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B.A.Part-1(Hons.)

(Paper-2)

Value Of Money

Preparation of Index Numbers:

The following steps are necessary for the preparation of index numbers:

(a) Selection of the Base Year:

The first thing necessary is to select a base year. It is the year with which we wish to compare the present prices, in order to see how much the prices have risen or fallen. The base year must be a normal year. It should not be a year of famine, or war, or a year of exceptional prosperity.

(b) Selection of Commodities:

The next step is to select the commodities to be included in the index number. The commodities will depend on the purpose for which the index number is prepared. Suppose we want to know how a particular class of people has been affected by a change in the general price level. In that case, we should include only those commodities which enter into the consumption of that class.

(c) Collection of Prices:

After commodities have been selected, their prices have to be ascertained. Retail prices are the best for the purpose, because it is at the retail prices that a commodity is actually consumed. But retail prices differ almost from shop to shop, and there is no proper record of them. Hence we have to take the wholesale prices of which there is a proper record.

(d) Finding Percentage Change:

The next step is to represent the present prices as the percentages of the base year prices. The base year price is equated to 100, and then the current year's price is represented accordingly. This will be clear from the index number given on the next page.

(e) Averaging.

Finally, we take the average of both the base year and the current year figures in order to find out the overall change. In May 1985, the price index was 355 which means that the price on the average were more than three-and a-half times as much or 255 per cent higher than what they were in 1970-71.

Uses of Index Numbers:

Index numbers can be used for a number of purposes:

(i) Index numbers are used not merely to measure changes in the price level or changes in the value of money. They can be used to measure quantitative change. Thus, we can prepare an index number of wages, imports, exports, industrial production, unemployment, profits, area under cultivation, enrolment in a college, etc.

Commodities	Base Year (1970-71) price	Base Year Index	Current Year (May 1985) price	Current Year index.
1. Wheat	Rs. 70 (per quintal)	100	Rs. 2.10	300
2. Sugar	Rs. 2.40 (per kg)	100	Rs. 5.40	225
3. Milk	Rs. 1.50 (per litre)	100	Rs. 4.50	300
4. Cloth	Rs. 2.00 (per metre)	100	Rs. 2.25	500
5. Kerosene oil	50 paise (per litre)	100	Rs. 10.00	450
Average		$\frac{500}{5} = 100$		$\frac{1775}{5} = 355$

(ii) Such quantitative changes as are measured by index numbers can indicate social and economic trends and help in framing policies with respect to them. For instance, an index number of cost of living can guide us in the adjustment of wages to changing prices.