Gujarat Board Textbook Solutions Class 12 Economics Chapter 3 Money and Inflation

1. Choose the correct option for the following questions :

Question 1. Who gave the definition "What is accepted universally in exchange of goods or services is money"?
(a) Marshall
(b) Keynes
(c) Pigou
(d) Robertson
Answer:
(d) Robertson

Question 2. What is the type of inflation called when there is an increase in demand?
(a) Demand-pull
(b) Cost induced
(c) Salary induced
(d) Profit induced
Answer:
(a) Demand-pull

Question 3. What is the value of money during constant and steady price increase?
(a) Increases
(b) Decreases
(c) Constant
(d)Doesn't change
Answer:
(b) Decreases

Question 4. What is the type of inflation when the government controls inflation via rules or laws?
(a) Suppressed
(b) Open
(c) Galloping
(d) Hidden
Answer:
(a) Suppressed

Question 5. Which economist believes that the true inflation is caused when there is rise in prices even when there is full employment?
(a) Marshall
(b) Crowhter
(c) Keynes

(d) Pigou
Answer:
(c) Keynes

Question 6. What is the economic system called that allows exchange of rice instead of clothes?
(a) Monetary system
(b) Banking system
(c) Barter system
(d) Loan system
Answer:
(c) Barter system

Question 7. Which of the following can be used as the best means for storage of value?
(a) Crops
(b) Animals
(c) Stones- minerals
(d) Coins
Answer:
(d) Coins

2. Answer the following questions in one line :

Question 1. Write the meaning of barter system.
Answer:
Barter is a system of exchange where
goods or services are directly exchanged for other goods or services without using a medium of exchange, such as money.

Question 2. Write the definition of money given by Marshall.
Answer:
"Money is that medium which is used as a means of exchange without any doubt or investigation regardless of time or place''.

Question 3. Normally what is inflation?
Answer:
Inflation is an economic problem which means increase in price levels of goods or services over a time period.

Question 4. What is cost-push inflation?
Answer:
Cost induced inflation is when there is inflation due to increase in production cost like increase in cost of raw material, machines, electricity, water rates, etc. The other name of cost induced inflation is supply shock inflation.

3. Answer the following questions in brief :

Question 1. Discuss the function of money as a medium of exchange.
Answer:
Money as a medium of exchange:

- The most important function of money is to act as a medium of exchange and trade.
- Money overcomes the limitation of the lack of 'double coincidence of wants' and makes exchanges easier.
  For example, a farmer can get money in exchange of wheat and then from that money he can buy
- clothes, shoes, oil, etc.
- An individual can spend money to satisfy his present demands of goods and supplies. He can also save the money to satisfy his future needs for goods and supplies.

Question 2. Discuss the function of money as store of value.
Answer:
Money as a store of value:
Before money became the medium of exchange it was difficult to generate and save wealth. for future needs of goods and supplies.

- It was not possible to keep animals as wealth because animals are living beings and they grow old and die one day. This made money the most successful means of storage of value in terms of time.
- It is easy to have money as a 'storage of value'. Moreover, it can also be used to exchange crops or any other goods and services needed presently or even in future.
- Another advantage of using money is that it can be used in deferred payment. The credit system, loans, investment rates, sales-purchase methods, etc. got benefitted due these characteristics of money.

Question 3. State the causes of inflation.
Answer:
Some important minor factors that may cause inflation are discussed below:

1. Taxation policy:

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

2. Increase in import price:

- India imports 70% of its total required petroleum products.
- When the price of crude oil rises in international market it will lead to rise in price of petrol and diesel. This then increase price of several other products too.

3. Scarcity:

- Scarcity of raw material, electricity or any resource needed for production leads to increase in price levels of the goods or services.
- If scarcity prevails for a longer period during production or is extensive in nature it can cause inflation.

4. Give answers to the point for the following questions :

Question 1. Define money and explain its functions in brief.
Answer:
Money:

- Money is such a thing which can be used as a means of exchange without any inconvenience or investigation regardless of time or place.
- In other words anything that performs the functions of money is called money.

Functions of money:
1. Money as a medium of exchange:

- The most important function of money is to act as a medium of exchange and trade.
- Money overcomes the limitation of the lack of 'double coincidence of wants' and makes exchanges easier.
- For example, a farmer can get money in exchange of wheat and then from that money he can buy clothes, shoes, oil, etc.
- An individual can spend money to satisfy his present demands of goods and supplies. He can also save the money to satisfy his future needs for goods and supplies.

2. Money as a store of value:

Before money became the medium of exchange it was difficult to generate and save wealth. for future needs of goods and supplies.

- It was not possible to keep animals as wealth because animals are living beings and they grow old and die one day. This made money the most successful means of storage of value in terms of time.
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3. Money as a measure of value:

Money plays an important role as a measure of value.

- In Barter exchange system it became increasingly difficult to remember the exchange rates and values of each of the goods or services.
- A person had to always remember how much goods or services he will get for 20 kg rice or how much cloth will he get for 1 kg ghee and so on.
- This limitation was overcome by money. Money makes this problem easier by allowing the values of different goods or services to be compared and assessed against each other.
- Money enables the working of the price-system. The price-system allows deciding the price of each goods and services and also makes it possible to compare the value of these goods and services with each other.
- Money also allows faster decision making and exchanges.

Question 2. Write a short note on the origin and evolution of money.
Answer:
Origin and evolution of money (Evolution of money):

(A) Use of animals:
Initially, people started using animals as standard measurement value, medium of exchange and as an easier means of storage:

- In olden days agriculture the major sector of the economy and hence there was a large production of crops.
- Producers used to stock the needed produce and sold rest of the crops to buy animals. In Other words they exchanged their crops against animals. They used to then sell animals when they wanted to buy goods or at times even other crops.
- This way animals like horse, cow, and buffalo became the means of exchange and trade. In India cows were considered as wealth and were used for trade in this system. Higher the animals a person possessed more rich and wealthy he was considered.
- The problem with this system was that animals are mortal. They get sick and die. Therefore it was not possible to store the wealth in the form of animals.

(B) Use of mineral-stones and coins:

- Owing to the limitations of the animals as a standard value, people started using mineral-stones instead of animals.
- When the era of imperialism began, people started using coins as a means of trade and exchange of goods and services in the kingdom. The only limitation was that they were used in limited societies and regions.

(C) Use of money:

- Democracy and industrialization inspired the need for the modern money as a means of exchange.
- Money with the support of central government became widely accepted as a means of exchange of goods and services.
- Money also succeeded in overcoming the limitation of storage of wealth.
- With the establishment of banks it even became easy to transfer and store money.

Question 3. Explain the statement "Too much money chasing too few goods causes inflation".
Answer:

- "Too much money chasing too few goods causes inflation" is a statement given by Machlup. With these words he points out that increased, demand demands more goods whose supply is less.
- When the demand increases and there is shortage of supply, there are more buyers for a good as compared to the sellers. So it is like more money is chasing less amount of goods available in the market. This becomes a cause of inflation.

5. Answer the following questions in detail :

Question 1. Define barter system and explain limitations of barter system.
Answer:
Barter system:
The system of exchange where goods or services are directly exchanged for other goods or services without using a medium of exchange, such as money is known as the Barter System. This system existed in olden times.

Limitations of Barter system:

- When the population increased and the world developed socially as well as economically, the demand for goods and services of people changed as well as increased.
- With the rise in industrialization, urbanization, division of labour and Specialization made the Barter system limited, less applicable and impractical.
- Dependency on mutual exchanges decreased and the personal needs increased which the Barter system proved unable to solve.

The limitations of Barter system are explained below:

1. Issue of 'double coincidence of wants' and mutual adjustment of wants:
When the world grew socially as well as economically, the needs of people grew and

changed continuously This made the economic system complicated. For example, those who had rice to exchange for wheat did not need wheat but clothes for the barter. While on the other hand the one who had clothes did not want rice but wanted oil in exchange of clothes. The Barter system assumes 'coincidence of wants' as a continuous process. This coincidence may not hold true always and the traders willing to exchange may not be in need of item that the other trader would like to exchange. This served as a major limitation of the Barter system.

Such needs made it difficult to barter. The rising needs also proved to be a challenge for establishing barter between indivisible and divisible goods.

2. Difficulty in storing wealth:

- The Barter system posed the problem of storage of the exchanged and acquired goods or wealth.
  For example, a farmer had to store large amount of crop that too for a very long period in order to fulfill even the simplest needs like shoes or clothes that he may need in the future. This became practically impossible.
- A person like farmer producing goods in large volumes had to immediately exchange his goods against other goods or services. In case he failed to do this he had to store his large volume of production for a long time which was not possible.

3. Problem of measurement of value:

- When the world moved towards division of labour and specialization problems of measuring the value of products, goods or services on equal basis arose.
- For example, it was easy to exchange wheat for rice and also easy to . maintain their rates. But, as economic development took place several goods and services started getting exchanged. This made exchange of products like wheat with other goods and services difficult.
- Problems like, if 20 kg of wheat can be exchanged for 40 kg of rice, 10 meters of cloth and 1 kg of ghee, then how much cloth can one get for 1 kg ghee?
- These problems posed the need of a common measure of value of goods to compare and assess the values of all goods against each other.
- These difficulties led to the origin of money. Money became a standard measure of value and a common denomination of trade.

Question 2. Define inflation and explain the causes of inflation.
Answer:
Inflation:

- An increase in price level of goods or services over a period of time is called inflation.
- The two major aspects that affect the price of goods and services are: Demand and Supply.

Based on these two aspects we can say that inflation is affected by two major factors namely,
(A) Increase in demand and
(B) Increase in production cost.

(A) Increase in demand:

- If the demand of a product rises, its price rises. Similarly, when the demand increases and the supply is lesser than the demand even then price rises.
- In economics if inflation takes place due to increase in demand compared to supply then such inflation is called 'Demand-pull inflation'. The major reasons for increase in demand are following are discussed below.

1. Increase in supply of money:

- Monetarists consider inflation as a purely monetary phenomenon.
- According to them, if the quantity of money increases in an economy then income of people rises.
- When income rises affordability of people increases and they demand more goods and services. This increases the demand of goods and services. Against this increasing demand, the supply does not increase much and so it leads to inflation.
- According to Machlup, "Too much money chasing too few goods causes inflation". In other words, increased demand demanding more goods i.e. more money demanding more goods whose supply is pretty less.

2. Increase in public expenses (Government expenses):

- The government of developing countries like India is involved in economic development of the country.
- In order to achieve economic development it invests huge money through various projects related to employment, fulfilling basic requirements, raising infrastructure and financial infrastructure. The money put in these projects increases the supply of money in economy.
- Owing to these investments people start gaining more income and their purchasing power increases. They then demand more goods and services. This increases the demand of goods and services which leads to inflation.
- The inflation rises even faster when the government does huge public expense and supplies more money for economic development as compared to production of goods and services done in the market.

3. Over-population:

- In India every year the population increases by 2%. The increasing population demands more goods and services. Price rise takes place when the supply is not able to match up with this rising population.
- Alternatively, if there is no rise in population i.e. it is steady but the purchasing power of people increases even then it leads to price rise.

(B) Increase in cost of production:

- Supply is the second major factor that affects the price of goods. People who support the theory of 'supply-side economics' believe that when the production cost increases the price of the good also increases.
- If there is an increase in cost of raw material, machines, electricity, water rates, worker's wages or transportation it will lead to increase in price of goods or services.
- Inflation caused due to increase in production cost is called 'Cost-push inflation' or 'Supply shock inflation'.

(C) Other reasons:

- Several other factors can affect the inflation. Some factors may look minor factors and may also affect for a short term but still such factors can shoot the price levels.
- For example, in case of industries that are dependent on foreign import, increase in import taxes or accidental shortage of some items can also lead to price rise.

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