong physical health that is basic requirement for agricultural activities.

7.8 Remedial Measures for Agricultural Backwardness

Following measures can reduce agricultural backwardness of our country:

1. Per Acre Yield

Modern agricultural technology and methods should be introduced to enhance per acre production. It shall increase income level of farmers enabling them to procure modern agriculture tools and implements. Increased income level shall improve farmers' standard of living.

2. Improving Irrigation Facilities

Irrigation facilities in many parts of Pakistan are very inadequate. Government should improve irrigation facilities by installing new tube wells, making new canal/water courses and brick-lining existing canal/water courses to reduce water losses.

3. Supply of Seed and Fertilizers

The Government should make plan for timely provision of adequate quantity of quality seed and necessary fertilizers. It shall bring about a positive change in agricultural production.

4. Improved Canal System

Pakistan's canal system though termed as the best in the world, needs a lot of improvements for optimum utilization of insufficient water resources and reduce water losses. Per acre yield could be increased by ensuring timely supply of adequate irrigation water. It shall also mitigate adverse effect of lack of rains in arid areas.

5. Further Agricultural Reforms

It is a proved fact that farmers with small/economical lands-holdings work harder than big landlords owing hundreds/thousands of acres. Therefore distributing unutilized/underutilized agricultural land of big landlords to landless farmers may give boost to agriculture production in the country. Therefore, the Government should effectively introduce land reforms to divide big agriculture lands-holdings among small or landless farmers.

6. Soil Erosion

Soil erosion means damages to fertile soil/land due to floods and severe wind/rain storms etc. Soil erosion could be checked by increasing area under forests. Pakistan has forest on its 5.02% area which is much less than requires.

7. Agricultural Mechanization

Introduction of mechanization in agriculture is very much important to improve its productivity. The Government should give special attention for arranging agricultural loans for the farmers to purchase of necessary agricultural machinery and implements.

8. Agricultural Credit

Majority of farmers in Pakistan are not able to purchase seeds, fertilizers and pesticides etc, due to financial problems. Provision of financial facilities to farmers shall enable the community for timely meeting his agricultural needs.

9. Agricultural Research

Agricultural research and development plays a pivotal role in increasing agricultural productivity. The Government has established agricultural research institutes at Faisalabad, Peshawar and Jamshoro. Pakistan needs more agricultural research organizations to provide research based facilities to the farmers.

10. Development of Agro-based Industry

Agro-based industries include forests, live-stock, dairy, poultry and fisheries etc. Due to insufficient agro-based industrial setup in the country, much of the agricultural produce is either used in least desired ways or is wasted. Therefore, agro-based industries should be established in rural areas for optimum utilization of agricultural products.

7.9 Industrial Backwardness

At the time of independence in 1947, there were only a few industrial units in Pakistan. Industrialization has, however, developed a lot in subsequent years and has been the second largest sector of the economy of Pakistan, with a share of 21.02% in GDP. Industrialization brings prosperity in any country through increase in employment opportunities and in national income. It also helps in improving balance of payment and bringing economic stability in the country.

7.10 Causes of Industrial Backwardness

Our country is an under-developed country. There are many reasons for it, which include the following:

1. Shortage of Capital

Level of savings in our country is very low due to low level of income. It is the main cause of shortage of capital, since capital formation depends on level of national savings.

2. Lack of Information and Technology

Cost of production is high in Pakistan because investors/industrialists are not fully aware of modern production techniques and latest research in their respective fields. For this reason, they are not able to make optimum utilization of available resources to improve quality of production at lesser cost. Less production at higher cost in Pakistan is a result of underutilization and inefficient utilization of available resources. This factor lessens profit margins and increases distress in business community.

3. Lack of Skilled Labour

Size of skilled labour force is very small in Pakistan. Unskilled and untrained labour increases cost more than increasing earnings of an organization. It reduces profit margins and increases worries and difficulties of investors, who do not make new investments and even withdrew already invested capital.

4. Deficient Infrastructure

Pakistan lacks basic infrastructure necessary to promote investment and industrial activities in the country. These basic infrastructure facilities include roads, telecommunication, ports, airports, railways, waste disposal, water, requires energy like electric power, gas etc, sanitation and services/facilities etc. Easy availability of efficient infrastructure facilities and services is very important for flourishing industrial sector.

5. Shortage of Foreign Exchange

Pakistan is an under developed country and has to import plants, machinery, spare parts, modern technology etc, which need a huge amount in foreign exchange. Pakistan does not have adequate amount of foreign exchange necessary to import the required hardware and services from foreign countries and therefore pace of industrialization is impeded.

6. Nationalization of industries

The Government nationalized a significant portion of industries in 1974, which shattered confidence of industrial/business community. Owners of nationalized industries were not compensated adequately and timely. Therefore, fear of nationalization prevails over investors/industrialists and consequently rate of industrial growth has slowed down very much.

7. Political Instability

Political instability in the country is also a reason for its industrial backwardness. Government's policies frequently change on political basis and there is no coordination or continuation in policies of various governments. It has very adverse effect on industrialization in the country and industrialists prefer to invest in foreign countries, resulting into depletion in foreign exchange reserves of the country. This flight of capital further has slowed down industrial growth in Pakistan.

7.11 Remedial Measures for Industrial Backwardness

1. Increase in Savings and Investments

Capital formation depends upon level of savings in the country. Level of savings is less in Pakistan due to low level of income. The Government should introduce policies to stimulate savings by providing incentives. Increase in savings shall increase capital formation and investment rate shall also rise.

2. Improvement in Education and Training

The Government should provide education and training facilities in various technical and professional disciplines. It should increase strength of educated, skilled and trained workforce to the industries and production shall improve.

3. Improvement in Infrastructure

The Government should give attention to improve means of communication for transportation of raw material and finished goods. Well-thought plans are required to overpower energy shortage for industrial consumers. In this regard, use of alternate and renewable energy sources should be planned and encouraged.

4. Market Expansion

Appropriate plans and projects should be made to expand local and international market of our industrial output. Domestic market could be expanded by increasing purchasing power of the people. Expansion in international market needs improvement in quality and steps for cost reduction, so that our products could compete with other countries. In this way, we can boost sales of our products in the national and international markets.

5. Information and Technology

Like developed industrial countries, Pakistan also needs modern industrial technology and knowledge. Modern technology and methods shall help local industries to improve quality and reduce cost of production. This will not only increase profit margins of industrialists, but also stimulate progress and prosperity in the country.

6. Industrial Advisory Institutions

The Government should set up industrial advisory institutions to guide interested investors. Expatriate Pakistanis should be informed of investment opportunities in the country. They should be given incentives for giving priority for investing in Pakistan. It shall promote industrial development in the country.

7.12 Population Pressure

Pakistan had a population of 32.5 million (three crores and twenty five lacs) at the time of independence in 1947. It has now touched the figure of 207.77 million 20 crore and 77 lacs in 2017-18.

7.13 Negative Impacts of Population Pressure

Adverse effects of population pressure are as under:

1. Population pressure reduces per capita income.
2. Increase in population growth rate badly affects people's health and also creates food shortage.
3. Higher population growth rate increased number of dependents. It also creates unemployment, depresses standard of living of the people and reduces productivity.
4. Rising population growth rate results in increase the number of dependents / children. People are forced to spend more money to provide for basic needs (food, clothing etc.) to their dependents/children. It reduces savings, having negative impact on investment, which ultimately comes to stand-still position.

7.14 Causes of Increase in Population Growth

There are three main reasons for the rise in population growth rate:

i. Decrease in death rate ii. Increase in birth rate

iii. Migration

1. Decrease in Death Rate

Government has given special emphasis to provide basic healthcare facilities to its people. Majority of the population of the country is now getting benefits from these medical facilities, which has reduced mortality rate. In Pakistan, expected average age has gone-up to 66 years. Reduced death rate has also increased population pressure.

2. Increase in Birth Rate

Rise in birth rate directly increases population. Although birth rate has come down, but it is still higher than the available resources.

3. Migration

After Soviet invasion in Afghanistan, Afghan people started migration to Pakistan in 1979 and their number increased to 3.7 million (37 Lacs) by mid-1990.

Migration of rural population to urban areas is on the rise because of limited employment opportunities there. This factor is increasing urban inhabitants, at a great speed. According to an estimate released in 2017-18, 63% people are living in rural areas while 37% in urban areas. People migrating from rural areas are mostly uneducated and unskilled, therefore their income remains low. Since cost of living in urban areas is far more than rural areas, they live in unhealthy and difficult situation.

4. People's Attitude

People believe that children are gift of God and therefore do not go for population planning. Most of the people lack correct information about family planning and think that it is injurious to health and against their religion.

5. Joint Family System

Joint family system reduces stresses and problems due to a large family. It is generally believed that larger family ensures more social gains.

6. Early Marriages

People prefer to get their daughters marry as soon as possible after they attain the age of puberty. This exposes the female population to a longer child bearing period and increased possibilities of a large family size.

7.15 Remedial Measures to Control Population Pressure

1. Female Education

Population growth rate can be brought down by providing education facilities and employment opportunities to our female population.

2. Role of Media

Media can play a positive role by dissemination of correct information regarding family planning and doing away with misconception of the people in this respect. The media should inform the people about personal, social and economic benefits of the family and the nation as a whole.

3. Optimum Use of Resources

Optimum use of available resources increases employment opportunities. It also increases output level at reduced cost. This will not only boost the national income but also provide additional employments to increasing population.

4. Government Efforts

The Government should make serious plans to attract population for family planning. These programmes should be prepared keeping in view our social environment and should be advertised properly.

5. Employment Opportunities

Unemployment is a big challenge for the country. The Government should formulate a comprehensive strategy to reduce unemployment and make serious efforts for its implementation. Since it requires drastic changes in our economic set up, therefore the Government should do all the needful in this respect.

7.16 Per Capita Income

Per Capita Income refers to the income of an individual. It can be determined by dividing total national income by population. People of Pakistan are poor because their per capita income is very low. According to Pakistan Economic Survey 2021-22, per capita income in Pakistan is US $ 1658.36.

Per capita income shows standard of living of the people. It therefore reflects state of economy of any country. An increase in per capita income means that people can obtain more useful services. It decreases poverty and increases standard of living of the people.

7.17 Causes of Low Per Capita Income

Per capita income in Pakistan is less as compared with many other countries due to the following major reasons:

1. Mis-utilization of natural resources

Natural resources are not properly utilized in our country. Agriculture land in Pakistan is suffering from salinity and water-logging. Cultivatable land is being divided into small and economically unsustainable areas. Small farmers have very limited access to agricultural loans. All these factors result in low standard of living of the farmers.

Further, due to various technical, political and financial causes, natural resources such as oil, gas, coal and other minerals, are not fully exploited. It, therefore, fails to completely fulfill our requirement.

2. Increase in population

Increase in population has raised demand for goods and services without corresponding increase in their supply. It is worsening the situations and pushing up the inflation. Government has to allocate majority of its resources to non-productive sectors like law and order etc, rather than giving priority to developmental projects. It is one of the main reasons for downward shift in our investment and productivity. Low per capita income and under-developed economy is the result of these factors.

3. Defective administrative set-up

Non-development expenditures have increased tremendously due to defective administrative set up. Personal gains, bribery, red-tapism, worsening law and order situation and unauthorized use of official resources are some of the chronic issues which have cause irreparable damage to our country. This results in lesser rise in national income as compared to growth in population. It has a consequential effect on lower per capita income.

4. Low productivity

Productive capacity of labourer is below-standard due to various political, social and economic factors. Therefore, productive resources could be used to optimum level. It causes low level of national income due to low productivity, which ultimately reduces per capita income.

5. Low labour force participation rate

There are only 61.04 million working persons out of total population of 207.77 million. Further, 60.1% of this labour belongs to rural area. This is another major cause of low per capita income.

6. Increase in public expenditure

Public expenditures are increasing in Pakistan at a very high speed. This increase is financed through borrowing from local and foreign banks/agencies. It increases debt burden on Pakistan.

7.18 Measures for Increasing Per Capita Income

The following measures are necessary to raise per capita income in Pakistan:

1. Natural resources should be explored and utilized to the optimum level.
2. Better education, training and healthcare facilities should be provided on priority basis.
3. Special attention should be given to mental, physical and technical training.
4. Agriculture should be managed on modern lines by employing latest and modern techniques and implements. Further, agriculture should be given status of the industry.

5. Industrial development should also be given due priority. In this regard, problems and bottle-necks of small, medium and large industries should be settled alike.
6. Well experienced and suitable qualified experts should be deputed to formulate policies and programmes.
7. Unfair and unequal distribution of wealth should be discouraged. All parts of the country should be provided equal participation in development process and schemes.
8. Population growth should be controlled.
9. Administrative set-up and basic infrastructure should be made appropriately efficient.
10. Special attention should be given towards education and health of women which makes over half portion of our population. They should be provided employment opportunities to play their active role in economic development.

Exercise

Q.1: Each statement has four possible answers; tick (✓) the best answer:

1. Life expectancy in Pakistan is:
   a. 61 years b. 66 years
   c. 73 years d. 71 years
2. Per capita income in Pakistan is:
   a. 1200 US $ b. 1658.36 US $
   c. 1561 US $ d. 1100 US $
3. Population growth rate in Pakistan is:
   a. 3.1% b. 2.4%
   c. 4.1% d. 1.1%
4. Contribution of agriculture sector to GDP is:
   a. 70% b. 19%
   c. 65% d. 35%
5. Total population of Pakistan, in 2021-22 , was:
   a. 170.69 million b. 231.4 million
   c. 165.93 million d. 150.36 million

Q. 2: Complete the following statements by filling in the missing words or phrases:

1. Pakistan is an .... country.
2. Per capital income is ....income.
3. Pakistan spends only .... % of its GNP on education.

4. .... % of our total population lives in rural areas.
5. .... % of our Pakistan's total area is suffering from salinity and water logging.

Q. 3: Match the statement in column A with statement in column B; choose the best answer to write in column C:

A	B	C
Agriculture sector's contribution to GDP is	58.9%	
Share of industrial sector in GDP is	21%	
Rate of population growth is	19%	
In 2021-22, literacy rate was	2.4%	
Share of expenditure on education in total national income is	2.2%	

Q. 4: Answer the following questions in three sentences:

1. What is meant by per capita income?
2. Write down three reasons of population growth?

Q. 5: Answer the following questions in detail:

1. What are the problems being faced by agriculture sector in Pakistan?
2. Write down a detail note on 'Industrial Backwardness'?
3. Explain reasons of illiteracy in Pakistan. Also give remedial measures to address this problem?
4. What are the reasons for population growth in Pakistan?
5. Give suggestions to control population growth rate?
6. Write down in detail causes of low per capita income in Pakistan?

PART - II

Chapter 8

BASIC CONCEPTS OF NATIONAL INCOME

8.1 Meaning of National Income

It is necessary to describe the meaning of income before understanding the concept of national income.

A reward or earnings that a person receives as a result of his mental or physical efforts is called income. A nation earns its income with the help of four important resources are called factors of production. These factors of production are land, labour, capital and entrepreneur. National income includes payments made to all these factors of production in form of rent, wages, interest and profit. Factors of production receive payments by producing goods and services; therefore money value of goods and services is also called national income.

8.2 Definition of National Income

As stated earlier, national income is the "total income which is earned by the individuals or four factors of production (land, labour, capital and organization) for producing goods and services in a year. Prominent economists have defined national income in their own way. We shall study here definitions offered by two famous economists, Alfred Marshall and Paul A. Samuelson.

According to Alfred Marshall, "**the labour and capital of a country acting on its natural resources produce annually a certain 'net' aggregate of commodities (material and immaterial) including all kinds of services. This net aggregate is called national income**".

In other words, Alfred Marshall describes national income as the money value of all goods and services produced by four factors during a particular year. Examples of goods produced are cereals, machinery, petroleum products and metals whereas services are performed by professionals like doctors, engineers, lawyers, clerks and accountants etc.

According to Paul A. Samuelson, **"The nominal value (face value) of all goods and services produced in a country during the course of one year is known as national income"**.

According to the definition of Paul A. Samuelson, certain points should be kept in mind when determining national income; firstly: national income is the nominal flow of goods and services produced in the country during the course of one year; secondly: national income can only be determined in the form of money value because it is difficult to express it in any other form or measuring units.

8.3 Various Concepts of National Income

National income has further been classified into following categories:

1.	Gross Domestic Product	(GDP)
2.	Gross National Product	(GNP)
3.	Net National Product	(NNP)
4.	National Income	(NI)
5.	Personal Income	(PI)
6.	Disposable Personal Income	(DPI)

(1) Gross Domestic Product (GDP)

'Gross Domestic Product' (GDP) measures the output by factors of production located in domestic economy regardless who owns the factors.

For example, incomes of all persons working in a multinational company (Say, Pak Suzuki Motor Company Limited) set up within geographical boundaries of Pakistan shall be included in the country's gross domestic product. It may be noted that income of all persons, whether Pakistanis or foreign nationals, in return for rendering services in Pakistan shall be included in Pakistan's gross domestic product. Similarly, income earned by Pakistanis working in other countries shall not be included in Pakistan's gross domestic product even if they remit money to their homeland. It is because services to earn such income have not been provided within Pakistan's geographical boundaries. Such income shall, however, be included in the gross domestic product of the country where Pakistanis have provided their services.

Therefore, gross domestic product (GDP) is the **'total market value of all final good and services produced within the country in one year'.**

(2) Gross National Product (GNP)

'Total market value of all final goods and services produced by the people of a country, whether within geographical boundaries of the country or otherwise, in one year is called Gross National Product (GNP).

People of a country use their natural and capital resources to produce goods in form of agriculture produce (for example: cereals, vegetables and fruits etc.), mineral exploration (for example: petroleum, iron and copper etc.), industrial outputs (for example: machinery, cement and sugar etc.) and services rendered (for example: lawyers, doctors and accountants etc.). We can find gross national product of a country by adding values of goods produced and services rendered by the people during a year within and without geographical boundaries of the country.

According to Professor Stanley Fischer, **Gross National Product measures the sum of money value of goods and services produced by productive resources of a country during certain period of time**.

Gross national product (GNP) is a term different from gross domestic product (GDP) with respect to inclusion of services provided in other countries. In GNP, remittances/services by persons in foreign countries are included whereas GDP excludes such portion of income and restrict itself to income earned by people within geographical limits of the country. Numerically, GNP can be expressed as:

GNP = GDP + Remittances sent to homeland by citizens serving abroad – Remittances sent out of the country by foreign national serving in the country

Following precautions are necessary for correct computation of GNP:

i. All goods and services should be counted once in any given year. To avoid risk of multiple counting, market value of final goods should be taken. For example, market value of shirt (final product) should be included instead of including market value of cotton, yarn or cloth used in making the final product.

ii. Market value of all goods and services produced in a country in the current year only should be included

iii. Remittances/income by citizens serving abroad should be included in GNP while remittances sent out of country by foreign nationals serving in the country should be excluded.

(3) Net National Product (NNP)

A number of plants, machinery, tools and equipments etc. are used in the manufacturing process to produce goods. These Capital Resources etc. depreciate with the passage of time due to usage and wear and tear. Money is spent to keep them in perfect operating condition so that production of goods is not disturbed. The amount spent for repair and maintenance of plant/machinery etc is called capital consumption allowance (CCA) or depreciation allowance.

If we deduct capital consumption/depreciation allowance (expenditure on maintenance of production plant/equipment etc) from gross national product, we can get net national product. Following equation shows relationship between net national product and gross national product:

NNP = GNP – Depreciation/capital consumption allowance

(4) National Income (NI)

National income is the total amount earned by all factors of production, in a year, for their services. The income of factors of production is in form of rent (from land), wages (from labour), interest (from capital) and profit (from organization).

National income can be computed at factor cost basis, by deducting all indirect taxes (excise/custom duty etc) from NNP and adding subsidies to it. Relationship between NNP and NI is explained by the following equation:

National Income = NNP – Indirect taxes + Subsidies

(5) Personal Income (PI)

Personal income is aggregate of all incomes actually received by all individuals and households during one year. It is a point to be noted that national income is always greater than personal income because certain deductions are required to be made from national income to determine personal income because all income earned by individuals is not distributed among them.

Following deductions are made from national income to arrive at personal income:

i. Undistributed profits of joint stock companies
ii. Social security and other compulsory welfare contributions
iii. Taxes and other levies on profits of joint stock companies

Some individuals and households receive transfer payments which they have not earned currently; for example unemployment allowance, old-age pension and relief aid etc. Such transfer receipts are, however, included in personal income. Personal income can be put in the form of an equation in the following way:

PI = NI – Corporate taxes – Undistributed profits – Social Security contributions + Transfer payments

(6) Disposable Personal Income (DPI)

Disposable personal income is the income which is available with an individual after payment of all taxes and levies, such as income tax, property taxes etc. A portion of the income left with an individual, after payment of taxes, is consumed and a part of it is saved. In form of equation, disposable personal income can be expressed as:

a. Disposable Personal income = PI – Direct taxes
b. Disposable Personal Income = Personal Consumption + Personal Saving

Illustration Explaining Various Concepts of National Income (With hypothetical figures)

Sr. No.	Description		Money Value Billion Rs.*
1.	Gross Domestic Product – GDP		900
	Add: Remittances received from abroad	+	60
2.	Gross National Product – GNP	=	960
	Less: Depreciation/Capital Consumption Allowance	–	20
3.	Net National Product – NNP	=	940
	Add: Subsidies by the government	+	5
	Less: Indirect Taxes and Levies	–	10
4.	National Income [at factor cost basis] – NI	=	935
	Add: Transfer Payments	+	20
	Less: Undistributed profits	–	20
	Less: Taxes/Levies on Corporate Profit	–	15
	Less: Compulsory Social Security/ Welfare Contributions	–	10
5.	Personal Income – PI	=	910
	Less: Direct Taxes	–	10
6.	Disposable Personal Income – DPI	=	900
	Less: Personal Consumption/Expenditure	–	850
7.	Personal/Private Savings	=	50

(*) Money value is hypothetical.

8.4 Per Capita Income

Per capita income of a person means the income which one gets in a year. Per capita income in an economy can be arrived at by dividing national income (NI) by the population of that country, as under:

$$\text{Per Capita Income} = \frac{\text{National Income}}{\text{Total Population}}$$

According to figures reported in Pakistan's Economic Survey 2021-22, its per capita income stands at US Dollars 1658.36.

Per capita income of a country not only represents standard of living of its people but also helps to measure economic development of that country as compared to other countries. High per capita income of a country means high standard of living of the people of that country. Consequently, people of that country enjoy the benefits of comforts of life.

Conversely, countries with low per capita income do not have all comforts of life and even may not have full access to basic necessities of life such as clean/safe drinking water, education and medical care etc.

8.5 Consumption of Wealth

Consumption of wealth plays an important role in all economic activities in a country. In terms of Economics, it means that portion of a person's income which he spends on consumers goods to get direct satisfaction.

Consumption of wealth depends upon levels of income of the people. A rise in income level increases consumption of wealth. In other words, consumption is a function of income. Following equation expresses relationship between income and consumption:

$$C = f(Y)$$

C is consumption and Y is income.

The above equation shows that a change in income brings about a change in consumption. This functional relationship between income and consumption is positive in its nature. An increase in income increases consumption and decrease in income decreases consumption.

Consumption patterns are of two types:

(i) Autonomous Consumption

Consumption which is independent of level of income is called autonomous consumption. These expenditure may continue even at zero income level.

(ii) Induced Consumption

Consumption which varies with change in income level is called induced consumption. It increases with increase in income and decreases with decrease in income.

8.6 Savings

Positive difference between income and consumption level is called saving. For example, if a person earns Rupees 10,000 and consumes Rupees 9,000, his saving would be Rupees1,000.

Savings plays a very significant role in economic development of a country. High ratio of saving encourages investment in a country. Volume of savings depends upon two major factors:

i. Power to save   ii. Will to save

As, in case of consumption, rate of saving also depends upon level of income. There is an increasing functional relationship between income and saving. It increases with rise in income and declines with fall in income. This relationship can be expressed as:

$$S = f(Y)$$

S is saving and Y is income.

8.7 Investment

Investment plays an important role in economic development of an economy. Increase in volume of investment will raise level of national income. It should be borne in mind that investment depends on the rate of savings. Higher savings rate means increased volume of investment. More investment will, in turn, boost national production and consequently per capita income will rise. Investment results in formation of new sources of production which adds to national capital assets.

For example, purchase/construction of a new building for renting out or setting up a factory is an investment whereas purchase of an old house or factory will not be included in the term 'investment'. Investment can be divided into following two types:

(i) Autonomous Investment

Investment which is not dependent on level of income is called autonomous investment. Examples of investment falling under this category are expenditures on construction of dams, roads, healthcare/education facilities and public utilities.

(ii) Induced Investment

Investment which responds to any change in level of national investment is called induced investment. Such investment increases with increase in income level and decreases with decline in income.

To clearly understand the above two types of investment, consider example of Pak Suzuki Motor Company Limited which was the first car manufacturing plant in Pakistan. However, with afterward increase in income level of the people raised demand for cars in Pakistan. This rise in demand encouraged not only Pak Suzuki Motor Company Limited to set up additional production facilities to satisfy increasing demand but also attracted other car manufacturers (Toyota, Honda and Hyundai) to establish factories in Pakistan. In this case, investment made to set up first plant in Pakistan comes under the category of 'autonomous' whereas subsequent investment in additional/new plants to satisfy rising demand of cars is classified as 'Induced'.

Exercise

Q.1 Each statement has four possible answers. Tick (✓) the best one:

1. Basically, national income is the sum of:
    - a. Money value of goods and services
    - b. Country's national resources
    - c. Income from government taxes
    - d. Value of industrial and agricultural goods
2. Which one of the following is called per capita income:
    - a. Annual income per person
    - b. Annual income per family
    - c. Monthly income per family
    - d. Monthly income per person
3. What is deducted from gross national product to get net national product:
    - a. Indirect taxes
    - b. Government subsidies
    - c. Depreciation allowances
    - d. Transfer payments
4. Which of the following is not related to disposable personal income?
    - a. Income received from scholarships
    - b. Zakat payments
    - c. Income received from gifts
    - d. Total Income of a clerk
5. In any country, investment depends upon:
    - a. Weather conditions
    - b. Business conditions
    - c. National savings
    - d. Consumption

Q. 2 Complete the following statements by filling in the missing words or phrases:

1. Per capita income is derived from dividing national income by ....
2. Total income of factors of production is always equal to the .... of goods and services.
3. .... income of a country represents standard of living of its people.
4. Unemployed and needy person gets .... from government without rendering any service.
5. The amount spent for repair and maintenance of plant and machinery is called ....

Q. 3 Match the statement in column A with statement in column B; choose the best answer to write in column C:

A	B	C
Reward of physical and mental labour is	Government allowances	
Per capita income is equal to	Zakat and gifts etc	
Subsidies are	Income	
Transfer payments are	Total National Income / total population	
Services without payments like	Ironing one's own clothes	

Q. 4 Answer the following questions in three sentences:

1. What does personal income mean?
2. What is difference between gross domestic product and gross national product?
3. What does net national product mean?
4. What is difference between income and transfer payments?
5. What does disposable personal income mean?

Q. 5 Answer the following questions in detail:

1. Define and explain concept of national income.

2. Explain various concepts of national income.
3. What is meant by per capita income? Also explain economic significance of transfer payments and depreciation allowances.
4. Explain the following economic concepts and establish relationship between them with the help of examples:

   a. Consumption b. Savings c. Investment

Chapter 9

MONEY

9.1 Barter System

History tells us that money did not exist in early days of economic evolution and there was no measure to be used as money which could be acceptable to all. Thus, in the beginning, people used to exchange goods for goods to fulfill their needs/wants. This practice 'of direct exchange of goods with goods, without usage of a measurable medium' is termed as barter system. It can, therefore, be defined as, **"Barter system means the direct exchange of one good for another, without using money as a medium of exchange".**

Before advent of money, human civilization was simple, but backward. The people used to satisfy their wants by exchange of their surplus goods with each other. For example, a farmer would exchange his agriculture produce with a weaver for cloth woven by him and for foot-ware made by a cobbler.

With the evolution of human civilization, human needs/wants kept on increasing and it was realized that exchange through barter was not satisfactory. Use of barter system declined due to its inherent difficulties and lost its position as the only medium of exchange.

Difficulties of Barter System

1. Lack of Double Coincidence of Wants

The major problem faced in the barter system was absence of corresponding demand of goods to be exchanged between people. One has to find a person who could exchange his goods with the goods he required. For example, if Mr. A has cloth and want wheat for his family, he will have to find out a person who has surplus wheat and at the same time would need cloth. Mr. A shall have to face a number of difficulties in finding a person who would be ready to exchange cloth for wheat. It is because he might find a person having surplus wheat, the other person might not be ready to exchange it with cloth because he did not need it but is ready to exchange it for ghee. Therefore, barter system simply failed due to lack of double coincidence of wants for exchange of goods.

2. Lack of Common Measure of Value

Under the barter system, there was no common yardstick to measure value of various goods. For example, if two persons are ready to exchange their goods, there rises an issue as to what quantity of one item shall be exchanged with how much volume of other item. For more clear understanding of the issue, consider that Mr. X has wheat and Mr. Y has a cow and they both agree to exchange their goods with each other. Now, an issue rises that how much wheat has to be given by Mr. X to have the cow. It is quite possible that Mr. Y wants more wheat to exchange his cow that Mr. X is ready to offer. Under these circumstances, transaction could not be completed due to lack of some common measure to determine value of goods, even after having double coincidence of wants.

3. Difficulty in Store of Value

During the barter system era, goods could not be stored since majority of those were perishable and could not be stored for a long time. For example, agricultural produce, vegetables, fruits and milk etc. Such commodities were always exposed to risks of losses because of lack of proper storage facilities. It was also one of the major reasons because of which barter system lost its importance and people ultimately discarded it.

4. Indivisibility of Goods

Indivisibility of certain commodities was another important difficulty in barter system. Exchange of such goods was a problematic task for the people. For example, if a person has a horse and wanted to buy a pair of shoes, he will either have to exchange his horse for it or live without having a foot-ware. Therefore, people have to face difficulties in easy and smooth exchange of goods.

5. Difficulty in Collection of Government Revenue

In the absence of a common currency, the Government has to receive/accept its revenue in the form of goods. Therefore, the Government treasury was in the form of commodities including perishable items. Due to lack of proper storage arrangements/facilities, the Government has to face loss even after collection of its revenue. Further, the Government has to face severe difficulties while remunerating its employees in the form of goods.

6. Problem in Transfer of Wealth

In barter economy, the people used to have their wealth/capital in the form of goods, which could not be easily transferable from one place to another. For instance, if a person wanted to migrate from a city to another by selling his property, he will receive sale proceeds of his property in shape of animals, agricultural produce etc, which he could not easily shift to his new place of residence. It was due to such innumerable shortcomings of barter system that it failed miserably.

9.2 Evolution of Money

Failure of barter system, due to its inherent difficulties, was the mother of money. Various goods were tried at various times as money. These include skins/hides, animals, stones, metals etc. However, all these items have some serious shortcomings that none of these items could survive as acceptable mode of money for a long period of time. At last, paper money was put into practice which may be called very important invention of modern economy. It not only resolved all problems faced under barter economic system, but also helped the economy to progress and prosperity. Modern monetary system has fostered the commercial activities and strengthened the economy.

9.3 Definition of Money

In the world of today, no country can progress without having a price system. Fluctuation in prices affects all segments of an economy. Money is an excellent expression to describe change in prices. Money is as important for our economy as is blood for our body. The whole economic system will collapse without circulation of money. It is very much similar to what will happen to our body if there is no blood circulation.

Hence, it is very important to define money comprehensively. Various economists have defined it in their own words. Definitions of money by some eminent economists are as under:

Professor Walker states, **'Money is what money does'**. It means that anything that performs the function of money is money. In the words of J.M. Keynes, **'Money is that by delivery of which debt and price contracts are discharged'**. According to Professor Morgan, '**Money is anything that is generally used in the payment of debts**'.

A better definition of money is given by Geoffrey Crowther, renowned British economic expert as **'Anything that is generally acceptable as a medium of exchange and that at the same time acts as a measure and store of value'**. A more careful examination of this definition reveals that anything acting as money should have the following properties:

1. It should have general acceptability as a general medium of exchange.
2. It should act as a measure of value to exchange goods.
3. It should work as unit of account, so that the prices of goods may be measured by it. For instance, Rupees is unit of account in Pakistan.
4. it should work as store of value. It should make it possible to store and preserve wealth in form of medium of exchange.

9.4 Functions of Money

Money performs the following important functions:

1. Medium of Exchange

It is the most important function of money. It acts as medium of exchange in the transactions of goods and services. During barter system era, goods were exchanged with goods. This causes very serious inconvenience for the general public due to lack of double coincidence of wants and satisfaction. As a medium of exchange, money cleared all shortcomings of barter system. Now, there is no need for double coincidence of wants because everyone gets money upon selling the products in the market and can buy a commodity by paying money to satisfy his wants. In this way, money has performed its function excellently and it has made economic activities of production, distribution and exchange of wealth quite easy and convenient.

2. Common Measure of Value

Money also acts as a measuring unit to determine value of goods and services. For instance, keeping the prevailing prices in view, we can ascertain that price of one liter of milk is Rupees thirty five. Under barter system, it was very difficult to compare/determine value of various commodities due to absence of a common measure of value. Therefore, under barter system, a person may have to exchange a large quantity of same commodity for exchange of one liter milk. However, money has now removed all such difficulties because we are now in a position to determine real value of any commodity or service with the yard-stick of money.

3. Store of Value

Another important function of money is its ability to store value of our wealth and keeps it intact for a long period of time. Whenever we need to buy some commodity or service, we can do it by paying equivalent sum of money. Contrarily, we could not store value of our goods under barter economy because most of the goods were perishable and lose their value with the passage of time. Money is not a perishable commodity. It is either in the form of metallic coins or currency-notes, which can be stored for a long period of time without having a risk of loss of value.

4. Transfer of Value

Under barter system, people had their wealth in form of goods in large quantities which were not conveniently portable and therefore could not be easily transported from one location to another. Creation of money has solved this problem. Now, one can sell his moveable and immoveable property/belongings at one place and get money. He can easily buy assets at some other location with the help of money he received from previous transaction. The money has, in this way, made transfer of wealth easy and one can conveniently transfer his immoveable assets from one place to the place of his choice.

5. Convenience in Government Revenue Collection and Payments

During the time of barter system, the Government used to collect its revenue in form of goods and make payments to its employees in form of goods. Therefore, the Government had to face a lot of difficulties in collection of revenue and thereafter releasing payments to its employees. Money has done away with this difficulty, too. Now, the Government easily collects its revenue in the form of money and makes payments to its employees in the shape of money.

6. Miscellaneous Functions

Besides, above-stated functions of money, its another important function is to serve as a standard of debts repayments. Now, people use money as a standard measure of deferred payments. It has made lendings and borrowing much easy and less risky. Under barter economic system, lending and borrowings used to be made in the form of goods which were not equal in size, shape and quality. It often caused inconvenience to the concerned parties in entering into debt contracts and afterwards discharge of such contracts. Additionally, money also acts as unit of account to express prices of goods and services to be transacted. During barter system era, there was no measure of value to express price of a commodity or service and therefore, there was no common unit of account to record business transactions.

9.5 Kinds of Money

Followings are the main kinds of money which remained in use at different times of the history:

1. Metallic Money
   a. Standard money or full bodied coins   b. Token money or legal tender
2. Paper Money
   a. Convertible paper money   b. Inconvertible paper money
3. Legal Tender
   a. Limited legal tender   b. Unlimited legal tender
4. Credit Money
5. Near Money

Different kinds of money are explained in the following text:

1. Metallic Money

Coins made of different metals are called metallic money. In the beginning, coins used as money were made of pieces of various precious metals of specific forms and weights. Afterwards, rulers of different states set up mints to make coins. These coins had denominations engraved thereon, along with names and figures of the concerned rulers.

a. Standard Money or Full Bodied Coins

It refers to that type of money that serves as a unit of account in the monetary system of an economy. It means that standard or full-bodied money whose face value is equal to its real value. In other words, representative value of a standard coin is equal to its intrinsic value, which is actual value of the precious metal (gold, silver etc) a coin is made of. Before 1883, coin in practice in undivided sub-continent was a standard coin which used to have an equal face and real value. For example, a silver was coin Rupee coin used to contain silver of equivalent amount in it. However, use of standards abandoned in the world due to limited availability and shortage of precious metals. In current age, no country issues standard coins.

b. Token Money

The metallic money with much higher face value than its real or intrinsic value is termed as token money. For example, coin of Rupee 5 has face value equal to Rupees 5 but its intrinsic value is quite less. It means that the value of metals used in its making is quite less than its representative value. Now-a-days, token coins are used all over the world. However, its proportion as compared to the total money is quite small.

2. Paper Money

It refers to currency notes issued by the Government or by the Central bank of a country. These currency notes have characteristic of general acceptability and no one can refuse to accept it. Therefore, paper money is used as a perfect medium of exchange in all transactions having money value. It has two following categories:

a. **Convertible Paper Money**

It is paper money which could be converted into equal value of silver/gold or foreign exchange on demand of the bearer.

b. **Inconvertible Paper Money**

This type of money is issued by the Government but the central bank does not take responsibility of its conversion into equal value of silver/gold or standard coins etc. So, it is inconvertible paper money which is currently in practice all over the world, including Pakistan.

3. Legal Tender

Legal tender is the type of money which one has to accept under the law in discharge of debts and all other transactions as a medium of exchange. In Pakistan, all coins and currency notes are legal tender and nobody can refuse to accept it, because it is backed by the Government. Legal tender is also called as 'fiat money'. It is of two types:

a. **Limited Legal Tender**

It is a type of money which everybody has to accept legally as mode of payment up to a specific value or limit and one can refuse to accept it if it exceeds already specified limit or value. In Pakistan, all coins of lower denominations come under this category. Government has specified different limits for payment using these coins. One may refuse accepting payment if it exceeds prescribed limits because of inconvenience in counting larger sums.

b. **Unlimited Legal Tender**

It is a type of money which everybody has to accept legally as mode of payment up to any limit. Nobody can refuse accepting unlimited tender for any amount or limit.

One has to accept it in any quantity. In Pakistan all currency notes and coins of higher denominations are unlimited legal tender.

4. Credit Money

Credit money circulates in monetary system on the basis of trust. Credit money includes cheques drawn on banks, hundies, drafts and credit cards etc. Credit money normally circulates among the business communities which enjoys a certain degree of credibility and trust among themselves. It is to be noted that accepting credit money is the sole discretion of the person to whom it is paid. He may or may not accept it as a mode of payment. This is why credit money is also named as 'optional money'. Total money circulation in Pakistan comprises of aggregate of credit money and legal tender.

5. Near Money

It refers to that money which is not in cash and can not be readily acceptable as medium of exchange; for example, bonds, government securities, insurance policies, investment instruments etc. Near money can be easily liquidated into cash. Shares of well established business entities, listed on stock exchange, are also considered as near money because those can easily be sold for cash at any time. Similarly, government securities, postal certificates and gift coupons are types of instruments which are not money but are easily convertible into cash. That is why such instruments are called near money.

9.6 Value of Money

Value of money means its purchasing power which it can realize for instance, if Rupees 30 can be exchanged for one kilogram of sugar; it would mean that value of Rupees 30 is equal to one kilogram of sugar. If price of sugar rises, lesser quantity of sugar could be bought from the same amount of money, which means the value of money (its purchasing power) has reduced. Contrarily, fall in price of sugar means an increase in value of money because same amount of money can purchase more quantity of sugar.

From the above example, we can conclude that there is an inverse relationship between value of money and price level. It means that a rise in price level shall reduce value of money whereas a decrease in price level shall increase value of money. It is to be remembered that there is a direct relationship between supply of money and price level. An increase in money supply increases price level and a fall in supply of money reduces price level. We can conclude from this discussion that an increase in quantity of money causes prices to rise, which ultimately reduces purchasing power (value) of money. Conversely, a contraction in the quantity of money results in fall in prices which causes a rise in purchasing power (value) of money.

The fact can be illustrated with the help of a simple example. Assume that Rupees 100 are issued in a country having 10 items available for buying. It means that price of each item is Rupees 10 because:

$$\text{Price} = \frac{\text{Total quantity of money}}{\text{Total commodities}} = \frac{100}{10} = \text{Rupees } 10$$

Considering the above example, if we double the quantity of money from Rupees 100 to Rupees 200 without changing the availability of commodities, price level shall shoot up to Rupees 20, as under:

$$\text{Price} = \frac{\text{Total quantity of money}}{\text{Total commodities}} = \frac{200}{10} = \text{Rupees } 20$$

It means that if we double the quantity of money without change in supply of goods, prices will be doubled and purchasing power of money will be reduced to half. We could buy goods for Rupees 20, which were previously available for half of the price (Rupees 10). Similarly, if we cut down quantity of money to Rupees 50 from Rupees 100, price of commodities fall down to Rupees 5, provided that there is no change in quantity of goods available for sale:

$$\text{Price} = \frac{\text{Total quantity of money}}{\text{Total commodities}} = \frac{50}{10} = \text{Rupees } 5$$

It is very clear from the above example that if quantity of money is halved, price level is also reduced in the same proportion and value of money is doubled. It means that a commodity which was previously available for Rupees 10 could now be purchased for Rupees 5.

Factors Causing Changes in Value of Money

1. Supply of Money

There is direct relationship between supply of money and price level. An increase in supply of money causes prices to rise and reduces value of money, whereas a decrease in supply of money (quantity of money) reduces price level and increases value of money.

2. Quantity of Production

If quantity of money remains constant, an increase in production brings a reduction in prices and strengthens value of money. On the other hand, a fall in production increases prices and value of money reduces.

3. Circulation of Money

The number of times a certain amount of money is used in buying activity or number of times money changes hands as a mode of payment of prices is termed as velocity of circulation of money or circulation of money. Increase in circulation of money increases price level and value of money decreases. Conversely, decrease in circulation of money causes prices to decrease and value of money gets strength.

4. Population Growth

Price level rises if rate of increase in production of goods, (such as food, shelter and clothing etc) is less than the rate of population growth. According to economists, one of the major causes for increasing prices is rapid increase in population. Due to aforesaid factor, quantity of goods and services falls short of the rising demand of increasing population. It is the main cause of rising prices in Pakistan.

5. Unfavourable Circumstances

Normally demand for goods and services increases in cases of natural calamities or other adversaries like outbreak of diseases, disaster of war, earthquake, floods etc. This was the situation in Pakistan during wars of 1965 and 1971 when prices increased abnormally and value of money took a nosedive.

6. Rate of Tax

In case of rise in rate of taxes, the burden of additional indirect taxes (sales tax, custom duty, excise duty etc.) is passed on to end-consumer. It brings about increase in prices and value of money weakens. However, if Government reduces rate of indirect taxes, prices of goods falls and value of money rises.

7. Foreign Trade

A country has to face unfavorable balance of payments if its exports are lesser than imports. The Government has to impose more taxes to arrange foreign exchange. It directly affects prices with ultimate decrease in value of money. On the other hand, an increase in prices of imported raw material and machinery it also increases prices of domestically produced goods and therefore value of money also reduces. Hence, value of money can only be stabilized by striking a balance in imports and exports.

Exercise

Q. 1: Each statement has four possible options. Tick (✓) the best one:

1. Which of the following is not included in the functions of money?
   - a. Medium of exchange
   - b. Standard of value
   - c. Store of value
   - d. Indivisibility
2. Which of the following economy does not use money as a medium of exchange?
   - a. Open
   - b. Barter
   - c. Islamic
   - d. Close
3. Which authority issues currency notes in Pakistan?
   - a. Commercial banks
   - b. Central bank
   - c. Agriculture bank
   - d. Industrial bank
4. Prices are increased with an increase in quantity of money; how value of money is affected in such cases:
   - a. falls
   - b. rises
   - c. remains constant
   - d. remains normal
5. Which kind of money has to be accepted legally in discharge of debt and routine business transactions?
   - a. Paper money
   - b. Credit money
   - c. Monetary goods
   - d. Near money

Q. 2: Complete the following statements by filling in the missing words or phrases:

1. In ...., goods are exchanged for goods.
2. Money having equal face value and real value is called ....
3. Money consisting of cheques, drafts, hundies and credit cards issued by banks is called ....
4. Money having more face value than its real value is termed as ....
5. Value of money .... with increase in its quantity/supply.

Q. 3: Match the statement in column A with statement in column B; choose the best answer to write it in column C:

A	B	C
Postal certificates	value of money	
Fiat money	is legal tender	
Source of transaction of goods	are near money	
Purchasing power of money means	is medium of exchange	
Easy transfer of wealth means	Easy transfer of the place	

Q. 4: Answer the following questions in three sentences:

1. Explain/Write down important features of G. Crowther's definition of money.
2. What is meant by paper money?
3. Differentiate between convertible and inconvertible paper money.
4. What is meant by value of money?

Q. 5: Answer the following questions in detail:

1. Define barter system. Also state difficulties faced by this system.
2. Define money and describe its important features.
3. Explain functions of money with the help of examples.
4. Describe in detail the following kinds of money with Examples:
   a. Credit money b. Near money c. Paper money
   d. Metallic money e. Token money
5. Explain in detail the factors causing changes in the value of money.

Chapter 10

BANKS

10.1 Definition of Bank

Bank is a financial institution which receives deposits of surplus money and savings of the people on the one hand and lends these funds, on the other hand, to needy persons (businessmen or traders etc.) for their business/personal usage. Bank accepts deposits at interest rate lower than the rate at which funds are lent. Difference in rates of interest to depositors and borrowers is earning of the banks to meet its expenditure and further financial progress.

In simple words, "bank is a financial institution which accepts deposits from people and give loans to needy persons to earn profit". According to Professor G. Crowther, **" A bank deals in lending of money; receives deposits of the people and advances loans to the needy. Since people accept bank's receipts without any objection, hence bank creates credit".**

10.2 Kinds of Banks

1. Central Bank

It is the heart and brain of the whole monetary and banking system of a country. It controls all commercial banks and regulates their activities on a particular path. State Bank of Pakistan is the central bank of Pakistan. Central bank enjoys monopoly to issue currency notes. It controls and stabilizes inflation and financial system by regulating circulation of wealth.

It should be noted that profit-making is a matter of secondary importance for the central bank. Its basic objective is to promote and regulate economic development through various tools such as controlling inflation/stabilizing the value of money, creating favourable conditions to promote savings and encouraging investment friendly atmosphere etc.

2. Commercial Banks

Profit-earning is the main objective of commercial banks. These accept deposits from general public at lower rate of interest and give loans at a higher interest rate, to needy persons like industrialists, traders etc for their business purposes. At present, beside industrial/commercial activities, commercial banks are also advancing loans for a number of other purposes like property purchase, house building/renovation, car purchase and consumer financing.

In Pakistan, commercial banks are functioning with very good professional efficiency. These commercial banks include Muslim Commercial Bank Limited, Allied Bank Limited, United Bank Limited, Habib Bank Limited, Bank Alfalah Limited ,Faysal Bank Limited, Askari Bank, Punjab Bank, City Bank etc.

3. Industrial Banks

This type of banks are set up with the basic objective to industrial development of a country. Industrial banks provide short-term and long-term loans to industrialists for the purchase of industrial plants, machinery, tools, equipment and other industrial needs. Interest rate of industrial banks is comparatively lower than commercial banks. Therefore, industrial development is promoted in the country.

In Pakistan, there are two major institutions in industrial banking. These are Industrial Credit and Investment Corporation (PICIC).

4. Agricultural Banks

Agricultural banks provide loans to farmers for agriculture and related activities. This type of banks play a very important role in the development of agrarian economy. These banks provide short-term and long-term loans to farmers for purchasing of agricultural inputs, such as seeds, fertilizers, pesticides, tube-wells, tractors, harvesters and other tools/equipments. Such banks provide agriculture loans on softer terms and conditions as compared to commercial banks, such as lower interest rate and easy repayment terms. In Pakistan, there is only one such bank which is known as 'Zarai Taraqiati Bank Limited'.

5. Scheduled and Non-Scheduled Banks

Scheduled banks are those which perform their functions strictly according to the rules and regulations set by the central bank. These banks are liable to keep some part of their assets with the central bank to meet its mandatory reserve requirement. In return, central bank helps scheduled banks at critical times. In Pakistan, examples of scheduled banks are National Bank of Pakistan, Bank of Punjab, and First Women Bank Limited etc.

Non-scheduled banks are those banks which are not attached with the central bank and therefore not bound to follow the rules and regulations formed by central bank.

10.3 Functions of Central Bank

Central bank performs the following functions:

1. Currency Issuing Authority

Central bank issues currency notes on behalf of the Government. The currency notes issued by the central bank are the legal tender and are generally acceptable to general public within a country. Pakistan's central bank has issued notes of denomination of Rupees 5, 10, 20, 50, 100, 500, 1000 and 5,000. Public uses currency as a medium of exchange for all economic transactions.

There are the following two systems to regulate the issue of currency:

a. Fixed Fiduciary System

Under this system, the central bank may issue currency up to a certain limit without having reserves (of gold, silver or foreign exchange). In case if the central bank has to issue currency beyond that particular limit, it shall have to keep 100% reserves (of gold, silver or foreign exchange) against this additional issue of currency. It means that currency issued beyond this limit is fully backed by metallic or foreign exchange reserves.

It can not be followed in Pakistan due to its rigidity and inelasticity because this system restricts government's ability to issue currency according to its financial requirements if it does not have reserves to back up the issue of additional currency.

b. Proportional Reserve System

Under this system, the central bank issues currency which is backed by a certain percentage of proportion of reserves. The government decides this percentage or proportion which is different in different countries. Pakistan follows this system and Government of Pakistan has fixed this proportion at 33%, which means that State Bank of Pakistan (the central bank) has to maintain reserves (gold, silver or foreign exchange) equivalent to 33% of the issue of currency

This varition in reserve percentage makes this system easily manageable because the government can control money supply by adjusting reserve ratio, keeping in view requirements of the economy.

2. Banker to the State

Central bank performs all those functions for the government which commercial banks perform for general public.

Central bank is called banker to the government because it acts as economic advisor to the government, besides performing following banking functions for the government:

- i). It advances long-term loans to the government for completion of development of projects.
- ii). It collects revenues and makes payments on behalf of government.
- iii). It collects loans from internal and external resources, on behalf of the government.
- iv). It controls and manages foreign exchange and balance of payments.
- v). It acts as financial advisor to the government. It advises government on all financial matters such as change in value of money, managing deficit in balance of payment, controlling inflation etc.

3. Banker to the Banks

Central bank regulates the whole banking system. In this capacity, it also acts as a banker to the banks and provides the following services to commercial banks:

i). It provides loans to the commercial banks by re-discounting their bills of exchange (hundies).

ii). It helps commercial banks at the time of financial and liquidity crises.

iii). It grants permission regarding formation of the new banks and to existing commercial banks to open new branches.

v). Commercial banks deposit a certain percentage of their assets with the central bank as mandatory reserve.

vi). Central bank regulates and controls all activities of commercial banks.

4. Lender of the Last Resort

Central bank advances loans to commercial banks during financial crisis and resolve their difficulties. For example, a commercial bank may be unable to meet requirements of depositors due to giving excessive loans. Therefore, its credibility and solvency may be in danger. Under these difficult circumstances, the central bank issues cheap loans to such banks by rediscounting their bills of exchange. This is why the central bank is called a lender of the last resort.

5. Clearing House for the Banks

Since entire banking system of a country is interlinked, numerous transactions of billions are settled daily among different banks. The central bank provides its services for clearing financial transactions among banks by holding collective meeting of their representatives. In this way, central bank performs its function of the clearing house.

6. Custodian of Money Market

The central bank also acts as controller of money supply. In this capacity, the central bank issues currency on the one hand and on the other hand, it also assures economic stability by managing the money supply. The ways and means adopted by central bank to control money supply for achieving specific objectives are called its monetary policy. This policy helps the central bank to effectively manage undesired situations of inflation and deflation. The central bank controls these situations by using the following tools:

i. Bank Rate Policy

Bank rate is the rate at which the central bank issues loans to commercial banks by rediscounting their bills of exchange. The central bank implements desired changes in credit money by changing bank rate. During inflation, bank rate is raised to make bank loans costly. At higher bank rate, neither commercial banks get costly loans from central bank, nor people get loan from them. It reduces money supply and therefore helps in controlling inflation. During deflation, the central bank lowers the bank rate and commercial banks get cheap loans from the central bank. It increases quantity of money and deflation is controlled.

ii. Open Market Operations

The central bank buys and sells government securities (prize bonds, saving certificate etc) in the open market to control inflation or deflation. In situation of 'inflation' the central bank shall start selling the government securities by receiving value in cash. In case of deflation, the central bank shall start buying government securities at higher rates. In this way, the central bank controls inflation and deflation.

iii. Cash Reserve Ratio

All scheduled banks are compulsorily required to deposit a certain percentage of customers' deposits with them. This mandatory deposit is known as 'cash reserve'. During times of inflation, the central bank raises cash reserve ratio to reduce cash availability. Conversely, during deflation, cash reserve ratio is relaxed.

iv. Credit Rationing

It is another effective tool to control money supply. Credit Rationing means putting a limit on the volume of credits by commercial banks. Credit rationing restricts commercial banks' ability to create more credit money. Similarly, the Central bank relaxes credit rationing during times when increase in money supply is required.

7. Custodian of Foreign Exchange

The central bank secures foreign exchange reserves of a country by maintaining a balance between imports and exports. In Pakistan, exporters have to surrender their foreign exchange earnings to the central bank which pays them equivalent amount in local currency. In the same way, the central bank is also a custodian of metallic currency in the country.

10.4 Interest Free Banking in Pakistan

Islam puts a great emphasis on justice, fair-play and mutual cooperation. It strongly condemns exploitation in any form and manner. It induces people to give interest-free loans to the needy ones. Pakistan is an Islamic country and Islam strictly prohibits interest in each and every form. Based on Islamic concepts, Islamic banking system can only be run on profit and loss sharing basis.

Various countries made a number of plans in the past to introduce and implement interest free banking. In Islamic countries, Egypt was the first country that started Islamic banking in 1963, by setting up a financial institution for accepting deposits and granting loans to agriculture sector. Its name was '**Mit Ghamar Social Bank'**. The bank occupied an important position among Egyptian financial institutions till 1970, when it was abolished by the then president of that country Jamal Abdul Nasir, due to certain political reasons.

In the year 1963, Malaysia also established a financial institution, basically, to assist people desiring to perform pilgrimage. Name of this bank was **'Pilgrim Management and Fund Board'** or **'Tabung Haji'**. The bank used to accept deposits from people and also advanced loans to them.

Similarly, an Islamic bank under the name of **'Al-barka Investment and development Company'** was formed in Saudi Arabia. Basic objective of this bank was to provide interest free loans to the Islamic countries. Islamic Bank of Saudi Arabia, Faysal Islamic Bank of Bahrain and Islamic Development Bank of Jeddah are also providing services in the field of interest free banking. Alarab Islamic Bank and Sudanese Islamic Bank are also operating in Sudan to promote interest free banking.

Pakistan took initiative in this direction in July-1981, by introducing profit and loss sharing bank accounts. Further, element of interest has been abolished from the banking system of the country, since July 1, 1985. The government has introduced steps to Islamize country's whole economic system:

1. Musharika

Under this mode, finance/loan is provided to businesses on the basis of sharing in profit or loss with the borrower. Finance provider and borrower, both, share profit or loss of the business on already agreed terms and conditions.

2. Mudaraba

Under this mode, one party provides finance and other party invests his skills/profession to set the venture operating. Results of business are shared among both parties on already settled terms.

3. Hire and Purchase

In this mode of financing, the bank provides loan to its customer for a specified period, for the purchase of an asset. The customer repays loan and bank's share in asset's rental value. After complete repayment of loan, asset becomes customer's property. For example, House Building Finance Corporation (the HBFC) provides loan for the purchase of homes. The loan installment, repayment period and rental value of the home is settled at the time of financing agreement. The rental value is again divided among borrower and lender according to their equity in the purchase of home. The borrower shall pay the loan installment (principal and rent) to the HBFC. On full repayment of loan, the borrower shall become owner of the house.

4. Equity Participation

Under this system, the bank provides finances to companies/businesses by purchasing their shares at market price. Profit or loss of that institution is shared among all shareholders according to their respective equity participation.

5. Interest Free Loans with Service Charges

Under this mode, the banks provide interest free loan and recover service charges from borrower, at agreed rate. This type of loans is usually provided to exporters.

6. Qarz-e- Hasna

Under this scheme, interest free loans are provided to needy ones. Usually, students are given such kinds of loans to meet their educational expenditures. These loans are normally long term loans.

The government has made necessary amendments in relevant law to give boost to the above forms of interest free (Islamic) financing. According to these amendments, majority of loans are issued, interest free and banking system shall become according to teachings of Islam.

Exercise

Q.1: Each statement has four possible options. Tick (✓) the best one:

1. The institution which accepts deposits and advances loans is called:
   - a. Central bank b. Commercial bank
   - c. Industrial bank d. Agricultural bank
2. Which of the following function is not performed by the central bank?
   - a. Issuing currency notes b. Managing and securing foreign exchange reserves
   - c. To control credit money d. Earning profit on deposits
3. Which of the following accounts are used by the central bank for advancing loans to the commercial banks:
   - a. Time deposits b. Hundies
   - c. Demand deposits d. Saving deposits

Q. 2: Complete the following statements by filling in the missing words or phrases:

1. The rate used by the central bank to advance loans to commercial banks is called ....
2. State bank of Pakistan issues currency notes following .... system.
3. Issuance of loans on profit and loss sharing basis was introduced in ....
4. Under ...., the bank provides finance (capital) and the borrower invests his skill/profession to set the venture operational.
5. Central bank has .... to issue currency notes.

Q. 3: Match the statement in column A with statement in column B; choose the best answer to write in column C:

A	B	C
Fixed fiduciary system	Controller of money supply	
Under the central bank	Inelastic	
Deflation	Central bank	
Issuance of notes	Decrease in purchasing power	
Central bank	Scheduled banks	

Q. 4: Answer the following questions in three sentences:

1. Explain the principles of note issuing?
2. Why the central bank is called banker to the state?
3. What is meant by bank rate policy?

Q. 5: Answer the following questions in detail:

1. What is meant by a commercial bank? Also explain its functions.
2. What are important kinds of banks?
3. What is the central bank? Write down its functions.
4. How does the central bank control credit money as the controller of money supply?
5. What steps have been taken for the success of interest free banking in Pakistan? Write in detail.

Chapter 11

TRADE

11.1 Domestic Trade

Exchange of goods among various regions (cities, towns etc) falling within geographical boundaries of a country is called internal trade or domestic trade. Under domestic trade, people of a country, whether citizens of that country or foreigners, exchange goods among its various regions mainly because of indivisibility of natural resources and cost of production.

11.2 Foreign Trade

Exchange of goods among people and entities belonging to different countries is called international trade or foreign trade. Opposite to domestic trade, in foreign trade, buyers and sellers of goods belong to different countries.

11.3 Difference between Domestic and Foreign Trade

Both, domestic and foreign trade is based on regional or geographical division of labour and specialization in cost of production. Basic objectives of both kinds of trades are to make commodities available and to earn profit. However, domestic trade is different from foreign trade due to following reasons:

1. Mobility of Factors of Production

There is no restriction on mobility of different factors of production within geographical boundaries of a country. Labour can freely move from one part of the country to another part to earn higher wages. Similarly, capital can also be transferred from one region of the country to another for earning higher profits. It is therefore clear that there are no restrictions on mobility of labour and capital within territorial limits of a country. On the contrary, cross-border mobility of these factors has to face a number of restrictions such as culture, language, laws, religions and weather etc.

2. Difference in Currency

Each country has its own currency which is freely used to pay for goods traded within geographical boundaries of that country. However, when there is cross-border trade of goods, the importing country (purchaser) has to pay the exporting country (supplier) in its currency. For example, Pakistan has to convert its currency into US dollars for importing goods from America and into Pound Sterling for importing goods from the UK.

3. Trade Restrictions

Normally, there is no restriction on movement of goods from one part of the country to its other region. Traders can freely transport goods from one place to another within the same country. However, movement of goods from one country to another country is subject to a number of restrictions such as import and export licenses, trade tariffs, imposition of duties and taxes etc. Nature and degree of these restrictions differ from country to country.

4. Transportation Expenditure

The traders have to incur additional expenditures for the transportation of goods from one place to the other. Transportation expenditure is less for movement of goods within the country as compared to the transportation of goods from one country to another country. Transportation expenditure is very high in case of foreign trade. This difference in freight cost causes instability in comparative prices of local and imported goods in any country.

11.4 Advantages and Disadvantages of Foreign Trade

International or foreign trade is one of the major economic needs of the current age, since no country is self-sufficient in production of its required goods and services. Significance of international trade can be assessed from its following advantages:

Advantages of International Trade

1. Availability of Essential Goods

Due to unequal distribution of natural resources, no country is self-sufficient in producing all goods it needs. The countries import such goods from countries which produce these, at comparatively lesser cost. For example, Pakistan is importing plant and machinery from developed countries to accelerate its industrial growth. In the same way, many countries are importing various agricultural produce, like, cotton, wheat etc., from it which Pakistan can spare after meeting its own requirements.

2. Specialization in Production

The countries specialize in producing same goods with comparatively lower cost. The countries import those goods which they cannot produce locally or it costs more to produce locally as compared to importing it. Therefore, international trade not only ensures optimum utilization of resources but also reduces cost of production.

3. Availability of Cheap Goods

International trade also facilitates the availability of cheaper goods to many countries. It is because that a country would like to import a commodity from a foreign country at comparatively lower price rather than to produce it locally at higher costs. Thus, such countries buy such goods from other countries for which they have specialization and skill and which they can produce at comparatively lower cost than they can themselves do.

4. Provision of Goods in Unfavourable Circumstances

Foreign trade facilitates provision of required commodities at the hour of need or when there are undesirable and unfavourable circumstances, such as famine, earthquake, floods and other natural calamities. Under such circumstances, the affected country may import required commodities (medicines, food, clothing and shelter etc.) from other countries to provide instant comfort to the suffering population/area.

5. Disposal of Surplus Output

International trade facilitates countries having surplus output to sell it to the countries where such goods are in demand. Such countries, in turn, can import their requisite goods and commodities from other countries with the finance they earned. Thus, surplus production is utilized in the international market and wastage of resources is saved.

6. World Peace and Mutual Cooperation

International trade promotes an atmosphere of harmony and peace at global level. Businessmen, producers and professionals come into contact with each other and discuss common economic interests. This situation creates feelings of cooperation and brotherhood and helps evolving this world as a peaceful place.

Disadvantages of International Trade

1. Misuse of Resources

The main disadvantage of international trade is that the resources of less-developed countries are misused or remain underutilized due to lack of technology and specialization. For example, developed countries exploit OPEC countries because later lack necessary technology. In this way, economies of such countries do not develop rapidly although availability of resources are with them.

2. Over Dependence on Foreign Goods

Specialization process slows down economic development of various (unspecialized) sectors of economy of a country, instead of promoting growth in all sectors. It is why that some countries heavily depend on importing foreign goods, except a few sectors of their economy. Such countries are highly exposed to economic difficulties and are easily affected by an unfavourable occurrence in the world. It is the reason that some countries have ignored element of specialization in international trade and continue to produce essential goods to promote its economic growth.

3. Danger to Freedom

History tells us that several countries faced economic depressions and lost their freedom due to foreign trade. For example, rulers of subcontinent allowed British traders to set up commercial and industrial concerns in the region and ultimately lost their control over sub-continent, which became a British colony for the next 100 years. As a result, people of the area and their generations suffered gravely. The British rulers, however, did not give local economy its due importance, but made it a source of raw material for development of its own trade and industry. It is the main cause of our lagging behind the world's leading economies, despite our gaining independence.

4. Availability of Harmful Goods

Another disadvantage of international trade is easy availability of dangerous goods, such as lethal arms, banned medicines and intoxicants etc by the money thus earned. People of many countries are not only wasting their money but also harming their health. Import of lethal arms is causing law and order situation to promote atmosphere of horror and terror. Its ultimate result is elimination of feelings of peace and harmony.

11.5 Balance of Trade and Balance of Payments

Balance of Trade

During a year, a country earns foreign exchange by exporting visible goods (rice, cotton, textile products, surgical goods etc.) and also spends foreign exchange on import of visible goods (medicines, cars, plant and machinery etc). Balance of trade is maintaining an account of foreign exchange earnings and expenditure. In simple words,

"Balance of trade of a country is the value of its visible exports and imports"

If money value of visible exports of a country exceeds money value of its visible imports, this situation is called 'Surplus Balance of Trade'. On the other hand, a country shall be called to have 'Deficit Balance of Trade' if money value of its imports exceeds money value of its exports.

Balance of Payments

"Balance of payment is a comprehensive record of all economic transactions between residents of one country and rest of the world".

Balance of payment includes both items, visible and invisible. Invisible goods or items are those which cannot be physically checked or seen. These include expenditure incurred on import/exports of goods during trade; for example, freight of shipping companies, insurance expenses, goods handling charges etc. Since balance of trade includes visible items only, it is a part of balance of payment. Therefore, balance of payment of a country shows full detail of its economic transactions with other countries.

In simple words, **"Account of monetary receipts and payments of a country during a year on visible and invisible imports and exports is called balance of payments"**.

Pakistan's balance of payment has always been in deficit, except for a few years, mainly due to following reasons:

1. Reduction in exports
2. Increase in import of goods such as raw materials, plant and machinery etc.
3. Habitual increase in consumption pattern
4. Inflation and instability in terms of trade
5. Excessive foreign debts and devaluation

11.6 Major Exports and Imports of Pakistan

Pakistan is basically an agricultural country. 70% of our agricultural produce is exported to the other countries in the form of raw material. However, ratio of our industrial products in the country's total exports has recently been increasing due to better policies and planning of the government.

Major Exports of Pakistan

Following are the major exports of Pakistan:

1. Cotton

Cotton occupies a key place in Pakistan's economy. Pakistan is earning enormous amount of foreign exchange by exporting cotton. However, production of cotton is affected by unfavourable weather conditions, pests' attacks and crop infections. It was due to aforesaid reasons that during some years, Pakistan has to face difficulties in earning foreign exchange by exporting cotton.

Major importers of our cotton are Japan, China, Singapore and Italy etc.

2. Rice

Rice is another important export of Pakistan. Foreign exchange earnings of Pakistan are increasing with the rise in export of rice. Pakistan is well-known all over the world for producing good quality rice. Many rice mills process rice, for export purposes, using latest technology and machinery. Major markets for Pakistani rice are Gulf States, Saudi Arabia, Iran, Turkey and Sri Lanka.

3. Cotton Yarn

Cotton yarn is a very prominent product in the list of Pakistan's exports. Pakistan is earning millions of dollars through export of cotton yarn. Export of Pakistan's cotton yarn is increasing with the increase in production of cotton in the country.

Main buyers of our cotton yarn are Japan, China, Germany and Hong Kong.

4. Cotton Cloth

Cotton cloth manufactured in Pakistan is considered one of the finest in the world and is therefore liked very much throughout the world. That is why cotton cloth is one of our major exports. A significant part of cotton cloth is used within the country due to increasing population. It is the reason for sluggish rise in foreign exchange earning through its export. However, cotton cloth still holds a top position among exports of the country.

Important customers of Pakistan's cotton cloth are the U.K., America, Russia and Iran.

5. Carpets

Pakistan is very well known for hand-knoitted carpets and rugs due to high quality and beautiful designs. Pakistani carpets are exported to other countries at good price and therefore earn precious foreign exchange for the country.

Pakistan exports carpets mainly to the U.K., Germany, America, France and Italy.

6. Leather and its Products

Demand for leather and leather-wears is increasing day-by-day all over the world. Pakistan is considered among top countries producing leather and its products of excellently high quality. Pakistan is earning significant amount of foreign exchange by exporting leather and its products to China, Italy, Japan and Russia.

7. Others Exports

Besides above mentioned major exports, Pakistan is exporting many other items to other countries of the world. These include surgical goods, sports goods, ready-made garments, bed-linen, hosiery, towels, shoes, and petroleum products etc.

Major Imports of Pakistan

Following are the major imports of Pakistan:

1. Petroleum and its Products

Pakistan lacks adequate resources of petroleum in its territory and, therefore, has to spend a huge amount of foreign exchange on its import to meet its energy requirements. Since petroleum prices are directly linked with the cost of production, any rise in its price in the international market adversely affects prices of almost all items in the domestic market. It also depletes our foreign exchange reserves.

2. Eatables

Despite Pakistan's being an agricultural country, it is not self-sufficient in some essential food items such as tea, dairy products, edible oil, sugar, wheat etc. Pakistan has to import these from various countries and spend a lot of foreign exchange.

3. Chemical Goods

Chemical is an important raw material for many industries of the country. Therefore, Pakistan has to import these chemicals to promote industry and its production. It has adverse impact on the country's foreign exchange reserves.

4. Machinery and Raw Material

Pakistan has to import machinery and raw material from various countries for industrial development of the country. The country's industrial and economic development is not possible without the import of necessarily required machinery, technology and raw materials. With increasing industrialization of the country, expenditure on this segment is rising.

5. Iron, Steel and its Products

Pakistan has very limited resources of iron ore and steel. Iron and steel are very important raw material for setting up a capital goods industry. Pakistan has established a steel mill in Karachi. However, its capacity is unable to satisfy steel demand of the country. Therefore, Pakistan has to import large quantities of iron, steel and its products from other countries.

6. Chemical Fertilizers

Pakistan has an agrarian economy and chemical fertilizers have an important role for development of agriculture sector. Pakistan is manufacturing majority of chemical fertilizers required for its agricultural usages. However, Pakistan still has to import some kinds of chemical fertilizers to satisfy ever increasing demand of chemical fertilizers.

7. Miscellaneous Imports

Besides above-stated major imports, Pakistan has to import many other commodities to meet its domestic requirements. These include silk yarn, colours and dyes, electrical goods, paper and stationery etc. A significant portion of foreign exchange is spent on such imports. It causes instability in balance of trade.

Exercise

Q. 1: Each statement has four possible options. Tick (✓) the best one:

1. The cause of international trade among various countries is:
   - a. Establishment of industries
   - b. Un-equal distribution of resources
   - c. Economic development
   - d. To increase production
2. A comprehensive record of all economic transactions of residents of one country and foreign countries is called:
   - a. International trade
   - b. Balance of payments
   - c. Balance of trade
   - d. Domestic trade
3. Which of the following items exported from Pakistan has maximum contribution in foreign exchange earnings:
   - a. Carpets
   - b. Leather
   - c. Hosiery
   - d. Cotton

4. Usually, Pakistan's balance of trade is in:
   a. Deficit b. Balance
   c. Protection d. Profit
5. Which of the following items causes maximum foreign exchange spending:
   a. Papers b. Colours and dyes
   c. Petroleum d. Silk

Q. 2: Complete the following statements by filling in the missing words or phrases:

1. Trade among different cities of a country is called ....
2. .... is at the top in the list of Pakistan's exports.
3. By following the principles of ...., cost of production may be reduced.
4. Balance of .... includes all visible and invisible goods.
5. Labour and capital mobility to foreign countries has to face..................

Q. 3: Match the statement in column A with statement in column B; choose the best answer to write in column C:

A	B	C
Optimum utilization of resources	Domestic trade	
Invisible goods	Machine	
Regional trade of goods	Buses and trucks	
Visible goods	Specialization	
Transportation of goods	Can not be seen	

Q. 4: Answer the following questions in three sentences:

1. Write any three advantages of international trade.
2. Write any three disadvantages of international trade.
3. Write names of three important imports and three important exports of Pakistan.

Q. 5: Answer the following questions in detail:

1. Clearly differentiate between domestic trade and international trade.
2. Describe advantages and disadvantages of international trade.
3. What is difference between balance of trade and balance of payment?
4. Explain important imports and exports of Pakistan.

Chapter 12

PUBLIC FINANCE

12.1 Definition of Public Finance

The relationship and management of public revenue and expenditure is called 'Public Finance'. In terms of Economics, public finance means government's fiscal policy governing its decisions relating to levy taxes, raising debts and making public expenditure. It also includes steps taken by the government to manage and regulate aforesaid activities.

In other words, government's fiscal policy describes the ways and means of its revenues and the expenditures to regulate economic activities in the country. In short, public finance is study of relationship between public revenue and expenditure.

12.2 Similarities and Differences Between Private and Public Finance

It has been stated earlier that public finance is the study of relationship between public revenue and public expenditure. It is related with the principles as to how the government will generate its resources (revenue) and how these resources will be spent according to the government's priorities. Contrary to it, private finance is concerned with the study of personal income and expenditure of individuals and the principles followed by them to create a balance between their private incomes and expenditure.

Comparative study of public finance and private finance reveals a number of similarities and differences between them, as discussed below:

Similarities Between Private and Public Finance

Following are the similarities between these types of finances:

1. Both, the Government and the individuals have limited revenue resources and therefore their basic objective is to explore the means and ways to get maximum utility from these limited resources.
2. Both, the Government and the individuals need loans to maintain a balance between their income and expenditure. Therefore, both of them obtain loans to meet their expenditure.
3. Both, the Government and the individuals make investments to increase their resources and means of income.

Differences Between Private and Public Finance

Private finance differs with public finance on the following grounds:

1. Balance between Revenue and Expenditure

An individual spends money according to his earnings and, therefore, has control over his expenditures. Contrary to this, the Government does not have much control over its revenues and expenditures. It is so because the Government, firstly, prepares estimate of its development expenditures and then sets targets for collection of revenue to meet its estimated expenditure. It is because the Government faces a lot of difficulties for maintaining a balance between its revenue collection and expenditure.

2. Budget Period

There is no fixed length of period for the budget of an individual person, who prepares its budget for income and expenditure depending upon the periodicity of his income. It may be weekly, fortnightly or monthly etc. However, the Government plans its income and expenditure on yearly basis and therefore prepares its budget annually.

3. Future Needs

Common persons tend to save their income to meet their future obligations for themselves and their families only. Contrary to this, the Government invests its income on development projects not only to meet current demands but also to keep in view the future needs of the masses. In other words, an individual spends his money for his own personal needs and obligations, whereas the Government spends for the welfare of the public at large.

4. Getting Loans

When required, an individual may borrow money from his friends, relatives or banks etc but cannot take loan from himself. It means that he can borrow money from external resources only. However, the Government can borrow money from external and internal resources. Internal resources refer to the country's commercial banks and financial institutions etc whereas external resources mean international financial organizations such as World Bank and International Monetary Fund, International Finance Corporation etc. Further, an individual has to face a number of difficulties for getting loan from banks/financial institutions as against the Government that can get finances easily.

5. Deficit Policy

In case if Government expenditures exceed its income, the Government can make up the deficit by levying more taxes and/or increasing money supply through printing of new currency. However, an individual can neither impose more taxes nor can print currency.

6. **Publicity of Revenue and Expenditure**

An individual hesitates to disclose his true income, expenditure and savings to others, due to various reasons such as tax evasion, business jealousy etc. However, the Government makes detail of its incomes and expenditure by using all available sources of media (newspapers, television, radio). The main purpose of this advertisement is to keep common man informed of the public expenditure and revenue.

12.3 Definition of Budget

Budget is an estimate of Government's revenue and expenditure for the ensuing financial year. Budget is a schedule which explains Government's assessment for its revenue and expenditure, with item-wise breakdown of sources of income and detail of expenditure. Pakistan's budget covers a period of one year, starting from 1st July of current year to 30th June of the next year such as (July 01, 2008 to June 30, 2009).

In other words, budget is a scheme of revenue and expenditure for a particular year, supported by numbers and facts. In case if government estimated expenditure exceeds its expected revenue, it is called a 'Deficit Budget' and if government's expected income exceeds its estimated expenditure, it is termed as a 'Surplus Budget'. When Government's expected revenue equals to its estimated expenditure, it is said to be a 'Balanced Budget'.

12.4 Public Revenue

Following are the important contributors to the revenue of the Government of Pakistan:

1. Taxes

Taxes are the major source of revenue for a Government. Taxes mean compulsory payments made to the Government. Taxes are calculated at prescribed rates on the income of individuals and businesses. The Government adopts various ways and means to collect taxes. Following are some of them:

i. Significant part of taxes is collected in the form of import and export duties and related levies

ii. Excise duty is another important part of taxes. It is imposed on goods manufactured in the country.

iii. Direct taxes imposed on the incomes and certain properties of individuals also add to the Government revenue.

iv. In addition to the above, the Government generates its revenue through other taxes including various surcharges, sales tax etc.

2. Price

It refers to that part of the Government revenue that it generates by sale of its goods/assets and/or by providing its services to the private sector. For example, amount received by the Government by selling timber from forests and lease/sale of state land etc.

3. Fee

Fee is a mandatory payment to be made in return for some services/benefits to the general public. Examples of such kind of revenue are radio/television license fee, driving license fee, arms license fee etc.

4. Fines and Penalties

These are also considered a part of public revenue. These are charged as a consequence of a violation/non--compliance with a rule/law, such as penalty/fine for non-observing traffic rules or for an act considered as offence under the law (kite flying using prohibited strings) etc.

5. Miscellaneous Revenues

The Government also collects revenue from means in addition to the above mentioned sources. These other sources include royalties, grants and gifts from foreign governments/organizations etc. All these resources are used for collective social welfare of the general public.

12.5 Public Expenditure

Following are the major components of expenditure of the Government:

1. Defence

The Government has to spend a major portion of its revenue to strengthen national defense and integrity. For this purpose, expensive modern arsenal and military equipment has to be purchased from other countries. Defence expenditure is one of the major part of the government spending.

2. Debt Servicing

The Government has to borrow from foreign governments or financial institutions to make up its budgetary deficit. These loans are interest based which go on increasing with the lapse of time. The Government has to pay interest as well as principal amount of the loan, which eats up a major portion of its revenue.

3. Courts

There is well established judiciary system in the Country to ensure supremacy of law and order and to pass on justice to the general public. The Government spends a fair portion of its revenue on judiciary for greater public welfare.

4. Administration

The Government has to engage people to manage its affairs so that it can work for public welfare, maintain law and order in the country, implement its development projects, ensure provision of facilities/comforts of life to the general public. For these purposes, the Government has to pay its employees and also has to provide necessary facilities for efficient discharge of their duties.

5. Miscellaneous Expenditure

In addition to the above, the Government spends considerable amount to provide basic amenities of life to the general public, such as education, healthcare, drinking water, communication network, and provision of food/daily-use items at affordable prices etc. Such public welfare activities/projects utilize a lot of the Government revenue.

12.6 Public Debt

Main and basic objective of a Government is to make progress in each and every field, to raise standard of living of its people and to ensure prosperity for the whole nation. However, scarce resources are the major obstacle in its way to economic development and prosperity. In such circumstances, the Government has to resort to loans from foreign government and financial institutions. These borrowing of the

Government are known are 'Public Debt'. In other words, public debt is the money borrowed by a Government to make up its deficit. Therefore, public debt comprises all loans obtained by a Government to finance its requirements including defense, trade/commerce, exploration of natural resources and social development projects/activities etc.

Generally, a Government has to obtain loans for the following reasons:

1. To make up the budgetary deficit.
2. To meet emergency requirements such as rehabilitation of flood victims or relief for the People of earthquake affected area or other natural calamities.
3. To complete development projects.
4. To accomplish social welfare activities and schemes.
5. To cover the deficit in the balance of payments.

12.7 Exercise

Q.1: Each statement has four possible options. Tick (✓) the best one:

1. Under public finance, the Government estimates its revenue and expenditure for:
   - a. one year
   - b. one month
   - c. two years
   - d. six months
2. Under public finance, the Government can cover the budgetary deficit by:
   - a. increase in production
   - b. increase in revenue
   - c. printing of currency notes
   - d. decrease in money supply

Q. 2: Complete the following statements by filling in the missing words or phrases:

1. In .... finance, individuals cut their coats according to their clothes.
2. The Government .... its annual revenue and expenditure.
3. .... is a compulsory payment.
4. Budget is also called as ....
5. Pakistan's budgetary period starts from July 01 of current year to .... of next year.

Q. 3: Match the statement in column A with statement in column B; choose the best answer to write in column C:

A	B	C
Budget duration	General public	
Source of public revenue	Direct deduction	
Do not disclose income	Wrong parking	
Income tax	One year	
Fines	Taxes	

Q.4: Answer the following questions in three sentences:

1. What is meant by public finance?
2. What is meant by private finance?
3. Write two points of difference between public finance and private finance?
4. Write down names of any five sources of public revenue?
5. What is meant by public debt?

Q. 5: Answer the following questions in detail:

1. Differentiate between public finance and private finance.
2. Describe similarities between public finance and private finance.
3. Explain sources of public revenue.
4. Write down major heads of public expenditure.
5. Write notes on the following:
   i. Budget ii. Public debt

CHAPTER 13

ECONOMIC DEVELOPMENT

13.1 Economic Development

Economic development is the most desired need of the present world, especially for underdeveloped countries which are victims of acute poverty and deprivation. Standard of living of people can not be raised without achieving goals of economic development.

Economic experts have described economic development in different words and ways. Some important definitions of economic development are given below:

According to Professor Watson, **"Economic development is the expansion of production and consumption faster than population"**. In simple words, economic development means increase in the country's output, in the long run.

Meier and Baldwin have defined economic development in a more comprehensive and clear manner that **"Economic development is a process whereby an economy's real national income increases over a long period of time"**. Salient features of this definition are:

- Economic development is a process which causes structural changes in the economy
- Country's resources are used with specialization and skill
- Productive capacity of all sectors of the economy starts increasing
- Standard of living of the people improves as a result of increase in income

It is important to note that economic development takes place only when real national income increases in the long run and not temporarily. During this process, infrastructure of the economy changes, which in turn adds to per capita income.

13.2 Factors of Economic Development

Economic development of a country depends upon the following factors:

1) Natural Resources

The countries with more natural resources such as forests, minerals, fertile land, water resources, oil, gas etc have high rate for economic development. Performance of productive sectors flourishes. People enjoy improved standard of living. On the contrary, countries with limited natural resources, or where these are mis-utilized, have to face growing poverty and deprivation. It causes decline in rate of economic development and consequently decline in standard of living of the people.

2) Technology

Efficiency of productive sector improves manifold with the use of technology. Modern tools and equipments increase quantity and quality of the output as well as the pace of the economic development. The countries, using obsolete and outdated techniques, have to face slow rate of economic development and consequently standard of living of the people declines.

3) Human Resources

Occupational and technical skills and capabilities of persons working in productive sectors of a country are called human resources. The countries endowed with skilled human resources can easily and rapidly attain high rate of economic development and growth. On the other hand, the rate of economic development and standard of living of the people decreases if countries use obsolete and old techniques/methods of production.

4) Capital Formation

The process of investing individual savings into productive channels is called 'capital formation'. Investment results in more availability of a country's resources in the form of factories, buildings, machinery, infrastructure etc. Therefore, rate of the capital formation shall be higher in countries with more savings. It shall increase economic development as well as standard of living of the people.

5) Social and Cultural Factors

Economic development of any country is directly affected by various factors such as relating to religious values, racial relationship, social grouping, caste system and resultant demonstrations effect etc. Societies with aforementioned problems can not make optimum and effective use of their resources and therefore obstruct the pace of economic growth. However, countries which do not have aforementioned problems make rapid economic development and provide better standard of living to their people.

6) Political Factors

Economic stability is one of the most important requirements for attaining high rate of economic development. In a politically stable country, productive sectors of the economy become more active, new development projects are implemented and proper investment opportunities made available to investors etc. It results in the improvement of overall performance of the Government and roadmap for rapid economic development is determined. Contrary to it, political instability impedes economic development.

13.3 Economic Development in Different Sectors of Pakistan

Economic development is a systematic expansion among economy's all important sectors such as agriculture, industry, trade and commerce, services, banks/financial services, communication and information technology etc. during a specified period of time, normally one year. Following paragraphs will analyze the role of these important sectors in the Pakistan's economic development:

13.4 Role of Agriculture Sector in Economic Development

Importance of agricultural sector in the economic development of Pakistan can be assessed from the following:

1. Main source of employment

Pakistan is basically an agricultural country. Around 70% of its total population lives in rural area and 50% of the country's population earns its livelihood from the agriculture. Remaining 50% of the country's population depends on all other sectors such as industry, trade and commerce, mining, transportation and communication etc.

2. Largest Source of national income

Agriculture sector contributes a huge amount to the national income. This sector's share in national income was 50% at the time of independence in 1947. This has been declined with the passage of time with increasing share of other sectors. However, agricultural sector still contributes around 19.8% of the country's gross domestic product, which is an impressive contribution as compared to the other sectors.

3. Source of earning of foreign exchange

Export of agriculture products is the largest source of the country's earning in the foreign exchange. Pakistan is self sufficient in the production of rice, cotton, cotton yarn, fruits and other agricultural products, surplus of which is exported to other countries to earn huge amount of foreign exchange. Development of this sector on modern lines can accelerate the rate of economic growth of the country.

4. Source of income of rural population

Pakistan is basically an agrarian economy. About 70% of its population is living in rural areas and is directly or indirectly dependent upon agriculture for its livelihood. Agriculture sector is, therefore, providing employment to a very significant portion of our population.

5. Provision of raw material

Agriculture sector is the largest raw material supplier to our industrial sector. For example, it supplies cotton to textile industry, sugarcane/beet to sugar manufacturing companies, oilseed to oil/ghee units, tobacco to cigarette industry etc. It, therefore, ensures domestic supply of raw material to manufacturing sector to increase its production. Agriculture sector therefore contributes in accelerating rate of economic progress of the country.

6. Provision of market for products

Agriculture sector acts as a big market for many industrial outputs such as fertilizers, pesticides and agriculture implements for example tractors, threshers, harvesters and tube wells etc are used by agricultural sector. It therefore provides a sound base for industrialization which provides employment and thus improves peoples' standard of living, a prerequisite for economic development.

7. Supply of workforce

Agriculture sector also provides its surplus/off-season workforce to the industrial sectors. It helps in industrialization of the country.

8. Source of food

Agriculture sector is the major source of food for local consumption, which includes cereals, vegetables, pulses, fruits, meat, eggs and milk etc. Agriculture sector therefore directly fulfills dietary needs of the people of Pakistan, promotes human health and contributes in improving standard of living of the people.

9. Engine for Promoting Industrial Development

Agriculture sector is a driving force in industrial development of the country in its capacities of supplier of raw material as well as consumer of industrial output. It therefore helps in setting up more and more industrial units to meet local consumption. Agriculture sector acts as a major force for acceleration of economic development of the country.

13.5 Role of industrial sector in economic development

The development of industrial sector is inevitable for balanced growth and economic sustainability and development of an economy. Pakistan's industrial sector is playing an important role in the economic development of Pakistan since its independence, as is evident from the following points:

1. Source of agricultural development

It is well known to everybody that Pakistan is an agricultural country; however the growth of the agricultural sector is not possible without the development of the industrial sector. Agricultural sector depends upon the industrial sector for modern and latest agricultural inputs such as agricultural machinery (tractors, ploughs, sprayers, tube-wells etc), fertilizers, pesticides and insecticides etc. It also needs construction machinery and material for construction of dams, and barrages/canals for irrigation purposes. Roads are also constructed to transport agricultural products from farms to markets. All of the above materials are manufactured in the industries without development of which agricultural sector could not progress at the desired level.

2. Increase in national income

Industrial sector is the second largest contributor to gross national product (GNP). Currently, this sector contributes 21.02% to the Pakistan's GDP.

Industrialization causes rapid growth in the domestic production which ultimately becomes source of increase in national income.

3. Source of earning of foreign exchange

Industrial development is an important source of foreign exchange earnings. A huge amount of foreign exchange is earned by increasing the production of goods and exporting those to other countries. Industrialization is not only a source of foreign exchange but also protects home-industries, which is much needed to increase speed of development of industrial sector.

4. Substitutes of imports

Local industries may produce goods which can provide a substitute for imported goods. It, therefore, saves national spending on import of such goods and reduces national dependence on imported goods. Industrial sector in this way not only saves foreign exchange, but also protects/promotes growth of local industries.

5. Increase in Employment

Unemployment is a very critical issue faced by under-developed countries. This problem can be tackled by the establishment of industries. New large and medium scale industries not only give direct employment to a large number of people, but also provide employment, indirectly, through small scale down-stream industries. It increases income of the people, thereby raising their standard of living, which is a prerequisite of economic development.

6. Strengthening the Sovereignty

Currently, investment is directly dependent upon safety and security situation of a country. This basic need of investment-friendly atmosphere can only be met with militarily strong country. Local defense industries play a vital role in strengthening the defense of the country and therefore protecting its people and industries from foreign aggression.

7. Terms of trade

Better quality goods are produced in industrially developed countries. Such goods can compete internationally to fetch its market share. Increased share in international market, as well as fulfilling domestic needs from local industry, can bring about a favourable impact on terms of trade of a country.

8. Development of culture and traditions

Industrialization helps in progress and evolution of art, culture and traditions of a society. During industrialization, new cities and towns are developed which becomes centre of activities relating to civilization, including culture and fine art etc. Further, with increased employment and per capita income, people gives more time to entertainment activities which promote and help progress of art and culture.

9. Technological development

Modern industries invest huge amounts in industry related research and development (R & D) projects. These (R & D) projects aim at evolving and inventing new technologies and methods to enhance quality and quantity of production with minimum cost.

10. Economic stability

Industrial development causes a rapid growth in productive sector of an economy. It not only feeds the domestic market, but also reduces imports and increases exports to earn foreign exchange. Industrialization increases employment level in the country and raises standard of living. All these factors contribute economic stability in the country and results in rapid economic growth.

13.6 Foreign Trade and Banking Sector

For rapid economic growth, the under developed countries shall have to promote development of foreign trade and financial sector. Both of these sectors are part and parcel of economic development. Foreign exchange earnings and exchange of goods in the international market helps in promoting economic development. In the same way, modern financial/banking sector can also promote economic growth by properly handling financial and monetary affairs of the economy.

Role of Foreign Trade in Economic Development

Foreign trade plays a vital role to accelerate economic development of under-developed countries like Pakistan. Following paragraphs explain the role of foreign trade in economic development:

1. Full usage of country's resources

The economies involved in foreign trade make efficient use of their resources and specializes to manufacture a certain class of goods. This principle of specialization does not only reduce cost of production of such goods, but also improves quality of the products.

2. Use of modern technology and science

International trade introduces usage of modern techniques and new improved scientific methods in production process. It reduces cost of production on the one hand and also increases quality of goods. Therefore, use of modern technology and science promotes economic development.

3. Increase in national income

Foreign trade increases volume of exports. New factories are set up and huge amount of foreign exchange is earned through export of goods. As a result, national income increases that leads to rapid economic growth.

4. Extension of market

Foreign trade provides opportunities to domestic products for their trade in international market. Countries involved in foreign trade expand their production facilities to manufacture more and more for export purposes. At the same time, those countries also produce goods domestically to provide a suitable domestic substitute to imports. It is very clear that these activities speed up economic development.

5. Economic stability

Foreign trade brings economic stability in the country. It facilitates countries to export surplus goods and import goods in case of their deficiency. It therefore saves countries from economic instability which may trigger depression like situation. Foreign trade therefore, strengthens economic stability on global level.

Role of Banking/Financial Sector in Economic Development

Banks and financial institutions are backbone of any economy and play very important role in the development of an economy, as explained in the following text:

1. Promoting savings

The banks provide various incentives to common man to save money and keep it in banks' custody. The banks mobilize these small investments in the form of loans to various sectors for setting up new projects. The bank thus helps in fostering economic development of any country.

2. Agricultural and Industrial development

As described above, the banks provide short term and long term loans to industry and agriculture sectors to modernize any existing unit or to start a new project. The loan is repaid in easy installments agreed upon mutually between the bank and borrower. The banks in this way help to increase investment in industrial and agricultural sectors, which ultimately brings about economic development.

3. Implementation of monetary policy

As you are aware, central bank formulates monetary policy to check inflation and to keep the economy on the right path. The banks play very important part to make monetary policy a success. The banks regulate interest rates in accordance with monetary policy and control inflation or deflation, without affecting economic development.

4. Completion of development projects

The banks provide loans to the government and private sector to complete on-going or new projects. The banks also offer loans on sectoral basis to speed up economic development.

5. Development of under-developed/backward sectors

The banks provide more funds to less--developed sectors of an economy to achieve the target of balanced economic growth.

13.7 Development of Communication and Modern Technology

In the modern age, economic development can not be achieved without developing communication and modern technology. The countries with modern communication system can have easy access to the new discoveries, inventions and innovations. Such countries may be benefited more from those innovations and therefore can make optimum utilization of their resources. It is also very well known that usage of modern technology increases production capacity of a country. Role of modern means of communication and technology in economic development of a country is discussed below:

Role of Communication in Economic Development

1. Means of communications (radio, television, internet, and print media) have turned the whole world into global village where news spread like a fire. Now, any invention or innovation in one part of the world reaches the other part within no time due to modern means of communication. Up-to-date knowledge about the world events helps in optimum utilization of resources and it leads to foster economic development.
2. Means of communications help in promoting cultural and social relationship with other countries. Such relationship introduces trade relationship which ultimately promotes economic development and stability.
3. Online trading system has been in use in many developed countries. Promotion and usage of these modern trading tools by under-developed countries can give a boost to international trade. It can give a big chance for economic growth of under-developed countries.
4. Market imperfections can be controlled through means of communications. It will ensure price stability and economic development.

Role of Modern Technology in Economic Development

The countries which do not have technical know-how and therefore do not use modern technology are called backward countries. Therefore, modern technology is the basic need for rapid economic growth. The following highlight the role of modern technology in economic development:

1. At present, high quality goods can be produced in large quantity with minimum cost with the help of modern technology. High quality surplus goods can be exported to the countries where those are required and exporting country may earn foreign exchange.

2. Modern technology has helped the mankind to uncover hidden treasures from the earth, oceans, mountains etc, for example oil, gas, coal, various ores, precious stones, minerals. These natural resources are very much helpful in accelerating economic growth of any country.

3. Modern technology has also helped us in getting rid of primitive methods of production and replaced it with modern plant and machinery. It helps in promoting economic growth.

5. New technology has introduced innovative designs and improved quality of products, besides reducing their price and cost. As a result, economic development progresses.

6. Modern technology has increased production capacity of projects. Employment opportunities are increasing and, as a result, standard of living of the people also rises.

13.8 Exercise

.Q. 1: Each statement has four possible options. Tick (✓) the best one:

1. Economic development is a process whereby real national income of an economy increases:
   a. for a short period of time b. for a long period of time
   c. for fixed period of time d. temporarily
2. Most important sector of Pakistan's economy is:
   a. industry b. trade
   c. communication d. agriculture
3. Industry contributes to Pakistan's GDP:
   a. 20 % b. 25%
   c. 21.02% d. 30%
4. Which one of the following factors is not necessary for economic development:
   a. economic factors b. political factors
   c. cultural factors d. private factors
5. Best definition of economic development is given by:
   a. Robbins b. Arther Lewis
   c. Keynes d. Meier and Baldwin

Q 2: Complete the following statements by filling in the missing words or phrases:

1. Under developed economies have a .... rate of economic development.

2. Agriculture sector is the .... of Pakistan's economy.
3. Cultural and trade links among various countries may be improved through ....
4. Specialization in production and production capacity of various sectors may be increased by use of ....

Q.3: Match the statement in column A with statement in column B; choose the best answer to write in column C:

A	B	C
Economic development	19.8 percent	
Infrastructure	Internet	
Contribution of agriculture sector	Increase in real national income	
Economic factors	basic needs of our economy	
Means of communication	Technology	

Q. 4: Answer the following questions in three sentences:
1. What is meant by economic development?
2. Write down names of economic factors of economic development?
3. Describe the importance of industrial sector in Pakistan.
4. Why is agriculture sector important for Pakistan?
5. What is the role of technology in economic development of Pakistan?

Q. 5: Answer the following questions in detail:
1. Define economic development.
2. Write down economic, social and political factors affecting economic development.
3. Explain the role of agricultural sector in economic development of Pakistan.
4. How is industrial sector helping in achieving economic growth in Pakistan?
5. Narrate the role of trade and banking in economic development of Pakistan.
6. Explain, 'Why are the means of communication and modern technology essential for economic development?'

CHAPTER 14

ECONOMIC SYSTEM OF ISLAM

14.1 Definition of Islamic Economic System

Islam is a complete code of life, based on natural instincts. It endorses us moderate economic system, as compared to other economic systems. It is based on moral values such as sympathy, brotherhood, justice, moderation and fair means of earning.

Islamic economic system is a set of principles, derived from the Holy Quran and Sunnah, relating to satisfy economic needs of people living in an organized society. Under Islamic economic principles, justice and moderation are basic elements to regulate wealth's production, consumption, distribution and exchange. Hence, Islamic economic system neither permits concentration of wealth like in capitalism; nor it allows state to own all resources, like in socialism. In fact, Islamic economic system is a moderate way between these two extremes.

14.2 CHARACTERISTICS OF ISLAMIC ECONOMIC SYSTEM

Following are the important characteristics of Islamic economic system:

1) Optimum Utilization of Natural Resources

Islamic economic system teaches us to get maximum benefits from the unlimited natural resources, such as minerals, forests, rivers, seas, mountains, fields etc. It urges mankind to make full use of these natural resources, through innovations and developments. Islam dislikes non-utilization, and therefore wastage, of these natural resources. It is the Islamic way of life that provides incentive to human-beings for innovations, research and development activities so that natural resources could be exploited to the maximum extent. Islamic economic system guarantees access of all mankind to all natural resources. Therefore, best utilization of natural resources causes increase in national wealth and production.

2) Right of Ownership

Allah is the creator and absolute Owner of each and every item of the universe. Allah also made the human being his Caliph on the Earth. Allah made him custodian of the resources of the universe. Islam recognizes right of personal ownership of property owned through fair means and not through exploitation or unfair means. Islam allows a person to use his wealth whatever righteous way he likes. It may be for one's personal/private consumption or to further generate his wealth. Islam, is, however, against undue concentration of wealth and stressed upon looking after the poor and the needy people by wealthy segment of the society.

3) Economic Freedom

Islamic economic system guarantees the availability of equal opportunity to all for fairly earning of livelihood. People are expected to earn their income by observing religious limitations and legal restrictions imposed by the Islamic state. Islam strictly prohibits earning of wealth using illegal ways or means declared unfair (Haram) by Islam; for instance, income earned through smuggling, hoarding, bribery and mean practices etc. It should be clearly understood that Islam's economic freedom permits people to earn income by using fair (Halal) means, as allowed by Islam. It also stresses putting their earnings to religiously legitimate usage.

4) Fair Distribution of Wealth

Islam gives special emphasis on fair distribution of wealth. On the one hand, Islam allows people to acquire wealth by using fair means and, on the other hand, it makes resourceful community responsible to take care of poor and needy people. Islam strictly orders for regular payment of Zakat and Usher and presses for frequent giveaways and Sadkat etc. In this way, Islam ensures fair distribution of wealth in the Society rather than its concentration into a few hands.

5) Circulation of Wealth

Islamic economic system is grossly against the concentration of wealth into a few hands and introduces Zakat as an effective tool to maintain flow of wealth from the rich to the poor. Islam encourages the use of wealth for personal comforts/needs and, equally, for caring the poor/needy. Islam has devised a system for annual distribution of wealth of the rich among eligible poor community in the form of Zakat. It increases purchasing power of the poor which raises consumption of goods and services. It, thus, stimulates investment in an Islamic economy.

6) Social Welfare

Islamic economic system gives great emphasis on social welfare of the people at large. Bait-ul-Mal helps the poor/destitute to ensure their access to basic amenities of life. Zakat inculcates feelings of brotherhood. Islam has banned all social evils and bad habits such as use of narcotics, keeping illegitimate relationship and gambling etc. Islamic economic system, therefore, assists in promoting a society free from evils.

7) Automatic System

New institutions and practices are established in an Islamic economic system. It sets free the people to take benefits of expertise/ideas of others to produce, consume and distribute wealth. It ensures operations of Islamic economy in an organized manner. Islamic economic system strictly prohibits unfair profiteering through hoarding or other un-permitted means and, therefore, brings all economic variables under direct control of forces of demand and supply. In this manner, it ensures automatic determination of price level, free from any exploitation.

8) Prohibition of Interest

Interest is very strictly prohibited in Islam. It emphasizes on interest free banking transactions such as 'Modaraba'. Under Modaraba, one invests its capital and the other person contributes his professional expertise and the profit/loss of the ventures is shared in predetermined agreed ratio. Islam, therefore, promotes an economically neat and clean society which is free from exploitation.

9) Positive Role of State

Islamic economic system is actually based on principles of freedom and justice for all. Under this system, State is responsible to provide the people with basic needs of life and to take necessary measures to eliminate unemployment and poverty. It corrects economic defects by use of free play of market forces for price determination and provides equal investment opportunities to all factors/sectors of the economy. Islamic economic system, therefore, should not be considered as a set of new ideas or practices but a name of guarantee for social welfare and economic development.

Role of Zakat, Usher and Charity in Poverty Alleviation and the Provisions of Employment

Islamic economic system has provided a permanent solution for poverty alleviation. Before discussing the role of Zakat, Usher and charity in poverty alleviation and the provisions of employment, it is necessary to understand meanings of these terms:

14.3 Concept of Zakat

Literary meanings of Zakat are 'Purity and Growth'. 'Purity' refers to the cleanliness of (halal) wealth and 'Growth' means increase in purified (halal) wealth.

Zakat is obligatory in Islam. Zakat is a defined sum of money which a wealthy person (Saheb-e-Nisab) pays to the eligible poor and the needy people. Zakat is one of the five basic commandants of Islam, which every Muslim has to comply with. Payment of Zakat brings about prosperity in the wealth of the payer.

Muslim's duties towards Allah and Allah's creature (the people) have been narrated, side by side, on many places in the Holy Quran. In other words, the Holy Quran stresses upon the Zakat equally as it does of 'Salat'.

Verse 42 of Surah 'Al-Bakarah' of the Holy Quran recites:

> "Establish worship, give zakat and bow down your heads with those who bow down (in worship)".

It is believed that if Zakat is fairly paid in a society, it shall end the poverty in a short period of time and promote brotherhood. It shall also accelerate economic growth and bring general prosperity.

14.4 Concept of Usher

Generally, Ushr means Zakat on agriculture produce, which is paid by the land-owners to the poor. Ushr is paid at the rate of 10% of the value of agriculture produce. Usher is paid in compliance of the Allah's orders.

14.5 Concept of Charity

Islam gives right of ownership of wealth to the people, as well as fixes certain responsibilities on the rich and well-to-do community of the Islamic society.

These responsibilities include helping the poor voluntarily, in addition to the payment of Zakat and Usher. Thus Islam encourages voluntarily spending by the rich to help the poor. This voluntary distribution of wealth among the needy people is termed as ' *infaq fee sabel lillah*'.

Verse 92 surah 'Al-Imran' of the Holy Quran recites:

> "By means shall you attain righteousness unless you give (freely) of that which you love. And whatever your give, Allah knoweth it well".

Charity basically aims at reducing concentration of wealth, increasing circulation of wealth and minimizing the social difference between the haves (the rich) and the have-nots (the poor). It is purely a voluntary activity to provide livelihood to the poor. It raises standard of living of the poor that ultimately pushes the society on the path of economic development.

Role of Zakat, Ushr and Charity

Zakat is one of the basic five commandments of Islam. Zakat, Usher and charity plays an important supportive role in maintaining social justice in the Islamic society. Thus, Zakat, Usher and charity are not only an individual's activity but is also a collective duty. These tools discourage social inequality and therefore help in promoting feelings of peace, love, brotherhood and prosperity. Islam stresses on circulation of wealth instead of its concentration in a few hands. It stimulates process of production and consumption of wealth.

Following highlights the importance of Zakat, Usher and Charity as effective instruments of social and economic justice in Islam:

(1) Poverty Alleviation

Economic systems, other than Islamic, prefer growth of capital over growth and welfare of the Society. Particularly, Capitalism does not take responsibility to support the poor, the elderly, the needy, the under-debt and unemployed people. Therefore, such people live below-the poverty line. Contrary to this, Zakat, Ushr and charity ensures economic prosperity of all deprived segments of the society and alleviates poverty. In brief, individual and collective welfare is the corner-stone of the Islamic economic system.

(2) Solution for Unemployment

Zakat, Ushr and charity discourages hoarding/concentration of wealth in few hands and Islam, therefore, requires transfer (a part of wealth) from the rich to the poor. This activity increases aggregate demand, which stimulates output level. Additional output is produced to meet increased demand. Rise production level requires more labour input, which promotes employment opportunities. In this way, Islamic tools of Zakat, Usher and charity provides vast opportunities to the people to improve their income level by using their mental and physical abilities and reduces unemployment.

(3) Expansion of Economy

Many people tend to hoard their wealth instead of using those in business. However, Islam provides its solution in form of Zakat which has to be paid on unused/surplus wealth. Obviously, any amount of wealth is bound to come to an end if it is not used in business activities. Therefore, wealth is invested in business activities and it brings about expansion and growth in the economy. Ultimately, it results in alleviation of poverty and reduction in unemployment.

(4) Fair Distribution of Wealth

In present days, our society is confronted with the major issue of unequal distribution of wealth. This issue has divided the society into two classes; haves (the rich) and have-nots (the poor). The rich are living in a very luxurious way, whereas miserable life is the fate of the poor. This unequal distribution of wealth is the root cause of feelings of hatred and malice among the poor and the rich. Islam, however, provides a practical solution of this issue in form of Zakat, Usher and charity. Every Muslim, having wealth exceeding a defined limit, has to pay Zakat to the deserving people. In this way, the poor also get their share in income/wealth. It alleviates poverty and promotes employment.

(5) Brotherhood and Cooperation

Zakat, Ushr and charity helps in promoting atmosphere of brotherhood, unity and peace. The mechanism of transferring of wealth from the rich to the poor fosters and boosts the love and respect of the rich in the eyes of the poor. In this way, the whole society lives in harmony and peace. There are very few crimes in an Islamic society since the people are employed and have basic necessities of life.

Instruments of Zakat, Usher and charity increase purchasing power of the poor through redistribution of income/wealth, which rises aggregate demand. It, in turn, increases output/production to meet additional demand which generates more employment opportunities. High employment level increases national income which ultimately results in economic growth and development of the economy.

Exercise

Q.1: Each statement has four possible options. Tick (✓) the best one:

1. In which system, rights of private ownership have been given to the human being as a Caliph?
   - a. Capitalism b. Socialism
   - c. Islamism d. Mixed system
2. Which system is based on the principles of moderation?
   - a. Capitalism b. Socialism
   - c. Islam d. Mixed system

Q. 2: Complete the following statements by filling in the missing words or phrases:

1. Islamic economic system is based on .... banking system.
2. .... of wealth is prohibited in Islamic economic system.
3. Literary meanings of .... are growth and purification of wealth.
4. Zakat is a religious duty of each .... Muslim.
5. Literary meanings of Usher are ....

Q. 3: Match the statement in column A with the statement in column B; choose the answer from column B to write in column C:

A	B	C
Islamic economic system	Religious financial duty	
Rate of Zakat	Purification and growth	
Zakat	Complete code of life	
Meanings of Zakat	2.5 percent	
Purpose of Zakat	Circulation of wealth	

Q. 4: Answer the following questions in three sentences:

1. What is meant by Zakat?
2. Write five characteristics of Islamic economic system.
3. Why it is said that Islamic economic system is moderate?
4. How are poverty and unemployment alleviated by Zakat?

Q. 5: Answer the following questions in detail:

1. What is meant by Islamic Economic system?
2. Write down salient features of Islamic economic system?
3. What is Zakat and who can be the recipient of Zakat?
4. How can the issue of unemployment be resolved through Zakat, Usher and charity in a Muslim state?

ANSWERS TO OBJECTIVE QUESTIONS

CHAPTER 1 INTRODUCTION TO ECONOMICS

Q. 1: (1) d (2) c (3) d (4) c (5) d

Q. 2: (1) Scare (2) Alfred Marshall (3) Alternative.
(4) Adam Smith. (5) Wealth

Q. 3: Column 'C'

(1) Scarcity, is less than required
(2) Material welfare's, measurement is not possible.
Micro-economics deals with, the study of an individual of a firm.
(3) Macro-economics deals, with, the study of economic aggregates as a whole.
(4) Social science deals with the study of human behaviour.

CHAPTER 2 SUBJECT MATTER OF ECONOMICS

Q.1: (1) c (2) c (3) d (4) b (5) c

Q.2: (1) falls (2) struggles (3) demand
(4) necessary (5) derived

Q.3: Column 'C'

(1) For economic goods, money is spent.
(2) For non-economic goods, money is not needed.
(3) For goods and services, expenditures are undertaken.
(4) For consumers' goods, producer goods are needed.
(5) For demand of a good, it must have a feature of satisfaction.

CHAPTER 3 DEMAND

Q.1: (1) a (2) a (3) d (4) c

Q.2: (1) increases (2) demand (3) increases (4) elasticity

Q.3: Column 'C'

(1) Complementary good: An increase in the price of one good decreases the demand for the other good.
(2) Inferior good is a good whose quantity demanded decreases with a decrease in price.
(3) Normal good: A decrease in the price of a good increases the quantity demanded.
(4) Scare good is a good whose quantity demanded increases with an increase in price.
(5) Substitute good: an increase in the price of a good increases the demand of another good.

CHAPTER 4 SUPPLY

Q.1: (1) c (2) b (3) b (4) b (5) b
Q.2: (1) is reduced (2) positive (3) stock (4) function (5) increases
Q.3: Column 'C'
(1) Elasticity of supply: Change in quantity supplied due to a change in price.
(2) If price is higher, then produces increases supply.
(3) Tax on goods: reduces the quantity supplied.
(4) More elastic supply: Small change in price but significant change in quantity supplied.
(5) Less elastic supply: Large change in price but small change in quantity supplied.

CHAPTER 5 EQUILIBRIUM AND PRICE DETERMINATION

Q.1: (1) d (2) d (3) d
Q.2: (1) equilibrium (2) supply (3) equilibrium price
(4) individual action (5) negative slope
Q.3: Column 'C'
(1) Market: A place where sellers and buyers are present.
(2) Perfect Competition: Where no one can fix price with individual action.
(3) Equilibrium price: Where supply and demand are equal.
(4) Demand curve: Negative slope.
(5) Supply Curve: Positive slope.

CHAPTER 6 MARKET AND PRODUCTION

Q.1: (1) d (2) d (3) c (4) d
Q.2: (1) variable (2) inelastic (3) long run (4) supply (5) income
Q.3: Column 'C'
(1) In imperfect market, prices of goods are different.
(2) In long run market, land is a variable factor of production.
(3) In daily market, price changes daily.
(4) In perfect market, there is a rule of one price.
(5) In short run market, land is fixed factor of production.

CHAPTER 7 ECONOMIC PROBLEMS OF PAKISTAN AND THEIR REMEDIAL MEASURES

Q.1: (1) 66 (2) 1658.36 (3) 2.4% (4) 19% (5) 231.4
Q.2: (1) under developed (2) per person (3) 2.2 (4) 63% (5) 20

Q.3: Column 'C'

(1) Agriculture sector contribution to GDP is 19.1%.
(2) Rate of industrial development is 21.02%.
(3) Rate of population growth is 2.4%.
(4) In 2021-22, literacy rate was 58.9%.
(5) Share of expenditure on education in total national income is 2.2%.

CHAPTER 8 BASIC CONCEPTS OF NATIONAL INCOME

Q.1: (1) a (2) a (3) c (4) d (5) c

Q.2: (1) total population (2) money value
(3) per capita income (4) transfer payments
(5) depreciation allowance

Q.3: Column 'C'

(1) Reward of physical and mental labour is: income
(2) Per capita income is $= \dfrac{\text{Total national income}}{\text{Total population}}$
(3) Subsidies are: government allowances.
(4) Transfer payments are Zakat and gifts etc.
(5) Services without payments are like: ironing one's own clothes.

CHAPTER 9 MONEY

Q.1: (1) d (2) b (3) b (4) a (5) b

Q.2: (1) barter system (2) standard money (3) credit money
(4) Taken money (5) falls

Q. 3: Column 'C'

(1) Postal certificates: are near money.
(2) Fiat money: is legal tender.
(3) Source of transaction of good: is medium of exchange.
(4) Purchasing power of money means: value of money.
(5) Easy transfer of wealth means: easy transfer of place.

CHAPTER 10 BANKS

Q.1: (1) b (2) d (3) b

Q.2: (1) bank rate (2) proportional reserve (3) 1981
(4) modaraba (5) monopoly

Q.3: Column 'C'

(1) Fixed fiduciary system - inelastic
(2) Under central bank –scheduled banks
(3) Deflation – decrease in purchasing power

(4) Issuance of notes – central bank
(5) Central bank – controller of money supply

CHAPTER 11 TRADE

Q.1: (1) b (2) b (3) d (4) a (5) c
Q.2: (1) domestic trade (2) cotton (3) specialization
(4) payments (5) difficulties
Q.3: Column 'C'
(1) Optimum utilization of resources - specialization
(2) Invisible goods can not be seen.
(3) Regional trade of goods – domestic trade.
(4) Visible good – machine
(5) Transportation goods – buses and trucks

CHAPTER 12 PUBLIC FINANCE

Q.1: (1) a (2) c
Q.2: (1) private finance (2) advertises (3) tax
(4) estimate (5) 30^{th} June
Q.3: Column 'C'
(1) Budget duration – one year
(2) Source of public revenue – taxes
(3) Do not disclose income – general public
(4) Income tax – direct deduction
(5) Fine – wrong parking

CHAPTER 13 ECONOMIC DEVELOPMENT

Q.1: (1) b (2) d (3) c (4) d (5) d
Q.2: (1) slow (2) backbone (3) means of communication
(4) modern technology
Q.3: Column 'C'
(1) Economic development – increase in real national income
(2) Infrastructure – basic need of our economy
(3) Contribution of agriculture sector – 19.1%
(4) Economic factor – technology
(5) Means of communication – internet

CHAPTER 14 ECONOMIC SYSTEM OF ISLAM

Q.1: (1) c (2) c

Q.2: (1) interest free (2) concentration (3) zakat
(4) sahib–e–nisab (5) 10%

Q.3: Column 'C'

(1) Islamic economic system – complete code of life
(2) Rate of zakat – 2.5%
(3) Zakat – religious financial duty
(4) Meanings of zakat – purification and growth
(5) Purpose of zakat – circulation of wealth

GLOSSARY

Assets: The goods which have some monetary value and are owned by an individual or institution, for instance car, real estate property, gold etc.

Autonomous Investment: Autonomous investment is motivated by service motives and is independent of margin of profit. It is income inelastic and as such, it is not influenced by variation in income. Since it is not profit oriented, it remains unaffected by the variation in income, price, wage, rent, etc.

Capital Formation: It is accumulation of or increase in capital of an economy during a particular period of time; for instance increase in industries, roads, dams, capital goods and tools etc during a specific period of time.

Capital Goods: The goods which do not directly satisfy human wants but help in production of goods required for satisfying human needs. Examples of such goods are machinery, buses/trucks, tools etc.

Consumer: Everyone who satisfies his wants by consuming goods and services is called consumer of those goods/services.

Consumers' Goods: The goods that directly satisfy human wants, such as food, clothing etc.

Consumption: An act of getting direct satisfaction by using goods and services is termed consumption. For example, satisfying hunger by eating food, acquiring education from a teacher etc.

Credit Money: It refers to the credibility and trust that a lender has in borrower that lender shall fulfill his obligation to repay the amount of credit on promised date.

Deficit Budget: A budget where government revenue falls short to meet its expenditure.

Derived Demand: Indirect demand of a factor of production is called derived demand, for example demand for service of labourer to build a house. Likewise, an increase in demand for goods brings about an increase in demand for labourer.

Economic Structure: Detailed explanation of an economic term, in relation to specific circumstances of an economy.

Equilibrium: A situation where various economic factors do not exhibit any tendency to change.

Factors of Production: Inputs used for production of goods and services are called factors of production. There are four factors of production which include capital, labour, land, and organization.

Fiscal Policy: Policy adopted by the government for raising its income and finances to meet its expenditure is called fiscal policy.

Function: The relationship between variable and variable factors is termed as 'function'. For example, quantity demanded is a function of price; a change in price shall bring about a change in quantity of that commodity.

Goods: The things which have utility are called goods. For instance, cloth, shelter, fruits, bread, pen etc.

Hoarding: Savings which temporarily remain unutilized and not invested.

Hundi: A document signed by a businessman at the time of purchasing goods on credit. The document acts as a security in favour of seller and contains terms and conditions relating to the transactions.

Increasing: When two variables move in the same direction, upward or downward, they are called having increasing relationship between themselves. For instance, increase in price of a commodity stimulates rise in its supply.

Induced Investment: The investment which is motivated by the margin of profit, i.e., the higher the margin of profit is, the larger the volume of investment. Since margin of profit depends on the size of income and as such, induced investment is income elastic. It means that as the income rises the investment also rises and vice versa.

Inflation: A continuous rise in price level is called inflation. Its main cause is increase in supply of money without corresponding rise in supply/production of goods.

Investments: Using the saved resources in productive activities to generate more income is called investment.

Invisible Goods: Intangible items movement or flow of which could not be physically checked. Invisible goods normally refer to services, such as shipping, communication, banking, insurance etc.

Joint Stock Company: A business venture the capital for which is contributed by a number of persons. Its shareholders could sell its shares in the stock/shares market.

Market Price: It refers to a temporary equilibrium of demand and supply of a particular commodity at a given day/time. It may keep on changing due to rise/fall in demand and supply of a particular commodity.

Material Requisites: The goods and services which can not be purchased without money, such as food, cloth, house, etc.

Monetary Policy: Monetary policy is a tool used by the central bank or the government in order to achieve specific targets, by increasing or decreasing the money supply.

Money Market: Money market generally is a market where there is buying and selling of short term liquid debt instruments. Financial instruments traded in money markets are short term bonds of the Government of Pakistan

(Federal Investment Bonds, Treasury Bills), Private sector corporate bonds, debentures are called money etc.

Nationalization: The act of the Government to own privately owned organizations and put them under its direct control is known as 'nationalization'.

Perfect Competition: It refers to a situation where a number of sellers and buyers are present in the market to transact a particular commodity at the same price.

Protection: It means government policies and actions to protect domestic industries/produces from tough competition that such industries/producers have to face if foreign firms are allowed to sell their products in the home market. For example, imposition of heavy import duty on import or providing subsidy to local producers shall make imported commodities costly as compared to locally produced goods.

Raw Material: Basic material used in production of consumable goods and commodities is called raw material. Examples of raw material are cotton used for production of cloth, sugarcane/beet for sugar, oil seed for ghee/cooking oil, animal skins/hides for leather-wears etc.

Reserve Capital: The money which commercial banks are legally bound to keep with the central bank is called reserve capital. The central bank keeps on changing this reserve capital ratio to respond money demand in the market and to achieve its goals.

Saving: It is that part of one's income which he does not spend but saves it for his future needs.

Scarcity: A good which has lesser supply than its demand and has a price is called 'a scare good'. For instance food, cloth etc; which are not free gift of nature like air, sunlight etc.

Securities: Documents issued to lenders at the time of their lending money to the Government or other organizations. Such documents stipulate terms and conditions governing the lending of money.

Services: It refers to intangible/non-material goods which satisfy human wants, for example services of doctor for healthcare, services of teachers for education, services of police for law and order etc.

Surplus Budget: A budget where government revenue exceeds its expenditure.

Terms of Trade: The rate at which goods are transacted in the international market is called 'terms of trade'.

The money sent to home-country from abroad in return to export of commodities or providing services. It refers to amount with the government in form of currencies of various countries.

Undistributed Profit: That part of profit of an organization which is not distributed among its shareholders but is retained in the business.

Unlimited Wants: This term means numerous desires of human being, such as food, clothing, shelter, car etc, which have no ends. Human being dies while struggling to satisfy those unlimited desires.

Utility: It is a measure of satisfaction. The amount of satisfaction a person derives from consumption of goods or service. For example, bread satisfies hunger and water satisfies thirst.

Visible Goods: Goods which exist physically, such as buildings, food, clothes etc. Flow/movement of such goods can be recorded at each stage of their transaction.

Wealth: Goods and commodities possessing certain value and are comparatively scarce in supply as compared to their demand, for instance gold, cash, car, real estate property etc.

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