

The classical model of full employment.

Q:- Give the meaning of the term 'full employment'.

Ans:- 'Full employment' as a situation when there is no 'involuntary unemployment' though there may be 'frictional or 'structural' unemployment.

Q:- What is 'voluntary unemployment'?

Ans:- When a worker refuses to work at the prevailing wage rate is called voluntary unemployment.

Q:- What is Say's law?

Ans:- "Supply creates its own demand."

Q:- Give two names of classical economists.

Ans:- (i) Adam Smith (ii) David Ricardo.

Q:- How do you define closed economy?

Ans:- The closed economy is self-sufficient, which means no imports come into the country and no exports leave the country.

Q:- What is real wage rate?

Ans:- Real wages can be defined as the amount of goods and services that a worker purchases from his/her nominal wages.

Q:- Define frictional unemployment?

Ans:- Frictional unemployment is a type of unemployment. It is sometimes called search unemployment and can be based on the circumstances of the individual. It is time spent between jobs when a worker is searching for a job or transferring from one job to another.

Q:- What is autonomous investment?

Ans:— Autonomous investment is that investment which is independent of the level of income or profit.

Q:— What is induced investment?

Ans:— Induced investment is that investment which is governed by income and amount of profit.

Very short answer questions (2 marks)

Q:— State two implications of Say's Law of market.

Ans:— (i) According to Say's Law, the economy has built-in flexibility and automatic adjustment ensures that whatever is produced, gets consumed. There is no question of overproduction.

(ii) Since supply creates its own demand, deficiency of aggregate demand does not arise, hence general unemployment and overproduction are impossible.

Q:— State the classical quantity theory of money.

Ans:— The classical quantity theory of money is given by Fisher which can be algebraically expressed as

$$MV = PT$$

where. M is the quantity of money in circulation
 V is the velocity of circulation of money.
 P is the general price level.
 T is the volume of goods and services transacted, per unit of time.

Q:- What is meant by wage flexibility?

Ans:- Wages are said to be flexible when they respond to changes in supply and demand and lead to the market clearing wage being set. It implies that the wage will be set by the marginal Revenue Product of labour and marginal cost of labour. Any change in supply and demand for labour will lead to a change in the wage rate.

Q:- Write two criticisms levelled by Keynes against the classical theory of employment.

Ans:- (1) Keynes first attack on the classical theory is the assumption of automatic full employment equilibrium in the economy. According to Keynes, this assumption is unrealistic and misleading. According to him, the normal feature of a capitalist economy is one of ~~the~~ underemployment, not full employment as propounded by the classical theory.

(2) Keynes did not agree with the classical view of automatic and self-adjustment process of the economic system under a laissez faire policy. ~~He~~ He maintained that state intervention through fiscal and monetary measures is necessary to adjust aggregate supply and demand in the economy.

Q:- Write two assumptions of the classical theory of employment.

Ans:- (1) In the economy, there is a normal situation of full employment without inflation.

⑩ Perfect competition exists both in the product and factor market.

Q:- Give two criticisms against the Say's Law of market.

Ans:- ① Unrealistic Assumption:- The entire Say's law is based upon several unrealistic assumptions like flexibility of prices, wages, interest rate, expandability of market, perfect competition etc. which are very difficult to realise in actual practice.

② Evidence of Depression:- Evidence of the 1929-32 Great Depression shows that it is not impossible to experience a glut in the economy. If Say's law is valid and supply creates its own demand, there is absolutely no reason for which such a situation can set in an economy.

Q:- Explain in brief the concept of underemployment equilibrium.

Ans:- In Keynesian economics, underemployment equilibrium is a situation with a persistent shortfall relative to full employment and potential output so that unemployment is higher than at the natural rate of unemployment.