

UNIT
3

Theories of Employment and Income

INTRODUCTION

FULL EMPLOYMENT

Full employment refers to a situation in which every able bodied person who is willing to work at the prevailing wage rate, is employed. In other words full employment means

UNEMPLOYMENT

Unemployment is problem faced when there are people, who are willing to work and able to work but cannot find suitable jobs.

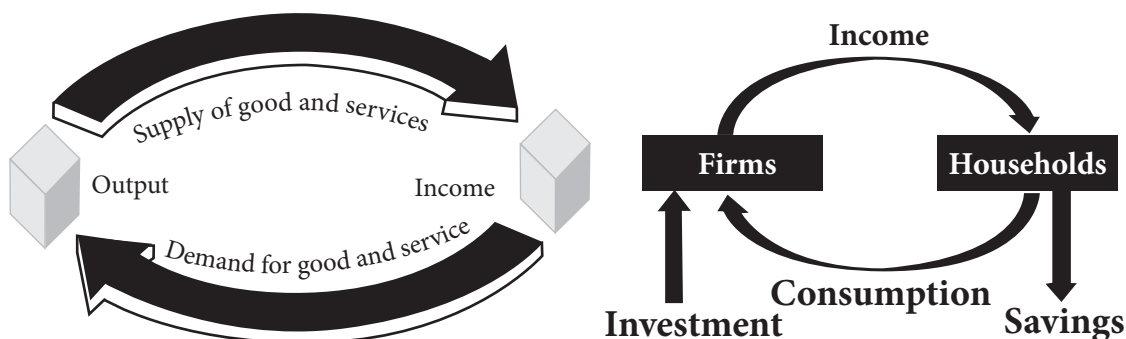
MAJOR TYPES OF UNEMPLOYMENT

Cyclical Unemployment, Seasonal Unemployment, Frictional Unemployment, Educated Unemployment, Technical Unemployment, Structural Unemployment, Disguised Unemployment

CLASSICAL MACRO ECONOMICS AND EMPLOYMENT THEORY

Classical macroeconomics relied on the unfettered market mechanism to resolve the problem of unemployment. Any involuntary unemployment according to the classics is a short run phenomenon in nature and any policy to correct the situation would lead to worse economic outcome

SAY'S MARKET LAW :Supply creates its own demand



KEYNESIAN ECONOMICS AND EMPLOYMENT DETERMINATION

- ❖ Keynesian economics is based on the book "The General Theory of Employment, Interest and Money" written by John M Keynes published in 1936.
- ❖ The book was written in the backdrop of great depression the first global economic crisis of the industrial society.

- ❖ The great depression saw widespread unemployment in the western world which raised some serious questions about the classical macroeconomics.

EFFECTIVE DEMAND

Effective demand signifies the money spent on consumption of goods and services and on investment. The total expenditure is equal to the national income, which is equivalent to the national output”.

$$ED = Y = C + I = \text{OUTPUT} = \text{EMPLOYMENT}$$

In Keynes’s macroeconomic theory, effective demand is the point of equilibrium where aggregate demand = aggregate supply. The importance of Keynes’ view is that effective demand may be insufficient to achieve full employment due to unemployment and workers without income to produce unsold goods.

DETERMINATION OF INCOME AND EMPLOYMENT.

- ❖ The determination of income and employment in the Keynesian theory depends on the level of AD and AS.
- ❖ Equilibrium level of income and output is determined where,
- ❖ 1) $AD=AS$, 2) Planned saving =planned investment.
- ❖ In a two sector economy $AD=C+I$, $AS=Y$, $Y=C+I$.

CLASSICAL –VS- KEYNESIAN THEORY

- ❖ Keynes refuted Classical economics' claim that the Say's law holds.
- ❖ The strong form of the Say's law stated that the "costs of output are always covered in the aggregate by the sale-proceeds resulting from demand".
- ❖ Keynes argues that this can only hold true if the individual savings exactly equal the aggregate investment.
- ❖ Classical economists believed in the long run and aimed to provide long run solutions at short run losses.
- ❖ Keynes was completely opposed to this, and believed that it is the short run that should be targeted first

BOOK EXERCISE QUESTIONS - MULTIPLE CHOICE QUESTIONS

PART - A

1. Every able bodied person who is willing to work at the prevailing wage rate is employed called as
 - (a) Full employment
 - (b) Under employment
 - (c) Unemployment
 - (d) Employment opportunity
2. Structural unemployment is a feature in a
 - (a) Static society
 - (b) Socialist society
 - (c) Dynamic society
 - (d) Mixed economy
3. In disguised unemployment, the marginal productivity of labour is
 - (a) Zero
 - (b) One
 - (c) Two
 - (d) Positive
4. The main contention of the Classical Economic Theory is
 - (a) Under employment
 - (b) Economy is always in the state of equilibrium
 - (c) Demand creates its supply
 - (d) Imperfect competition
5. J.B. Say is a
 - (a) Neo Classical Economist
 - (b) Classical Economist
 - (c) Modern Economist
 - (d) New Economist
6. According to Keynes, which type of unemployment prevails in capitalist economy ?
 - (a) Full employment
 - (b) Voluntary unemployment
 - (c) Involuntary unemployment
 - (d) Under employment
7. The core of the classical theory of employment is
 - (a) Law of Diminishing Return
 - (b) Law of Demand
 - (c) Law of Markets
 - (d) Law of Consumption
8. Keynes attributes unemployment to
 - (a) A lack of effective supply
 - (b) A lack of effective demand
 - (c) A lack of both
 - (d) None of the above
9. Flexibility brings equality between saving and investment.
 - (a) Demand
 - (b) Supply
 - (c) Capital
 - (d) Interest
10. theory is a turning point in the development of modern economic theory.
 - (a) Keynes'
 - (b) Say's
 - (c) Classical
 - (d) Employment
11. The basic concept used in Keynes Theory of Employment and Income is.....
 - (a) Aggregate demand
 - (b) Aggregate supply
 - (c) Effective demand
 - (d) Marginal Propensity Consume
12. The component of aggregate demand is
 - (a) Personal demand
 - (b) Government expenditure

- (c) Only export
(d) Only import

13. Aggregate supply is equal to

- (a) $C + I + G$
(b) $C + S + G + (x-m)$
(c) $C + S + T + (x-m)$
(d) $C + S + T + R_f$

14. Keynes theory pursues to replace laissez faire by

- (a) No government intervention
(b) Maximum intervention
(c) State intervention in certain situation
(d) Private sector intervention

15. In Keynes theory of employment and income,is the basic cause of economic depression.

- (a) Less production
(b) More demand
(c) Inelastic supply
(d) Less aggregate demand in relation to productive capacity.

16. Classical theory advocates

- (a) Balanced budget
(b) Unbalanced budget
(c) Surplus budget
(d) Deficit budget

17. Keynes theory emphasized on equilibrium.

- (a) Very short run (b) Short run
(c) Very long run (d) Long run

18. According to classical theory, rate of interest is a reward for

- (a) Investment (b) Demand
(c) Capital (d) Saving

19. In Keynes theory , the demand for and supply of money are determined by

- (a) Rate of interest
(b) Effective demand
(c) Aggregate demand
(d) Aggregate supply

20. Say's law stressed the operation of in the economy.

- (a) Induced price mechanism
(b) Automatic price mechanism
(c) Induced demand
(d) Induced investment

Answers

1	2	3	4	5	6	7	8	9	10
a	c	a	b	b	d	c	b	d	a
11	12	13	14	15	16	17	18	19	20
c	b	d	c	d	a	b	d	a	b

PART - B

Answer the following questions in one or two sentences

21. Define full employment.

- ❖ Full employment refers to a situation in which every able bodied person who is willing to work at the prevailing wage rate, is employed.
- ❖ Keynes defines full employment as the absence of involuntary unemployment.
- ❖ Lerner defines full employment as "that level of employment at which any further increase in spending would result in an inflationary spiral of wages and prices".

22. What is the main feature of rural unemployment?

- ❖ India's rural economy has both

unemployment and underemployment.

- ❖ The main feature of rural unemployment is the existence of unemployment in the form of disguised unemployment and seasonal unemployment.

23. Give short note on frictional unemployment.

- ❖ Frictional unemployment arises due to imbalance between supply of labour and demand for labour.
- ❖ This is because of immobility of labour, lack of necessary skills, break down of machinery, shortage of raw materials etc.

24. Give reasons for labour retrenchment at present situation.

- ❖ The Industrial Dispute Act, 1947 states that 'retrenchment means termination of service of a workman by an employer for any reason whatsoever.
- ❖ Now a days, invention and innovations lead to the adoption of new techniques there by the existing workers are retrenched (eliminated).
- ❖ Labour saving devices are responsible for technological unemployment.

25. List out the assumptions of Say's law.

1. No single buyer or seller of commodity or an input can affect price.
2. Full employment.
3. People are motivated by self interest and self – interest determines economic decisions.
4. The laissez faire policy is essential for an automatic and self adjusting process of full employment equilibrium.

5. There will be a perfect competition in labour and product market.
6. There is wage-price flexibility.
7. Money acts only as a medium of exchange.
8. Long - run analysis.
9. There is no possibility for over production or unemployment.

26. What is effective demand ?

Effective demand denotes money actually spent by the people on products of industry. The money which entrepreneurs receive is paid in the form of rent, wages, interest and profit. Therefore effective demand equals national income.

$$ED = Y = C + I = \text{Output} = \text{Employment}$$

27. What are the components of aggregate supply ?

1. Aggregate (desired) consumption expenditure (C)
2. Aggregate (desired) private savings (S)
3. Net tax payments (T) (Total tax payment to be received by the government minus transfer payments, subsidy and interest payments to be incurred by the government) and
4. Personal (desired) transfer payments to the foreigners (Rf)(eg. Donations to international relief efforts)

Aggregate Supply = C + S + T + Rf =
Aggregate income generated in the economy

PART - C

Answer the following questions in one Paragraph.

28. Explain the following in short

(i) Seasonal unemployment

This type of unemployment occurs during certain seasons of the year. In agriculture and agro based industries like sugar, production activities are carried out only in some seasons. These industries offer employment only during that season in a year.

(ii) Frictional unemployment

Frictional unemployment arises due to imbalance between supply of labour and demand for labour. This is because of immobility of labour, lack of necessary skills, break down of machinery, shortage of raw materials etc.

(iii) Educated unemployment

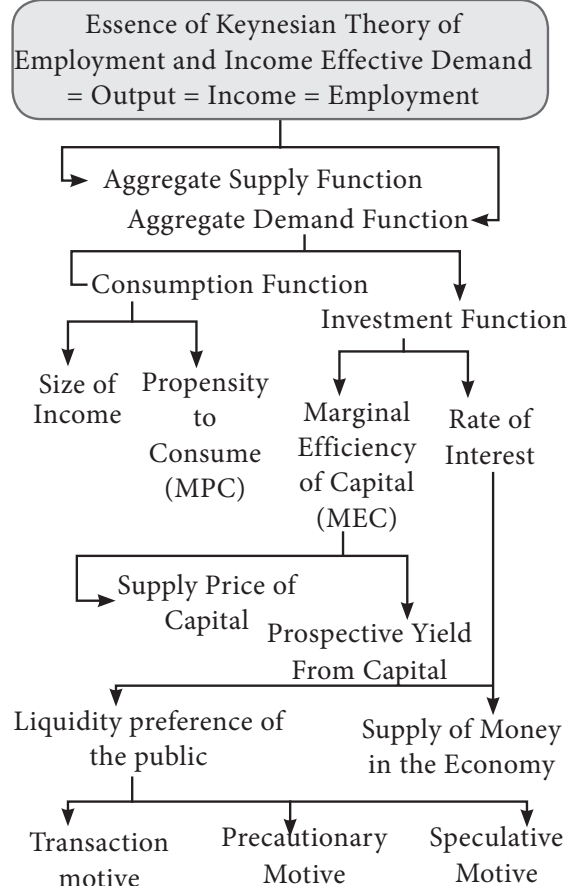
Sometimes educated people are underemployed or unemployed when qualification does not match the job. Faulty education system, lack of employable skills, mass student turnout and preference for white collar jobs are highly responsible for educated unemployment in India.

29. Write short note on the implications of Say's law.

1. There is no possibility for over production or unemployment.
2. If there exist unutilized resources in the economy, it is profitable to employ them up to the point of full employment.
3. As automatic price mechanism operates in the economy, there is no need for government intervention.
4. Interest flexibility brings about equality between saving and investment.

5. Money performs only the medium of exchange function in the economy, as people will not hold idle money.

30. Explain Keynes' theory in the form of flow chart.



31. What do you mean by aggregate demand? Mention its components.

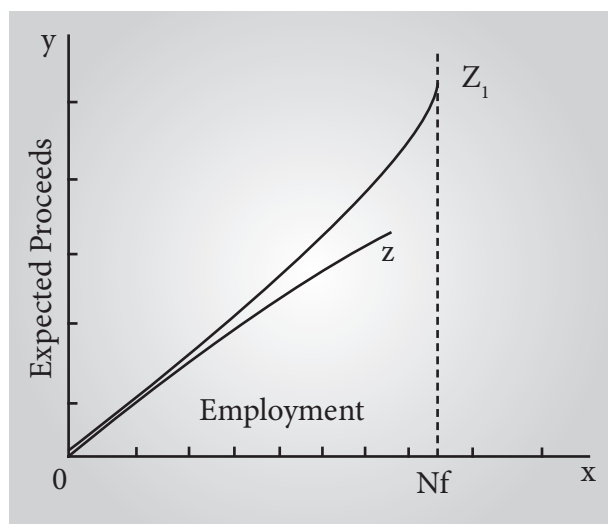
- ❖ The aggregate demand is the amount of money which entrepreneurs expect to get by selling the output produced by the number of labourers employed.
- ❖ Therefore, it is the expected income or revenue from the sale of output at different levels of employment.
- ❖ Aggregate demand has the following four components:
- ❖ Consumption demand 2. Investment demand 3. Government expenditure and 4. Net Export (export – import)

$$AD = C + I + G + (X - M)$$

32. Explain about aggregate supply with the help of diagram.

- ❖ Aggregate supply function is an increasing function of the level of employment.
- ❖ Aggregate supply refers to the value of total output of goods and services produced in an economy in a year.
- ❖ In other words, aggregate supply is equal to the value of national product, i.e., national income.

Aggregate Supply = $C + S + T + R_f$ = Aggregate income generated in the economy



- i. The above figure shows the shape of the two aggregate supply curves drawn for the assumption of fixed money wages and variable wages.
- ii. Z curve is linear where money wages remains fixed;
- iii. Z1 curve is non - linear since wage rate increases with employment.
- iv. When full employment level of N_f is reached it is impossible to increase output by employing more men. So aggregate supply curve becomes inelastic (Vertical straight line).

- v. The slope of the aggregate supply curve depends on the relation between the employment and productivity.
- vi. the aggregate supply depends on the relationship between price and wages.
- vii. If prices are high and wages low, the producers will try to employ labourers.
- viii. Thus aggregate supply is an important factor in determining the level of economic activity

33. Write any five differences between classism and Keynesianism.

Sl. No	Keynesianism	Classicism
1.	Short-run equilibrium	Long-run equilibrium
2.	Saving is a vice	Saving is a social virtue.
3.	The function of money is a medium of exchange on the one side and a store of value on the other side.	The function of money is to act as a medium of exchange.
4.	Macro approach to national problem	Micro foundation to macro problems
5.	State intervention is advocated	Champions of Laissez-fair policy
6.	Applicable to all situations - full employment and less than full employment.	Applicable only to the full employment situation.
7.	Capitalism has inherent contradictions	Capitalism is well and good.
8.	Budgeting should be adjusted to the requirements of economy.	Balanced budget.

PART - D

Answer the following questions in about a page.

35. Describe the types of unemployment.

Introduction

Unemployment is problem faced when there are people, who are willing to work and able to work but cannot find suitable jobs.

Types of unemployment

In developing countries like India, the nature of unemployment is different from that of developed countries. In the developing countries, it is largely structural unemployment which is due to slow rate of capital formation.

Types of unemployment

Cyclical Unemployment

Seasonal Unemployment

Frictional Unemployment

Educated Unemployment

Technical Unemployment

Structural Unemployment

Disguised Unemployment

1. Cyclical Unemployment

This unemployment exists during the downturn phase of trade cycle in the economy. In a business cycle during the period of recession and depression, income and output fall leading to widespread unemployment.

2. Seasonal Unemployment

This type of unemployment occurs during certain seasons of the year. In agriculture and agro based industries like sugar, production activities are carried out only in some seasons. These industries offer employment only during that season in a year.

3. Frictional Unemployment (Temporary Unemployment)

Frictional unemployment arises due to imbalance between supply of labour and demand for labour. This is because of immobility of labour, lack of necessary skills, break down of machinery, shortage of raw materials etc.

4. Educated Unemployment

Sometimes educated people are underemployed or unemployed when qualification does not match the job. Faulty education system, lack of employable skills, mass student turnout and preference for white collar jobs are highly responsible for educated unemployment in India.

5. Technical Unemployment

Modern technology being capital intensive requires less labourers and contributes to technological unemployment.

6. Structural Unemployment

Structural unemployment is due to drastic change in the structure of the society. Lack of demand for the product or shift in demand to other products cause this type of unemployment.

7. Disguised Unemployment

Disguised unemployment occurs when more people are than what is actually required. Even if some workers are withdrawn, production does not suffer. This type of unemployment is found in agriculture.

36. Critically explain Say's law of market.

Introduction

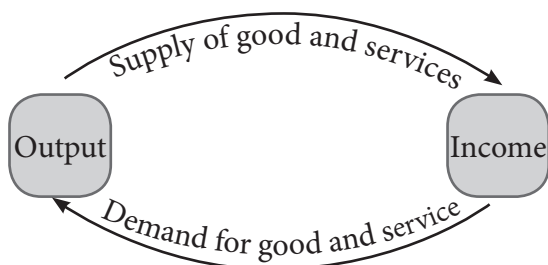
Say's law of markets is the core of the classical theory of employment. J.B. Say (1776 – 1832) was a French Economist and an industrialist.

Say's Market Law

J.B. Say enunciated the proposition that “Supply creates its own demand”. Hence there cannot be general over production or the problem of unemployment in the economy.

Explanation of Say’s Market Law

- ❖ According to Say, “When goods are produced by firms in the economy, they pay reward to the factors of production.
- ❖ The households after receiving rewards of the factors of production spend the amount on the purchase of goods and services produced by them.
- ❖ Therefore, each product produced in the economy creates demand equal to its value in the market.



Assumptions of Say’s law.

1. No single buyer or seller of commodity or an input can affect price.
2. Full employment.
3. People are motivated by self interest and self – interest determines economic decisions.
4. The laissez faire policy is essential for an automatic and self adjusting process of full employment equilibrium.
5. There will be a perfect competition in labour and product market.
6. There is wage-price flexibility.
7. Money acts only as a medium of exchange.
8. Long - run analysis.

9. There is no possibility for over production or unemployment.

Implications of Say’s law.

1. There is no possibility for over production or unemployment.
2. If there exist unutilized resources in the economy, it is profitable to employ them up to the point of full employment.
3. As automatic price mechanism operates in the economy, there is no need for government intervention.
4. Interest flexibility brings about equality between saving and investment.
5. Money performs only the medium of exchange function in the economy, as people will not hold idle money.

Criticisms of Say’s Law

1. According to Keynes, supply does not create its demand. It is not applicable where demand does not increase as much as production increases.
2. Automatic adjustment process will not remove unemployment.
3. Money is not neutral. Individuals hold money for unforeseen contingencies while businessmen keep cash reserve for future activities.
4. Say’s law is based on wrong proposition that supply creates its own demand and there is no over production.
5. Keynes regards full employment as a special case because there is under - employment in capitalist economies.
6. The need for state intervention arises in the case of general over production and mass unemployment.

37. Narrate the equilibrium between ADF and ASF with diagram.

Introduction

The relationship between employment and output of an economy depends upon the level of effective demand which is determined by the forces of aggregate supply and aggregate demand.

Effective Demand : Equilibrium between ADF and ASF

Effective Demand

Effective demand denotes money actually spent by the people on products of industry. The money which entrepreneurs receive is paid in the form of rent, wages, interest and profit. Therefore effective demand equals national income.

$$ED = Y = C + I = \text{Output} = \text{Employment}$$

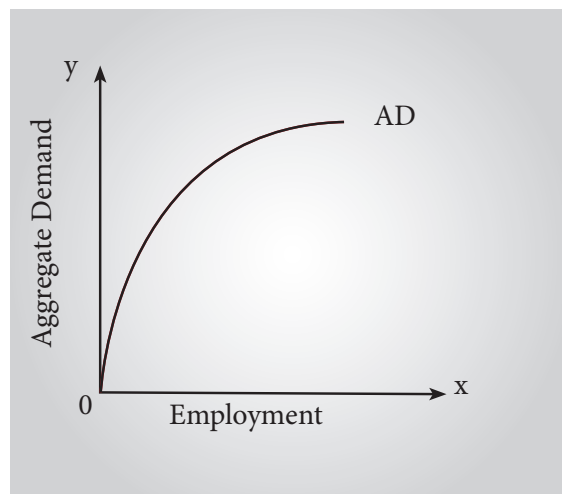
Aggregate Demand Function (ADF)

In the Keynesian model, output is determined mainly by aggregate demand. The aggregate demand is the amount of money which entrepreneurs expect to get by selling the output produced by the number of labourers employed.

Aggregate demand has the following four components:

1. Consumption demand 2. Investment demand 3. Government expenditure and 4. Net Export (export – import)

$$AD = C + I + G + (X - M)$$



- i. Figure explains that aggregate demand price increases or decreases with an increase or decrease in the volume of employment.
- ii. Aggregate demand curve increases at an increasing rate in the beginning and then increases at a decreasing rate.

Aggregate supply function

Aggregate supply function is an increasing function of the level of employment. Aggregate supply refers to the value of total output of goods and services produced in an economy in a year.

In other words, aggregate supply is equal to the value of national product, i.e., national income.

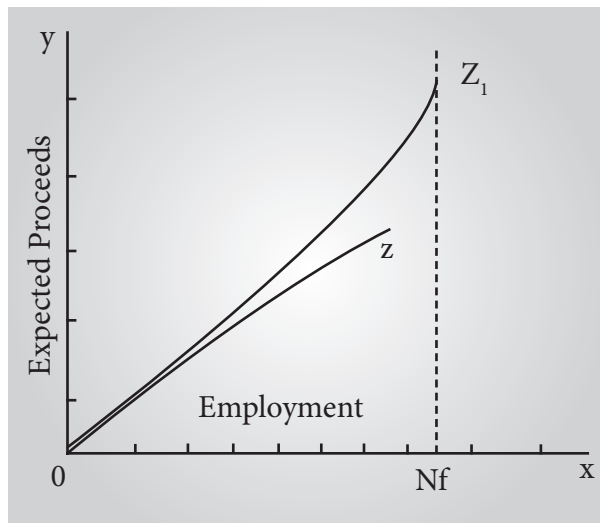
Aggregate Supply = $C + S + T + R_f$ = Aggregate income generated in the economy

i. The above figure shows the shape of the two aggregate supply curves drawn for the assumption of fixed money wages and variable wages.

ii. Z curve is linear where money wages remains fixed;

iii. Z₁ curve is non - linear since wage rate increases with employment.

iv. When full employment level of N_f is reached it is impossible to increase output by employing more men. So aggregate supply curve becomes inelastic (Vertical straight line).



v. The slope of the aggregate supply curve depends on the relation between the employment and productivity.

vi. The aggregate supply depends on the relationship between price and wages. If prices are high and wages low, the producers will try to employ labourers.

vii. Thus aggregate supply is an important factor in determining the level of economic activity

viii. Equilibrium between ADF and ASF

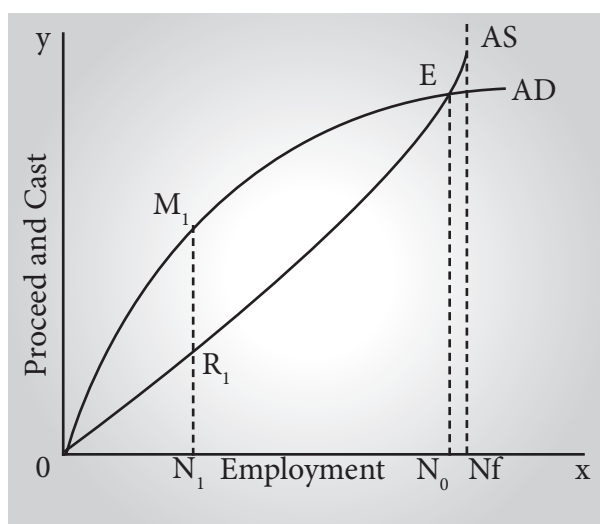
ix. Under the Keynes theory of employment, a simple two sector economy consisting of the household sector and the business sector is taken to understand the equilibrium between ADF and ASF.

i. In the figure, the aggregate demand and aggregate supply reach equilibrium at point E. The employment level is N₀ at that point.

ii. At ON₁ employment, the aggregate supply is N₁ R₁.

iii. But they are able to produce M₁ N₁. The expected level of profit is M₁ R₁.

iv. To attain this level of profit, entrepreneurs will employ more labourers. The tendency to employ more labour will stop once they reach point E.



v. It is important to note that the equilibrium level of employment need not be the full employment level (N_f) from the Figure, it is understood that the difference between N₀ – N_f is the level of unemployment.

38. Explain the differences between classical theory and Keynes theory.

- ❖ Classical economists stressed the self-adjusting tendencies of the economy. They expressed that if there are no government policies, economy would achieve full employment and full potential
- ❖ On the other hand, Keynesians view the economy as unstable as a result of instability of aggregate demand, primarily due to private investment component.
- ❖ A summary of the differences between the two theories is shown in table.

S. NO	BASIS OF DIFFERENCES	CLASSICAL THEORY	KEYNES THEORY
1	Equilibrium	Long-run equilibrium	Short-run equilibrium
2	Savings and Investment	Saving and investment equilibrium through interest rate	Saving and investment equilibrium through income levels
3	Money	The function of money is to act as a medium of exchange	The function of money is a medium of exchange on the one side and a store of value on the other side.
4	Approach	Micro foundation to macro problems	Macro approach to national problems
5	Intervention	No government intervention	Government intervention is necessary for stabilization of economy
6	Employment	Full employment (under employment is voluntary and temporary)	Unemployment and under employment are possible
7	Output	Supply determined (Say's Law: Supply creates demand)	Aggregate demand determined (Demand creates supply. Model based on concept of aggregate demand)
8	Budget	Balanced budget	Budgeting should be adjusted to the requirements of economy.
9	Capitalism	Capitalism is well and good	Capitalism has inherent contradictions
10	Economic System	Laissez faire policy, self adjusting and self stabilizing	Discard Laissez faire and approves stabilizing measures by the government

Additional One marks

1. A situation in which every able bodied person who is willing to work at the prevailing wage rate, is employed.....?
 - a. Less than full employment
 - b. Full employment
 - c. underemployment
 - d. structural employment
2. Who said this? "that level of employment at which any further increase in spending would result in an inflationary spiral of wages and prices"
 - a.J.S.Mill
 - b.J.M.Keynes
 - c. Lerner
 - d.Pigou
3. Assertion (A) The concept of full employment generally refers to full employment of labour force of a country
Reason (R) Every economy in the world aims at attaining the level of full employment equilibrium where all its available resources are fully and efficiently employed to achieve maximum level of output.
 - a. Both (A) and (R) are true and (R) is the correct explanation of (A).
 - b. Both (A) and (R) are true, but (R) is not the correct explanation of (A).
 - c. (A) is true, but (R) is false.
 - d. (A) is false, but (R) is true.
4. Which of the following economies have the unemployment is purely temporary or cyclical or frictional?
 - a. Developed Economies
 - b. Underdeveloped economies
 - c. Developing economies
 - d. None of the above
5. Which of the following economies largely structural unemployment which is due to slow rate of capital formation?
 - a. Developing economies
 - b. Underdeveloped economies
 - c. Developed economies
 - d. None of the above
6.can be cured by public investment or expansionary monetary policy.
 - a. Frictional unemployment
 - b. Structural unemployment
 - c. Cyclical unemployment
 - d. educational unemployment
7. Find the unsuitable example for Seasonal unemployment
 - a. ice cream industry
 - b. doctors
 - c. holiday resorts
 - d. farmers
8. Which of the following is not responsible for educated unemployment in India?
 - a. Faulty education system
 - b. lack of employable skills
 - c. Foreign Education
 - d. mass student turnout

9. Structural unemployment results from massive and deep rooted changes in

- a. political structure
- b. economic structure
- c. social structure
- d. cultural structure

10. Identify the odd one.

- a. David Ricardo b. J. M. Keynes
- c. J. S. Mill, d. J. B. Say

11. Find the incorrect assumption of Say's Law.

- a. No single buyer or seller of commodity or an input can affect price.
- b. government intervention
- c. Full employment.
- d. There is wage-price flexibility.

12. Find the author of book, "The General Theory of Employment, Interest and Money" published in 1936.

- a. David Ricardo b. J. S. Mill,
- c. J. M. Keynes d. J. B. Say

13. What is considered as the starting point of Keynes theory of employment and income?

- a. The principle of effective demand
- b. The principle of effective supply
- c. The principle of effective equilibrium
- d. Say's Market Law

14. Find the odd one with the context of aggregate demand.

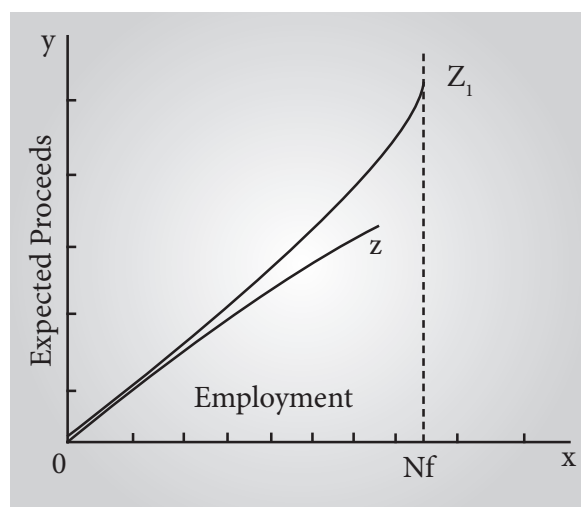
- a. Consumption demand
- b. Investment demand
- c. Government expenditure
- d. interest is equilibrating factor

15. Assertion (A) Aggregate demand curve increases at an increasing rate in the beginning and then increases at a decreasing rate.

Reason (R) Aggregate demand shows that as income increases owing to increase in employment, expenditure of the economy increases at a decreasing rate.

- a. Both (A) and (R) are true and (R) is the correct explanation of (A).
- b. Both (A) and (R) are true, but (R) is not the correct explanation of (A).
- c. (A) is true, but (R) is false.
- d. (A) is false, but (R) is true.

16. Consider the following diagram.

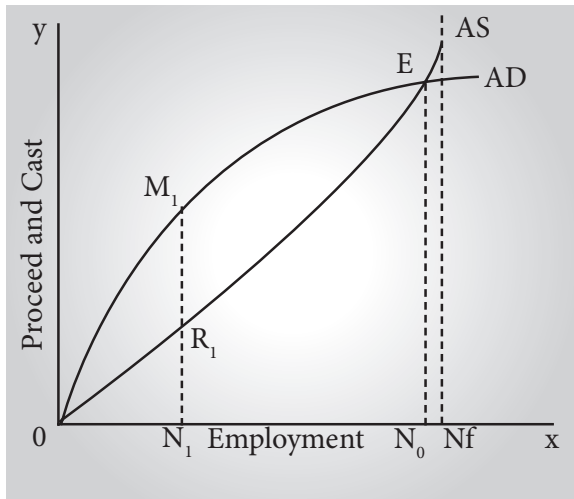


Assertion (A) Z curve is linear where money wages remains fixed; Z1 curve is non - linear since wage rate increases with employment.

Reason (R) The slope of the aggregate supply curve depends on the relation between the employment and productivity

- a. Both (A) and (R) are true and (R) is the correct explanation of (A).
- b. Both (A) and (R) are true, but (R) is not the correct explanation of (A).
- c. (A) is true, but (R) is false.
- d. (A) is false, but (R) is true.

17. Consider the following diagram.



What do you understand about the difference between $N_0 - N_f$?

- the level of employment
- the level of unemployment
- the level of underemployment
- none of the above

18. Which of the following is not an assumption of classical theory?

- Price flexibility
- Unemployment
- Say's law
- Neutrality of money

19. Which of the following is not an obstacle to full employment in classical theory?

- Excess of saving over investment
- Liquidity trap
- Price rigidity
- Wage Flexibility

20. In classical theory of employment, there is the possibility of:

- Voluntary unemployment
- No unemployment
- Involuntary unemployment
- Disguised unemployment

21. The idea that a general cut in wages will finally lead to a state of full employment was suggested by :

- Keynes
- Marshall
- J.B.Say
- A.C.Pigou

22. Say's law of market says:

- Supply creates its own demand
- Demand creates supply
- Income generates demand
- Savings create demand

23. In the classical theory, one of the following is an important assumption:

- Wages and prices are inflexible
- There is full employment
- Agents are price setters
- Adjustment is through quantity.

24. "Supply creates its own demand" is a law of:

- Investment
- Inflation
- Consumption
- Market

25. In classical system which of the following keeps the economy at full employment:

- Level of saving
- Increase in money supply
- Adjustment in investment
- Adjustment in money wages

26. In classical theory which of the following is found in the economy:

- Unemployment
- Involuntary unemployment
- Less than full employment
- Full employment

27. Frictional unemployment exists:

- When there is a decrease in real GDP
- Because it takes time to find a job when one is first entering the labour force
- As a result of technological change
- When an individual retires

28. The natural rate of unemployment equals the sum of those who are:

- Frictionally and structurally unemployed
- Frictionally and cyclically unemployed
- Structurally and cyclically unemployed
- Frictionally structurally and cyclically unemployed

29. The concept of effective demand is associated with the name of

- Marshall
- Keynes
- Krugman
- Say

30. In the Keynesian two sector economy, $AD > AS$, then

- $S = I$
- $S > I$
- $S < I$
- $S = 0$

31. In the Keynesian two sector economy, $AD < AS$, then

- $S = I$
- $S > I$
- $S < I$
- $S = 0$

32. In the classical theory the equality between saving and investment is brought about by:

- Income
- Rate Interest
- Consumption
- None of these

33. Find the incorrect match with context of classical theory

a. Equilibrium	-	Short-run equilibrium
b. S & I	-	Saving and investment equilibrium through interest rate
c. Money	-	The function of money is to act as a medium of exchange
d. Approach	-	Micro foundation to macro problems

34. A positively sloped aggregate supply curve indicates that

- An increase in aggregate demand will be associated with an increase in the

price level and no change in equilibrium output.

- An increase in aggregate demand will be associated with an increase in both the price level and equilibrium output.
- An increase in aggregate demand will be associated with an increase in equilibrium output and no change in the price level.
- None of the above.

35. Which of the following are true of disguised unemployment?

- It represents potential savings.
- The marginal productivity of labour is zero or extremely low.
- It is due to the existence of joint family system.
- It is confined to the rural areas.

Codes:

- II and IV
- III and IV
- I, II and III
- I, II, III and IV

36. Suppose there is full employment and vertical aggregate supply schedule. An increase in the nominal money supply

- reduces the rate of interest and changes the composition of output
- causes a proportional increase in real output
- has no effect on the real money supply or the composition of output
- causes the real money supply to increase, which changes composition of output

37. Assertion (A) : In developing countries like India, the nature of unemployment is different from that of developed countries.

Reason (R) :In developed countries, the unemployment is purely temporary or cyclical or frictional.

- Both A and R are true and R is the correct explanation of A.
- Both A and R are true but R is not the correct explanation of A.
- A is true but R is false.
- A is false but R is true.

38. Assertion (A) :Structural unemployment is due to drastic change in the structure of the society.

Reason (R) :Lack of demand for the product or shift in demand to other products cause this type of unemployment.

- Both A and R are true and R is the correct explanation of A.
- Both A and R are true but R is not the correct explanation of A.
- A is true but R is false.
- A is false but R is true.

39. Assertion (A) :The theory of Keynes was against the belief of classical economists that the market forces in capitalist economy adjust themselves to attain equilibrium.

Reason (R) :Keynes not only criticized classical economists but also advocated his own theory of employment.

- Both A and R are true and R is the correct explanation of A.
- Both A and R are true but R is not the correct explanation of A.
- A is true but R is false.
- A is false but R is true.

40. Assertion (A) :The starting point of Keynes theory of employment and income is the principle of market law.

Reason (R) :Market Law denotes money actually spent by the people on products of industry.

- Both A and R are true and R is the correct explanation of A.
- Both A and R are true but R is not the correct explanation of A.
- A is true but R is false.
- Both A and R are false

41. Assertion (A) :Effective demand determines the level of unemployment in the economy.

Reason (R) :When effective demand increases, employment will increase. When effective demand decreases, the level employment will decline.

- Both A and R are true and R is the correct explanation of A.
- Both A and R are true but R is not the correct explanation of A.
- A is true but R is false.
- A is false but R is true.

42. Assertion (A) :Aggregate supply function is an increasing function of the level of employment.

Reason (R) :Aggregate supply refers to the value of total output of goods and services produced in an economy in a year.

- Both A and R are true and R is the correct explanation of A.
- Both A and R are true but R is not the correct explanation of A.
- A is true but R is false.
- A is false but R is true.

43. **Assertion (A)** : The slope of the aggregate supply curve depends on the relation between the employment and productivity.
Reason (R) : The capital stock is often fixed and hence the law of diminishing marginal returns takes place as more workers are employed.
- Both A and R are true and R is the correct explanation of A.
 - Both A and R are true but R is not the correct explanation of A.
 - A is true but R is false.
 - A is false but R is true.
44. **The total demand for goods and services in an economy is known as:**
- Aggregate demand.
 - Gross national product.
 - Economy-wide demand.
 - National demand.
45. **Unemployment means that:**
- People are not willing to work at the going wage rate.
 - At the going wage rate, there are people who want to work but cannot find work.
 - There are some people who will not work at the going wage rate.
 - There is excess demand in the labour market.
46. **Which of the following was not a classical economist?**
- Adam Smith.
 - Thomas R. Malthus.
 - John Stuart Mill.
 - John Maynard Keynes.
47. **The Keynesian remedy for unemployment is to**
- decrease aggregate demand.
 - reduce tax rates or lower interest rates.
 - decrease government spending.
 - decrease private consumption and investment.
48. **Mohan used to work as an autoworker, and due to the decline of the Indian auto industry, is now unemployed and thinking about retraining as a bicycle assembler. What type of unemployment is he experiencing?**
- frictional unemployment
 - structural unemployment
 - cyclical unemployment
 - natural unemployment
49. **Thalib lost his job during the last recession. What type of unemployment is he experiencing?**
- frictional unemployment
 - structural unemployment
 - cyclical unemployment
 - natural unemployment
50. **After raising two children, Ancy has started looking for a job and sent out a few job applications. What type of unemployment is she experiencing?**
- frictional unemployment
 - structural unemployment
 - cyclical unemployment
 - natural unemployment
51. **In the classical model:**
- flexible markets will keep the economy at a full-employment level of spending and output.
 - both households' saving activity and firms' investment activity are quite sensitive to changes in the interest rate.
 - adjustments in the interest rates quickly correct any imbalances between saving and investment.
 - all of the above.

52. Match the correct codes

1	J.B. Say's Market Law	i	A person receives his income from production which is spent on the purchase of goods and services produced by others
2	Keynes theory of employment	ii	Denotes money actually spent by the people on products of industry
3	Market Law Meaning	iii	Effective demand signifies the money spent on consumption of goods and services and on investment
4	Effective demand	iv	Supply creates its own demand

Codes

- (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)
- (1) – (ii) (2) – (iii) (3) – (iv) (4) – (i)
- (1) – (iv) (2) – (iii) (3) – (i) (4) – (ii)
- (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)

53. Match the correct codes

1	"An Enquiry into the Nature and Causes of the Wealth of Nations"	i	1776
2	"The General Theory of Employment, Interest and Money"	ii	1936
3	Market Law	iii	ADP equals ASF
4	Effective Demand	iv	S equals D

Codes

- (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)
- (1) – (ii) (2) – (iii) (3) – (iv) (4) – (i)
- (1) – (iv) (2) – (iii) (3) – (i) (4) – (ii)
- (1) – (i) (2) – (ii) (3) – (iii) (4) – (iv)

54. Match the correct codes

1	This unemployment exists during the downturn phase of trade cycle in the economy.	i	Cyclical Unemployment
2	This type of unemployment occurs during certain seasons of the year.	ii	Seasonal Unemployment
3	Frictional unemployment arises due to imbalance between supply of labour and demand for labour.	iii	Temporary Unemployment
4	Sometimes educated people are underemployed or unemployed when qualification does not match the job.	iv	Educated Unemployment

Codes

- (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)
- (1) – (ii) (2) – (iii) (3) – (iv) (4) – (i)
- (1) – (iv) (2) – (iii) (3) – (i) (4) – (ii)
- (1) – (i) (2) – (ii) (3) – (iii) (4) – (iv)

55. Match the correct codes

1	Modern technology being capital intensive requires skillfulness contributes to technological unemployment.	i	Technical Unemployment
2	Due to drastic change in the structure of the society.	ii	Structural Unemployment
3	Occurs when more people are than what is actually required.	iii	Seasonal Unemployment
4	ice cream industry, holiday resorts etc.	iv	Disguised unemployment

Codes

- a. (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)
 b. (1) – (ii) (2) – (iii) (3) – (iv) (4) – (i)
 c. (1) – (iv) (2) – (iii) (3) – (i) (4) – (ii)
 d. (1) – (i) (2) – (ii) (3) – (iii) (4) – (iv)

56. Match the correct codes

1	AD	i	$C + S + T + R_f$
2	ED	ii	Supply = Demand
	Occurs when more people are than what is actually required.	iii	Seasonal Unemployment
3	AS	iii	$Y = C + I = \text{Output} = \text{Employment}$
4	Market Law	iv	$C + I + G + (X - M)$

Codes

- a. (1) – (i) (2) – (ii) (3) – (iv) (4) – (iii)
 b. (1) – (ii) (2) – (iii) (3) – (iv) (4) – (i)
 c. (1) – (iv) (2) – (iii) (3) – (i) (4) – (ii)
 d. (1) – (i) (2) – (ii) (3) – (iii) (4) – (iv)

Answers									
1	2	3	4	5	6	7	8	9	10
b	c	b	a	a	c	b	c	b	b
11	12	13	14	15	16	17	18	19	20
b	c	a	d	a	a	b	b	d	a
21	22	23	24	25	26	27	28	29	30
d	a	b	d	d	d	b	a	b	c
31	32	33	34	35	36	37	38	39	40
b	b	a	b	d	c	b	a	b	d
41	42	43	44	45	46	47	48	49	50
d	b	b	a	b	d	b	b	c	a
51	52	53	54	55	56				
d	c	a	d	a	c				

Additional Two Marks**1. List various types of unemployment.**

- Cyclical Unemployment
- Seasonal Unemployment
- Frictional Unemployment
- Educated Unemployment
- Technical Unemployment
- Structural Unemployment
- Disguised Unemployment

2. What is Cyclical Unemployment?

- ❖ Cyclical unemployment exists during the downturn phase of trade cycle in the economy.
- ❖ In a business cycle during the period of recession and depression, income and output fall leading to widespread unemployment.

3. Write a short note on Seasonal Unemployment.

- Seasonal Unemployment type of unemployment occurs during certain seasons of the year.
- In agriculture and agro based industries like sugar, production activities are carried out only in some seasons.
- These industries offer employment only during that season in a year.

4. Write the meaning of Temporary Unemployment.

- Temporary unemployment arises due

to imbalance between supply of labour and demand for labour.

- ii. This is because of immobility of labour, lack of necessary skills, break down of machinery, shortage of raw materials etc.

5. What is Technical Unemployment?

- i. Modern technology being capital intensive requires less labourers and contributes to technological unemployment.
- ii. Now a days, invention and innovations lead to the adoption of new techniques there by the existing workers are retrenched.

6. Mention few names of Classical theory.

David Ricardo, J.S.Mill, J.B.Say and A.C.Pigou.

7. Write any two Criticisms of Say's Law.

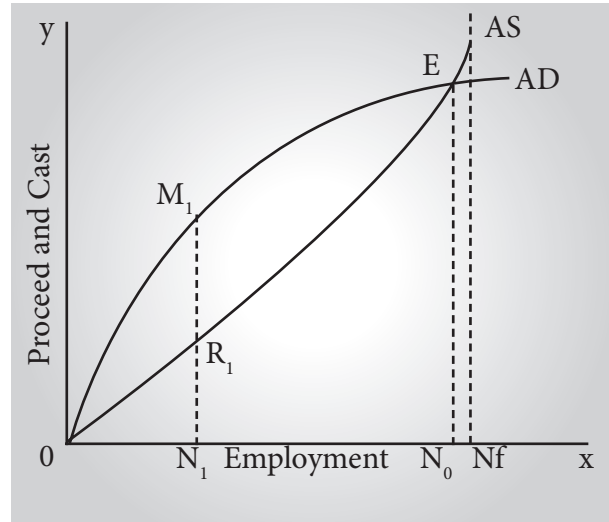
The following are the criticisms against Say's law:

1. According to Keynes, supply does not create its demand. It is not applicable where demand does not increase as much as production increases.
2. Automatic adjustment process will not remove unemployment. Unemployment can be removed by increase in the rate of investment.

8. Write the equation of effective demand.

$$ED = Y = C + I = \text{Output} = \text{Employment}$$

9. Draw the diagram of effective demand.



10. Write the equation of Aggregate Supply.

Aggregate Supply = $C + S + T + R_f =$ Aggregate income generated in the economy.

11. What is Aggregate supply?

The value of total output of goods and services produced in an economy in a year.

12. What is Aggregate demand?

The amount that households, firms, the governments and the foreign purchasers would like to spend on domestic output..

13. Write a note on “wage-price flexibility” of classicals.

- i. According to the classicals, the wages and prices are flexible.
- ii. This flexibility ensures equilibrium in market. In other words, demand will be equal to supply in all markets.
- iii. All disequilibrium conditions in the market will be corrected with the wage-price flexibility.

14. Write a note on “wage-price rigidity”

Keynes.

- i. According to Keynes there is wage-price rigidity.
- ii. In the real world it is not possible to reduce the wages on account of government policy and due to the existence of trade unions.
- iii. So the wages are more or less rigid rather than flexible.

15. Comment : “Self-Adjustment not Possible”

- i. According to Say's Law, full employment is maintained by an automatic and self adjustment mechanism in the long run.
- ii. But Keynes had no patience to wait for the long period for he believed that – In the long run we are all dead.
- iii. It is not the automatic adjustment process which removes unemployment.
- iv. But unemployment can be removed by increase in the rate of investment.

16. What is the main criticism of Keynes on Classical?

- i. Keynes did not accept the classical view that reduction in money wages led to full employment.
- ii. He emphasized that unemployment could be removed by raising the effective demand.
- iii. According to Keynes, a cut in money wages applied to the economy as a whole reduces employment rather than increasing it.

Additional Three Marks

1. Distinguish between Fictional and Structural unemployment.

	Fictional unemployment	Structural unemployment
1	Frictional unemployment arises due to imbalance between supply of labour and demand for labour.	Structural unemployment is due to drastic change in the structure of the society.
2	This is because of immobility of labour, lack of necessary skills, break down of machinery, shortage of raw materials etc.	Lack of demand for the product or shift in demand to other products cause this type of unemployment.
3	The persons who lose jobs and in search of jobs are also included under frictional unemployment.	This kind of unemployment results from massive and deep rooted changes in economic structure.

2. Comment - “Ex ante and Ex post in Say's Law

- ❖ The statement that supply creates own demand or equivalently that the aggregate in investment equals the aggregate saving always holds good in the ex post sense since it is simply an accounting identity.
- ❖ Say's la of markets, however, states that these two are equal in ex ante sense, i.e.,

the total quantity which people produce i.e., aggregate supply must be equal to the total quantity which they plan to buy i.e., aggregate demand.

3. Write a note of John Maynard Keynes

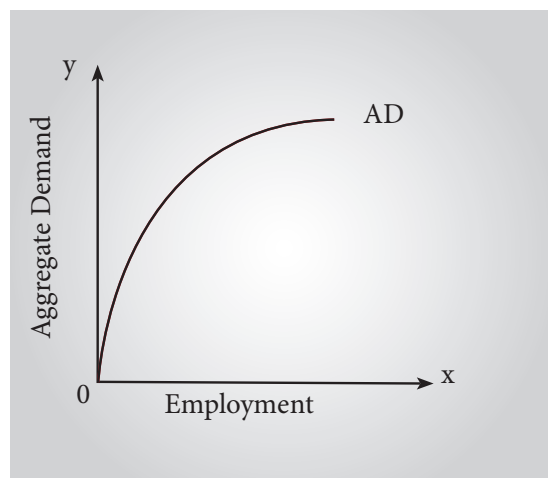
- ❖ John Maynard Keynes was one of the most influential economists of the 20th century.
- ❖ He was born in Cambridge in 1883. In addition to his work as an economist he held position as civil servant a director of the Bank of England, and leader of British delegation of negotiators at the Bretton Woods conference at points in his career.
- ❖ Economic theory based on his idea is known as Keynesian economics, and remain highly influential today, particularly in the field of macroeconomics.

4. Aggregate Demand Function (ADF) – Explain.

- ❖ In the Keynesian model, output is determined mainly by aggregate demand.
- ❖ The aggregate demand is the amount of money which entrepreneurs expect to get by selling the output produced by the number of labourers employed.

Aggregate demand has the following four components: 1. Consumption demand 2. Investment demand 3. Government expenditure and 4. Net Export (export – import)

$$AD = C + I + G + (X - M)$$



- i. Figure explains that aggregate demand price increases or decreases with an increase or decrease in the volume of employment.
 - ii. Aggregate demand curve increases at an increasing rate in the beginning and then increases at a decreasing rate.
5. Explain how it might be possible for the unemployment rate to decline even though the number of unemployed is growing.
- i. This may be possible if the number of new entrants into the labor force is increasing at a greater rate than the number of people who are becoming unemployed.
 - ii. Since the unemployment rate is a ratio and the numerator is growing more slowly than the denominator then the unemployment rate will fall.
6. What are the economic costs of unemployment?
- i. Whenever resources are unemployed there is always some sort of waste.
 - ii. In the case of unemployment it manifests itself in the potential

production of goods and services irretrievably lost.

- iii. There are also other costs such as increased burdens to taxpayers to fund unemployment compensation programs and the individual cost in terms of a loss of self esteem and dignity.

Additional Five Mark

1. Classify the following as either employed, unemployed or not in the labor force.

An individual who has been temporarily absent due to caring for an elderly relative whether they are paid or not.	
A person 18 years old or older who works without pay for 15 or more hours per week in a family enterprise.	
Someone who works for pay in his or her own business.	
A woman who spends five hours a week sending bills to her husband's clients. She is not paid for her work. Otherwise she performs non-market work at home.	
A retired person	
A person who quits one job in favor of looking for work elsewhere but has yet to find work.	

Answers

An individual who has been temporarily absent due to caring for an elderly relative whether they are paid or not.	Employed
A person 18 years old or older who works without pay for 15 or more hours wper week in a family enterprise.	Employed
Someone who works for pay in his or her own business.	Employed
A woman who spends five hours a week sending bills to her husband's clients. She is not paid for her work. Otherwise she performs non-market work at home.	Not in the labour force
A retired person	Not in the labour force
A person who quits one job in favor of looking for work elsewhere but has yet to find work.	Unemployed

2. In each of the following scenario, classify the individual as frictionally, structurally, or cyclically unemployed. Explain your classification.
- (a) There has been a general economic slow down. Because of weak demand, Kumar has lost his portering job at the railway station.
- (b) Sathish, a newly qualified dental graduate, is looking for a place to set up practice.
- (c) Latha is thrown out of work by the introduction of a more mechanized production process.
- (d) Devi, a computer programmer with a large bank, quit her job two months ago in search of a better-paid programming position. She is still looking.



Answers

- (a) Kumar is cyclically unemployed. He has lost his job as a result of the general economic recession.
- (b) Sathish is frictionally unemployed. Job openings exist for him. It is merely a case of tracking down a position.
- (c) Latha is structurally unemployed. Unemployment due to technological change in an industry is classified as structural.
- (d) Devi, is frictionally unemployed. Job openings exist for her.

3. State the 'Full Employment' in The Classical view.

- i. The classical economists always believed in the existence of full employment in the economy.
- ii. To them full employment was a normal situation and any deviation from this was regarded as something abnormal.
- iii. According to Pigou, the greatest exponent of the classical view, the tendency of the economic system was to automatically provide full employment in the labour market.
- iv. Full employment exists "when everybody who at the ruling rate of wages wishes to be employed".
- v. Those who are not prepared to work at the existing wage rate are not unemployed in the Pigovian sense because they are voluntarily unemployed.
- vi. There is, however, no possibility of involuntary unemployment in the sense that people are prepared to work but they do not find work.

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