Victoria University of Bangladesh

Mid Term

Course Code: ECO 219

Course Name: Macro Economics

Submitted To

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1. Define the term Macro Economics. What are its scopes? Explain.

- Macroeconomics is a branch of economics that studies how an overall economy the markets, businesses, consumers, and governments behave. Macroeconomics examines economy-wide phenomena such as inflation, price levels, rate of economic growth, national income, gross domestic product (GDP), and changes in unemployment.

  Macroeconomics attempts to measure how well an economy is performing, understand what forces drive it, and project how performance can improve.

  - The two main areas of macroeconomic research are long-term economic growth and shorter-term business cycles.
  - Macroeconomics in its modern form is often defined as starting with John Maynard Keynes and his theories about market behavior and governmental policies in the 1930s; several schools of thought have developed since.
  - In contrast to macroeconomics, microeconomics is more focused on the influences on and choices made by individual actors in the economy (people, companies, industries, etc.).

2. Differentiate between Macro and Micro Economic.

- Macroeconomics differs from microeconomics, which focuses on smaller factors that affect choices made by individuals and companies. Factors studied in both microeconomics and macroeconomics typically influence one another.

  A key distinction between micro- and macroeconomics is that macroeconomic aggregates can sometimes behave in very different ways or even the opposite of similar microeconomic variables. For example, Keynes referenced the so-called Paradox of Thrift, which argues that individuals save money to build wealth (micro). However, when everyone tries to increase their savings at once, it can contribute to

a slowdown in the economy and less wealth in the aggregate (macro). This is because there would be a reduction in spending, affecting business revenues and lowering worker pay.

Meanwhile, microeconomics looks at economic tendencies, or what can happen when individuals make certain choices. Individuals are typically classified into subgroups, such as buyers, sellers, and business owners. These actors interact with each other according to the laws of supply and demand for resources, using money and interest rates as pricing mechanisms for coordination.

3. What do you know about National Income? Mention Some of the Dimensions of NI.

- National Income defines a country's wealth. This income depicts the value of goods and services which are produced by an economy. This gives effect to the net result of all the economic activities performed in the country.
  It is the accumulated money value of all final goods and services produced in a country during one financial year. Computation of
  National Income is very vital as it indicates the overall health of our economy for that particular year.

There are three ways of measuring the National Income of a country.

1. Product Method

Under this method, values of output produced or services rendered by the different sectors of the economy during the year in order to calculate the National Income.

This method, include only the value added by each firm in the production process in the output figure.

Hence, the value-added method. The value-added output of all the sectors of the economy is the GNP at factor cost.

However, this method is unscientific as it adds the value of only those goods and services that are sold in the market or are available for sale in the market.

2. Income Method

Under this method, all the incomes from employment and ownership of assets before taxation received from all the production activities in an economy.

Thus, it is also the Factor Income method. The undistributed profits of the private sector and the trading surplus of the public sector corporations.

However, exclude items not arising from productive activities such as sickness benefits, interest on the national debt, etc.

3. Expenditure Method

This method measures the total domestic expenditure of the economy. It consists of two elements, viz. Consumption expenditure and Investment expenditure.

Consumption expenditure includes consumption expenditure of the household sector on goods and services and consumption outlays of the business sector and public authorities.

Investment expenditure refers to the expenditure on the making of fixed capital such as Plant and Machinery, buildings, etc.

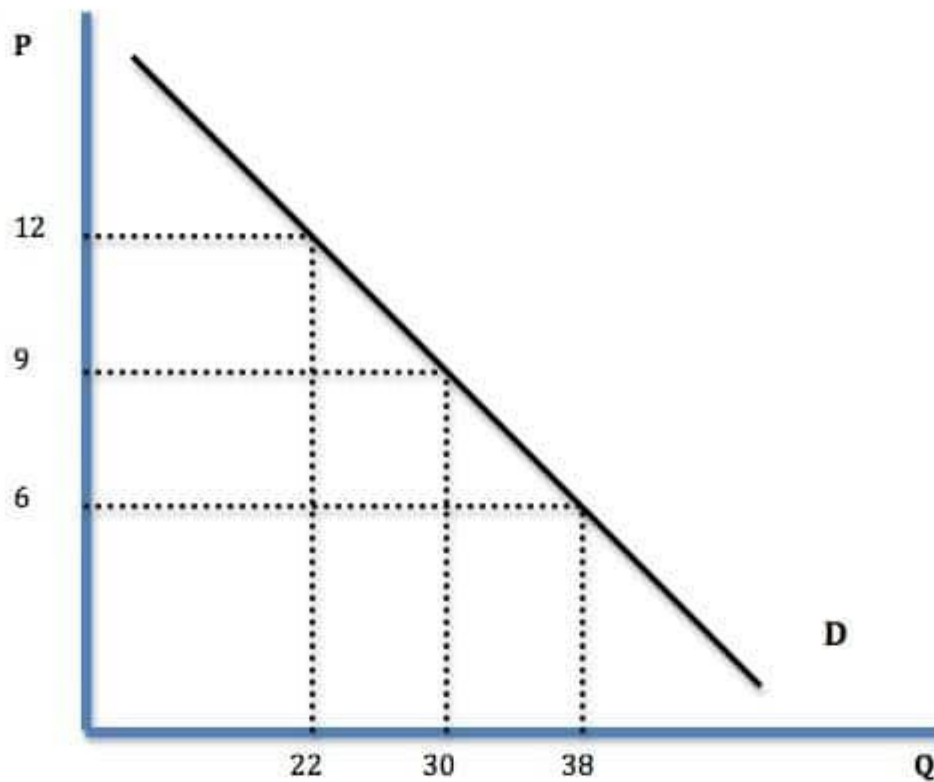
4. **Write shorts notes on the following topics (any 2): Savings-Investment Equality, Wage flexibility, Employment, Product method, Primary sector.**
   - **Savings-Investment Equality:** A fundamental macroeconomic accounting identity is that saving equals investment. By definition, saving is income minus spending. Investment refers to physical investment, not financial investment. That saving equal's investment follows from the national income equals national product identity.
   - **Wage flexibility**: Wage flexibility is defined as the speed with which real wages react to macroeconomic condition and it is measured as the responsiveness of real wages to shocks, usually measured as unemployment variations.

5. **"Theory of Effective Demand"- write briefly on this topic.**
   - Effective demand refers to the willingness and ability of consumers to purchase goods at different prices. It shows the amount of goods that consumers are actually buying – supported by their ability to pay.

     Effective demand excludes latent demand – where the willingness to purchase goods may be limited by the inability to afford it – or lack of knowledge.

     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.

Demand curve showing individual's effective demand



In this case, the consumer will be willing and able to purchase 22 goods when the price is £12.

Factors affecting effective demand

The main factors affecting 'effective demand' will be

- Price
- Income – a rise in income will tend to cause rising demand.
- Availability of credit. If consumers and firms are able to borrow, then they have an effective demand to buy or invest. If credit is constrained, their effective demand is limited by the lack of access to credit.