***Mid term exam paper***

***Macroeconomics***

*Submitted by :*

 ***Rida Shams Qureshi***

 ***ID = 14482***

***BBA***

 

**Q1: Select the best suitable answer** **(10)**.

The circular-flow of income diagram is a (b. visual model of the relationships among money, prices, and businesses.)

**2.** The two loops in the circular-flow diagram represent **(**a. (i) the flow of goods and (ii) the flow of services.)

**3.**During a recession the economy experiences (d. falling employment and income.)

**4.** Real GDP (c. also measures real income).

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**5.** If we deduct direct taxes from the personal income, we get (b. Disposable personal income).

**6.** GNP includes (d. Commission payments)

**7.** Which of the following is not macroeconomics (c. Output level of the economy)

**8.** In equilibrium of national income (b. S=I)

**9.** For 3 sector economy, the income equation is (a. Y=C+I+G)

**10.** Which type of unemployment is considered as a healthy sign for economy (d. Frictional unemployment)

**Q2:** Give brief answers to the following questions.**(2+2+3+2+3+3=15)**

1. Thinking about the definition of GDP, explain why transfer payments (zakat, donations etc) are excluded from the calculation of GDP?

ANS: GDP is defined as total market value of all of the full and final goods and services within country in financial year.The transfer payments are made by the government. Transfer payment include social security medicare unemployment insurance welfare programs and subsidies these are not included in GDP because they are not payments for goods and services.

1. Why Net National Product(NNP) isn’t commonly used for the calculation of national income figures?

ANS: Net National Product(NNP) isn’t commonly used for the calculation of national income Because. Net national product (NNP) is the monetary value of finished goods and services produced by a country's citizens, overseas and domestically, in a given period. It is the equivalent of (GNP), the total value of a nation's annual output, minus the amount of GNP required to purchase new goods to maintain existing stock, otherwise known as depreciation.

1. The Bureau of Labor Statistics announced that in December 1998, of all adult Americans 138,547,000 were employed, 6,021,000 were unemployed and 67,723,000 were not in the labor force. How big was the total labor force? What was the unemployment rate?

ANS:

* labor force = employed + unemployed

= 138,547,000 + 6,021,000 = 144,568,000

* Labor force participation rate = labor force/ adult population

Adult population = 138,547,000 + 6,021,000 + 76,723,000 = 212,291,000

= 144,568,000 / 212,291,000 \* 100 = 68,09 %

* Unemployment rate = number of unemployed / labor force \* 100

= 6,021,000/144,568,000\*100 = 4,1648 %.

1. What is the concept of “natural rate of unemployment”?

ANS: The natural rate of unemployment is a mixture of frictional and structural unemployment that in an efficient expanding economy when labor resource in equilibrium. It is really important because it shows the number of unemployed people due to the structure labor force including those replace by technology or those who lack the skill to get hired.

1. Briefly discuss Okun’s Law.

ANS: okuns law pertain to relationship between the U.S economy emeployment rate and its gross national product. It shows that when unemmpolyment goes down by 1% the GNP rises by 3%. Arthure okuns was yale profesor and economist wh studied the relationship between unemplomnt and production. The percentage increases by which GNP changes when unemployement falls by 1% is the okuns coefficient. The economist support an inverse relationship between unemployment and production.believing that when unemployment rises, GNP and GDP will simultaneously fall, and when unemployment declines, GNP and GDP are expected to increase, but the exact amount varies.

Equation: when unemployment goes up by 1% the GDP goes down by 2 %.

**6.** Classical macroeconomics considers the two assumptions of

* Money as just the medium of exchange and Automatic adjustment mechanism

Briefly discuss these two.

ANS: The classical economists believed in the existence of full employment in the economy. To them, full employment was a normal situation and any deviation from this regarded as something abnormal.

If there is general overproduction in the economy, then some labourers may be asked to leave their jobs. The problem of unemployment arises in the economy in the short run. In the long run, the economy will automatically tend toward full employment when the demand and supply of goods become equal.

The classical economists believed that there was always full employment in the economy. In case of unemployment, a general cut in money wages would take the economy to the full employment level. This argument is based on the assumption that there is a direct and proportional relation between money wages and real wages.

**Q3 (a)**Explain the “**consumption equation** “as given by Keynes in his theory.

ANS: The consumption function, or Keynesian consumption function, is an economic formula representing the functional relationship between total consumption and real national income. Where C= Aggregate Consumption of the economy . b = Marginal propensity to consume. Y = Real income or the total output. According to him, as the income increases, a smaller proportion of income is consumed.Since the average propensity to consume falls as income increases, the marginal propensity to consume (MPC) is less than the average propensity to consume (APC).

 **(b)** Suppose the consumption function for two sector economy is given by

 C= 100+ 0.8Y, while I =50

1. What is the equilibrium level of income?

ANS:

C= 100 + 0.8Y

I= 50

So, y= AD , Y = C+ I

Y= 100+0.8+50

0.2y = 150

 y= 750.

1. What is the level of savings at equilibrium level?

ANS: S= Y-C

 = Y - 100 -0.8y

 = 0.2y -100

 = 150 - 100

 = 50.

If output = 800

 = y - AD

 = 800 - 150 - 0.8 \* 800

 = 800 - 150 - 640

 = 10. ans

#  End of the Paper