Name ; Arzoo
ID ; 16225
Department : MSMC
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# Final Assignment.

Q1) Discuss the following concepts ?

1. Gross Domestic product
2. Gross National product
3. Inflation Rate and exchange rate
4. Government expenditure
5. Aggregate demand and aggregate supply
6. Consumption expenditure

Ans) **Gross domestic product :**

Gross domestic product (GDP) is the total monetary or market value of all the finished goods and services produced within a country's boarders in a specific time period. As a broad measure of comprehensive scorecard of a given country's

economic health . Though GDP is typically calculated on  an annual basis, it is sometimes calculated on an annual basis as well.in the U.S., for example ,the government releases an annualized GDP estimate for each fiscal quarter and also for the calendar year. The individual data sets included in this report are given in real terms ,so the the data is adjusted for price changes and is, therefore,net of inflation . In the U.S., the Bureau of Economic Analysis (BEA) calculates the GDP using data escertained through surveys of retailers,manufactures, and builders, and by looking at trade flows.

- Gross Domestic product GDP is the monetary value of all finished goods and services made within a country during a specific period.
- GDP provides an economic snapshot of a country ,used to estimate the size of an economy and growth rate .

- GDP can be calculate in three ways, using expenditures, production, or incomes. It can be adjusted for inflation and population to provide deeper insights

Though it has limitations,GDP is a key tool to guide policymarkers,investors,and businesses in strategic decision making

Gross National product ; Gross national product (GNP) is an estimate of total value of all the final products and services turned out in a given period by the means of production owned by a country'S residents.GNP is commonly calculated by taking the sum of personal comsumption expenditures.private domestic investment ,government expenditures, net export and any income earned by residents from overseas invetsment, minus income earned within the domestic economy by foreign residents a

country exports minus any import of goods and services. GNP is related to another important economic measure called gross domestic product (GDP), which takes into account all output porduced within a country’s borders regardless of who owns the means of production . GNP start with GDP , adds resident,s investment income from overseas investments, and subtracts foreign residents investment income earned within a country.

# Inflation and exchane rate:

The rate of inflation in a country can have a major impact on the value of the country,s currency and the rates of foreign exchange it has with the currencies of the nations. However,inflation is just one factor among many that combine to

influence a country's exchange rates with other nations negatively.

Inflation is closely related to interest rates, which can influence exchange rates.countries attempt to can influence exchange rates. Countries attempt to balance interest rates and inflation,but the interrelationship between the two is complex and often difficult to manage .low interest rates spur consumer spending and economic growth, and generally positive influences on currency value. If consumer spending increases to the point where demand exceeds supply, inflation may ensue,which is not necessarily a bad outcome.but low interest rates do not commonly attract foreign investment ,which is likely to increase the demand for a country's currency. The ultimate determination of the value and exchange rate of a nation,s currency is the perceived desirability of holding that nations currency.

# Government expenditure ;

Government expenditure is and important component of AGGREGATIVE DEMND in the circular flow of income/expenditure  accounted for 15% of gross final expenditure(GFE)  on domestically produced output. GFE minus imports =GROSS DOMESTIC PRODUCT. Government expenditure is used as an instrument of fiscal policy in regulating the level of spending in the economy. However ,short-term changes in government expenditure may be difficult to achieve because of administrative and political difficulties,especially where cuts in expenditure are being made with a view to contracting aggregate demand.for example ,short -term cuts can be difficult to achieve in health , education , etc ,.expenditures given the labour-intensive nature of these activities ,without heavy redundancies and disruption of public

services, while cuts in transfer payments to poorer members of the community are politically unpopular . Furthermore,where the brunt of exchanges fall upon public investment expenditures, this can severaly disprut long term investment projects while cut serve to deplete the social infrastructure . In addition , where government expenditure includes spending on goods and services bought in from businesses , changes can private sector .

# Aggregate demand and Aggregate supply ;

In the short run,output is determined by both the aggregate demand and aggregate supply within an economy . Anything that causes labor ,capital,or efficiency to go up or down results in fluctuations in economic output .

Aggregate supply and aggregate demand are graphed to gather to determine aquilibrium . The equilibrium is the point where supply and demand meet.

According  to Hume, in the short run, and increase in the money supply will lead to an increase  in production .

According to Hume, in the long run, an increase in the money supply will do nothing.

Aggregate supply is the total amount of goods and services that firms are willing to sell  at a given services that firms are willing to sell at a given price in an economy . The aggregate demand is the total amounts of goods and services that will be purchased at all possible price levels.  In a standard AS-AD model ,the output (y) is the x-axis and

price (p) is the y-axis. Aggregate supply and aggregate demand are graphed toghether to determine equilibrium. The equilibrium is the point where supply and demand meet to determine the output of a good or service.

# Consumption expenditure;

Consumption expenditure is the spending by households on goods and services , excluding new housing . In developed countries it has become the largest component of Gross domestic product. Final consumption expenditure of households includes all goods and services ecquired by the household from finland and abroad for its private consumption during the survey period, including own and received gardening and collected products and imputed housing expenditure. In addition,includes are goods and

services received from other households and current transfers comparable to consumption . Reypayment of housing and comsumption loans is not included in consumption expenditure . Consumption expenditure does not either contain direct taxes , investments.(e,g . Purchase of a dwelling), expenditure of business activities and products bought for other households. The consumption concept does not includes benefits gained from households use of public welfare services (e,g.health care and education).

Households final consumption expenditure is formed as follows:

+purchases of consumption goods and services

+own products (agricultural,gardening and collected products )

+imputed dwelling income from an owner -occupied dwelling and a dwelling provides as a benefit in kind

+ goods and services received

+ current transfers comparable to consumption(e.g church tax and labour union membership fees and interest on consumption loans)

= total consumption expenditure

The classification of consumption used in the household budget survey is based on Eurostats COICOP-HSB comsumption by purpose).

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Q2) Explain the following  concepts in detail ?

1. Natural rate of unemployment
2. Frictional unemployment

3. Structural unemployment
4. Cyclical unemployment
5. Minimum wage law
6. Efficiency wage thery

Ans) **Natural rate of unemployment:**

The average rate of unemployment around which the economy fluctuates.

In a recession,the actual unemployment rate rises above the natural rate.

In a boom ,the actual unemployment rate falls below the natural rate.

## A first model of the natural rate

Notation:

L= # of workers in labor force

E= # of employment workers

U= # of unemployed

U/L= unemployment rate

# Assumptions:

1. L is exogenously fixed .
2. During any given month,

S= fraction of employed workers that become separated from their jobs

S is called the rate of job separations

F= fraction of unemployed workers that find jobs

F is called the rate of job finding

S and F are exogenous

## The steady state condition; The labor market is in steady state , or long run equilibrium, if the unemployment rate is constant.

The steady state condition is:

S ,E

Of employed people who lose or leave their jobs

F,U

Of unemployed people who find jobs

Finding the “equilibrium” U rate

F,u = s,E

= s,L – s,U

Solve for U/L

(F+s),U =s,L

So,

U , s

L , s,f

Example; each month

1% of employed workers lose their jobs

(S=0.01)

19% of unemployed workers find jobs

(f=0.19)

Find the natural rate of unemploment :

U, s , 0.01 , 0.05, or 5%

L , s ,f 0.01,0.19

**Policy implacation;** if job finding were instantaneous (f=1), then all spells of unemployment would be brief, and the natural rate would be near zero.

There are two reasons why f< 1:

1. job search
2. wage rigidity.

Frictional unemployment; caused by the time it takes workers to search for job. Occurs even when wages are flexible and there are enough job to go around occurs because . Workers have different abilities , preferences .

Job have different skill requirements

Geagraphic mobility of workers not instantaneous

Flow of information about vacancies and job candidates is imperfect.

# Structural unemployment;

changes in composition of demand among industries or regions.

Example; Technological change

More jobs repairing computers ,fewer jobs repairing typewriters

A new international trade agreement labor demand increases in export sectors, decreases in import-competing sectors

## Sectoral shifts: late 1800s: decline of agricultural ,increase in manufacturing

Late 1900s :relative decline of manufacturing, increase in service sector

1970s; energy crisis caused a shift in demand away from gas guzzlers toward smaller cars.

Cyclical unemployment : cyclical unemployment is the component of overall unemployment that results directly from cycles of Economic upturn and downturn. Unemployment typically rises during recessions and declines during economic expansions. Moderating cyclical unemployment during recession is a major motivation behind the study of economics and the goal of the various policy tools that governments employ to stimulate the economy.

Cyclical unemployment is the impact of economic recession or expansion on the total unemployment rate .

Cyclical unemployment genrally rises during recessions and falls during.economic

expansions and is a major focus of economic policy.

Cyclical unemployment is one factor among many that contribute to total unemployment , including seasonal,structural,frictional,and intitutional factors.

## Minimum wage law:

Minimum wage laws set forth the lowest hourly wage rate an employer may pay employees to perform work. Although minimum wage laws are fairly comprehensive in their coverage , most provide exemptions and/or limitations to their applicability based on factors such as an employes age, an employers size, the type of industry,whether an employee recieves tips , the type of work perfurmed by the

employee,etc  Additionally ,minimum wage laws apply regardless of whether an employer pays an employee by the hour, by salary , by piece,by commission  etc ,unless an exception to the minimum wage law applies.

## Efficiency wage theory :

The idea of the efficiency wage  theory is that increasing wages can lead to increased labour productivity beacuase workers feel more motivated to work with higher pay.

Therefore if firms increase wages -some or all of the higher wage costs will be recouped through increased staff retention and higher labour productivity. In the theory ,higher wages could causes increased labour productivity (MRP). In this

case,the wage increases can pay for themselves.

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Q4) Explain all the factors which can shift aggregate demand and aggregate supply?

Aggregate Demand: The amounts of real domestic output which domestic concumer,businesses,governments,and foreign buyers collevtively will desire to purchase at each possible price level.

Why Aggregate Demand is Downward Sloping;

- Real Balances Effect :because higher reduce real spending power,prices and output are negatively related.

- Foreign purchases Effect ;when domestic prices are high we will export less to foreign buyers and we will import more from foreign producers. Therefore higher prices leads to less domestic output.
- Interest Rate Effect; higher prices lead to inflation which leads to less borrowing and a lowering of RGDP.

## Aggregate supply : The level of real domestic output available at each possible price level

# The Ranges of AS :

.Keynesian Range: large amounts of unemployment make it so that increase in aggregate demand have no effect on wages or prices.

.Classical Range: Full employment makes it so that increase in aggregate demand only increase wages or prices.

.Intermediate Range: Some sectors of the economy reach full employment more quickly than others.

# Variables that shift Aggregate Demand :

- Taxes
- Interest Rates
- Confidance
- Strength of the Dollar
- Government Spending

# Determinants of AD:

Variable : GDP component C,I,G,X

Effect of an increase on AD

Effect of a decrease on AD

Taxes: C,I

Decrease so AD<=

Increase so AD=>

Interest Rates: C,I

Increase so AD=>

Decrease so AD=>

Confidance: C,I

Increase so AD=>

Decrease so AD=>

Strenght of The dollar:  X(exports import)

Decrease so AD <=

Increase so AD=>

Government spending :G

Increase so AD=>

Decrease so AD<=

# Causes of Inflation:

.Demand Pull inflation: The inflation caused by an increase in aggregate demand

.Cost Push Inflation:  Inflation caused by a decrease in aggregate supply

# Government Influence :

# Aggregate Demand

. Government can influence ecomomic activity with aggregate demand side policies effecting:

.Taxes

.government spending

.Interest Rates

## Government Influence : Aggregate Supply

. Government can influence economic activity with aggregate supply side policies affecting

.input costs (labor and wage )

.reducing regulation

. Increase incentives to

Work

Take Riks

. The actions are call supply side Economics.

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