

INTRODUCTION TO MACROECONOMICS



INTRODUCTION TO MACRO ECONOMICS

INTRODUCTION:

Economics is classified into micro economics and macro economics. *Ragnar frisch*, a norwegian economist the first noble prize in economic sciences. He only coined the term micro(small) and macro(large) in 1933. *John maynard keynes* is the '*father of modern macro economics*' his book name is "*the general theory of employment, interest and money*" in 1936. He gave explanation for fallout of great depression. There goods reminded unsold and workers unemployed.

MEANING OF MACROECONOMICS.

The word macro is derived from the greek word *makros* meaning large. Hence, macro economics is the study of the economy as a whole. In other words macro economics deals with aggregates such as national income, employment and output. Macro economics is also known as **'income theory'** subject matters covered the areas such as employment, national income, inflation, business cycle, poverty, inequality, etc.



IMPORTANCE OF MACROECONOMICS

To understand the functioning of the whole economy and to solve the basic problems prevailing in an economy. To understand the future problems needs and challenges of an economy. To use scientific investigation to understand the reality. To make meaningful comparison and analysis of economic indicators. Helps for better prediction about future.



SCOPE OF MACROECONOMICS

- **NATIONAL INCOME**: Measurement, trends, and composition of national income provide a long term understanding of growth process.

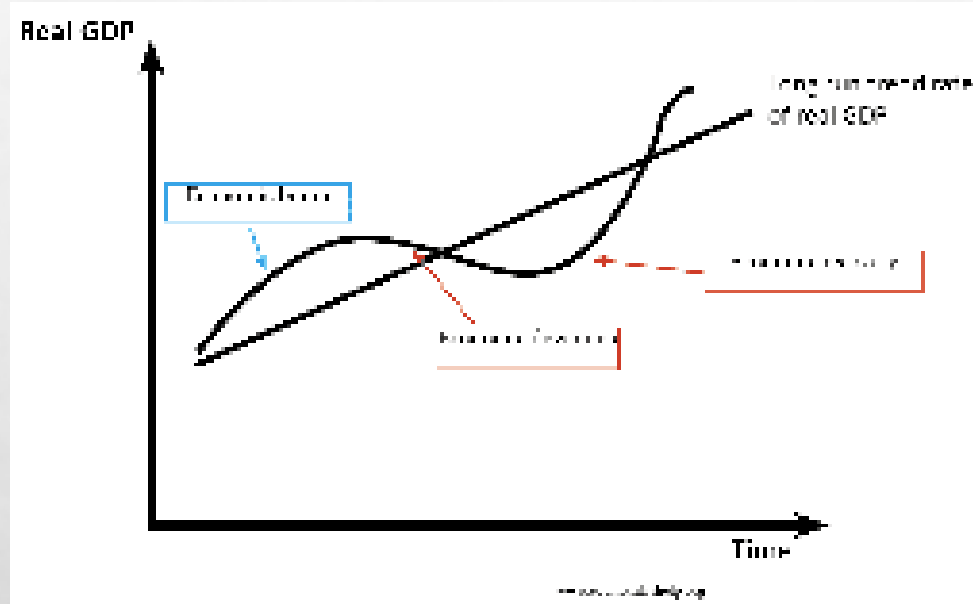


- **INFLATION**: It refers to steady increase in general price level by constructing price index such as whole sale price index, consume a price index etc.



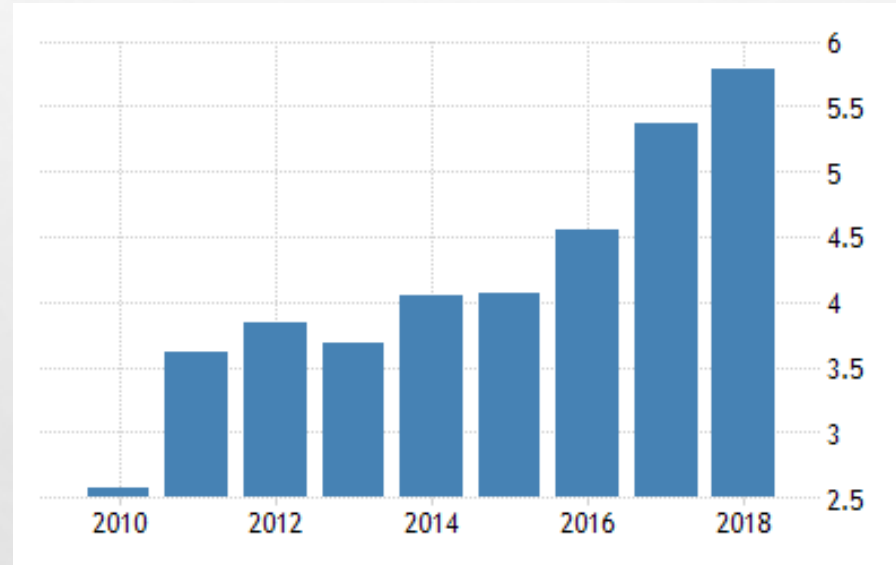
• BUSINESS CYCLE:

All economies face this problem . cyclical movements like boom, recession ,depression , and recovery .We can know about changes in the economy.



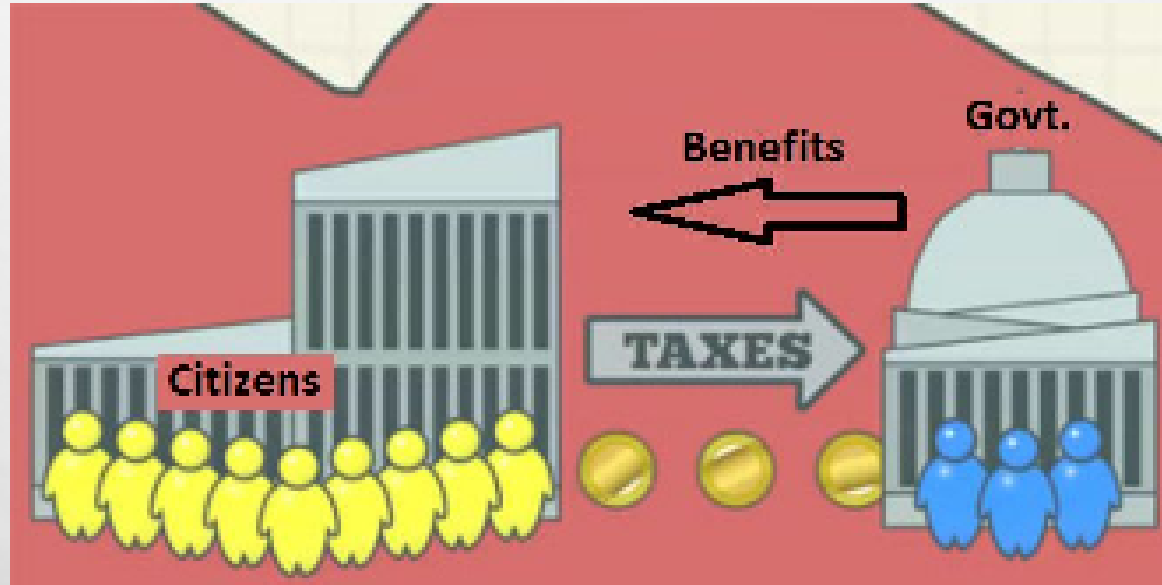
- **ECONOMIC GROWTH:**

Growth and development of the economy and factors determining them can be understood through macro analysis.



• **ECONOMIC POLICIES**

MACRO ECONOMICS HELPS TO MAKE ECONOMIC POLICIES .ECONOMIC POLICY WILL SOLVE BASIC PROBLEMS, OVERCOME OBSTACLES AND ACHIEVE GROWTH



LIMITATIONS OF MACROECONOMICS.

- Danger of excessive generalisation
- Assumes homogeneity among individual units.
- Fallacy of composition.
- Non economic factor determine economic activity. But they do not find place in macro economic book.

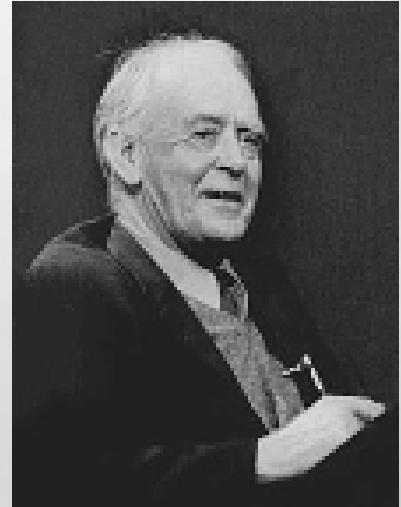
ECONOMY AND ITS TYPES:



• **ECONOMY DEFINITION:**

J.R.Hicks defined as A system by which people earn their living. Production , consumption.

Main aim to achieve growth economic include (transportation , banking , advertising, planning etc.) And non economic activities (environment, education ,health , entertainment ,governance , regulation etc.)External activities(import, export, international relations, emigration, immigration, foreign investment etc.)

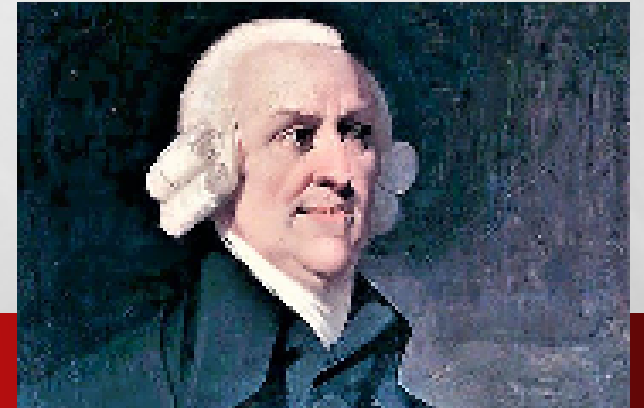


• **TYPES OF ECONOMIES:**

- Status of development – developed, underdeveloped, undeveloped & developing.
- System of activities – capitalistic, socialistic & mixed.
- Scale of activities – small & large.
- Nature of functioning – static & dynamic.
- Nature of operation – closed & open.
- Nature of advancement – traditional & modern.
- Level of national income – low, middle & high.

ECONOMIC SYSTEMS

- **THREE TYPES**: Capitalistic (private ownership and total freedom), socialistic (more freedom, public ownership) and mixed (co-existence of public and private).
- **CAPITALISM**:
- **ADAM SMITH – FATHER OF CAPITALISM**.
- Capitalism is also termed as free economy or market economy
- Government role is minimum, profit motive, private ownership.
- Eg. USA, west germany, australia, japan.



FEATURES

- 1. **PRIVATE OWNERSHIP OF PROPERTY AND LAW OF INHERITANCE**: All resources owned by private individual. The owner has right to own ,sell , buy any amount of property. Property can be transfered to his heirs after death.



- **2.FREEDOM OF CHOICE AND ENTERPRICE:** Induividual is free to choose any occupation or trade at any place . consumers are free to buy any commodity.



- **3.PROFIT MOTIVE:** Golden rule for producers is maximisation of profit . they produce goods which gives higher profit.



- **4.FREE COMPETITION:** There is competition between buyers and sellers . free competition between product market and factor market.



- **5.PRICE MECHANISM**:(Heart)all economic activities are regulated by market forces of demand and supply.



- **6.ROLE OF GOVERNMENT:** Government role is minimum like defence, health education etc.



- **7. INEQUALITIES OF INCOME:** There is difference between haves and havenot. le rich and poor . so inequalities is increasing.



• **MERITS:**

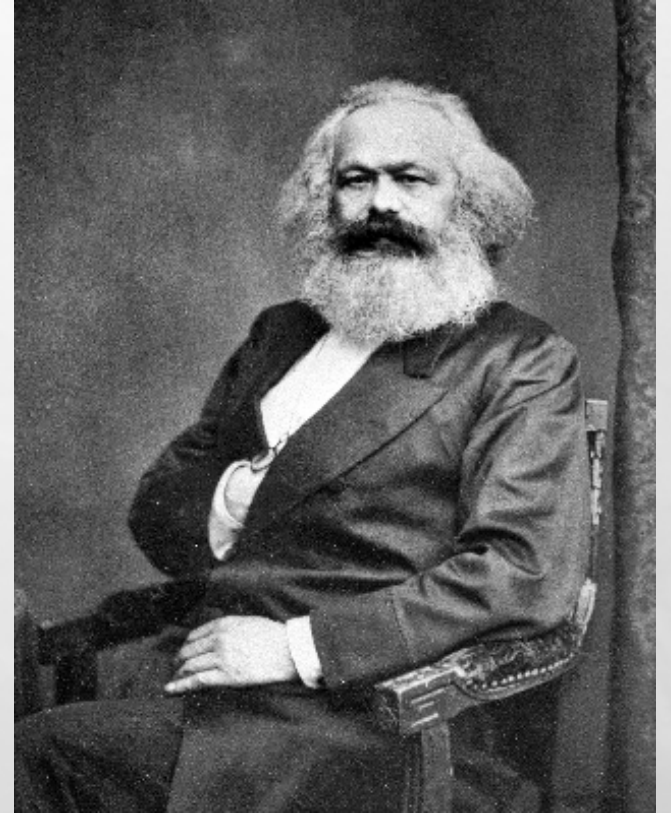
- 1. Automatic working-without govt econmy works automatically
- 2. Efficint use of resources-resources put into optimum use.
- 3. Incentives for hardwork-entreproners get more profit for more efficiency.
- 4. Economic progress-production is very high.
- 5. Consumers sovereignty-production activities satisfying the consumers.
- 6. Higher rates of capital formation-increase in saving and investment leads to increase in capital formation.
- 7. Devt of new technology-producers invest in new technology and produce quality goods.

• **DEMERITS:**

- 1. Concentration of wealth and income-wealth only in few hands. So there will be inequality.
- 2. Wastage of resources-resources are wasted on advertisement and duplication.
- 3. Class struggle-struggle between capitalist and workers.
- 4. Business cycle-business cycle fluctuation and crises.
- 5. Production of non essential goods-even harmful goods are produced if it makes profit means.

SOCIALISM.

- KARL MARX -FATHER OF SOCIALISM
- State controls economic activity
- Other name – planned economy or command economy
- Public welfare motive and equality
- Example :china,vietnam,poland,cuba



FEATURES:

- **1.PUBLIC OWNERSHIP OF MEANS OF PRODUCTION-** ALL RESOURCES ARE MANAGED BY GOVERNMENT AND NATIONALISED
- **2.CENTRAL PLANNING-** ALL DECISIONS ARE UNDER TAKEN BY CENTRAL PLANNING AUTHORITY.
- **3.MAXIMUM SOCIAL BENEFIT-** INVESTMENTS ARE PLANNED TO MEET THE BENEFITS AND WELFARE OF THE SOCIETY.
- **4.NON EXISTENCE OF COMPETITION-** STATE CONTROLS PRODUCTION AND DISTRIBUTION .SO NO COMPETITION ,CONSUMERS WILL HAVE LIMITED CHOICE.

- **5.ABSENCE OF PRICE MECHANISM-**PRICE SYSTEM REGULATED BY CENTRAL PLANNING AUTHORITY.
- **6.EQUALITY OF INCOME-**THERE IS NO PRIVATE PROPERTY AND LAW OF INHERITANCE , SO REMOVAL OF INEQUALITY.
- **7.EQUALITY OF OPPORTUNITY-**EQUAL OPPORTUNITY FOR ALL(FREE EDUCATION , HEALTH, TRAINING ETC.)
- **8.CLASSLESS SOCIETY-**IN SOCIALISM EVERY ONE IS EQUAL.



• **MERITS:**

- 1.Reduction in inequalities-no private ownership of property
- 2.Rational allocation of resources-it is done by planned authority in a planned manner, so no wastage of resources.
- 3.Absence of class conflicts-no conflict between rich and poor,no inequality
- 4.End of trade cycle-planning authority will have control over production and distribution so no economic fluctuation.
- 5.Promote social welfare-absence of exploitation and reduction of inequality lead to social welfare.

• **DEMERITS:**

- 1.Red tapism and bureaucracy-official approval and movement of files from one table to another take time and leads to red tapism.
- 2.Absence of incentive-no incentive for innovation.So productivity will suffer.
- 3.Limited freedom of choice-consumer will have limited choice for consumption.
- 4.Concentration of power-state has the power . sometime state may misuse the power.

FEATURES

- 1.Ownership of property and means of production-both public and private have the right to buy , use and transfer the resources.
- 2.Coexistence of public and private sector-private industries work for profit and public sector work for social welfare.
- 3.Economic planning -national plans are drawn by government, public and private sectors abide. All the functions of the economy based on this plan only.
- 4.Solution to economic plan -what to produce, how to produce, for whom to produce and how to distribute are solved through price mechanism and state intervention.
- 5.Freedom and control-though private has the freedom, overall control of economic activity rest with govt.

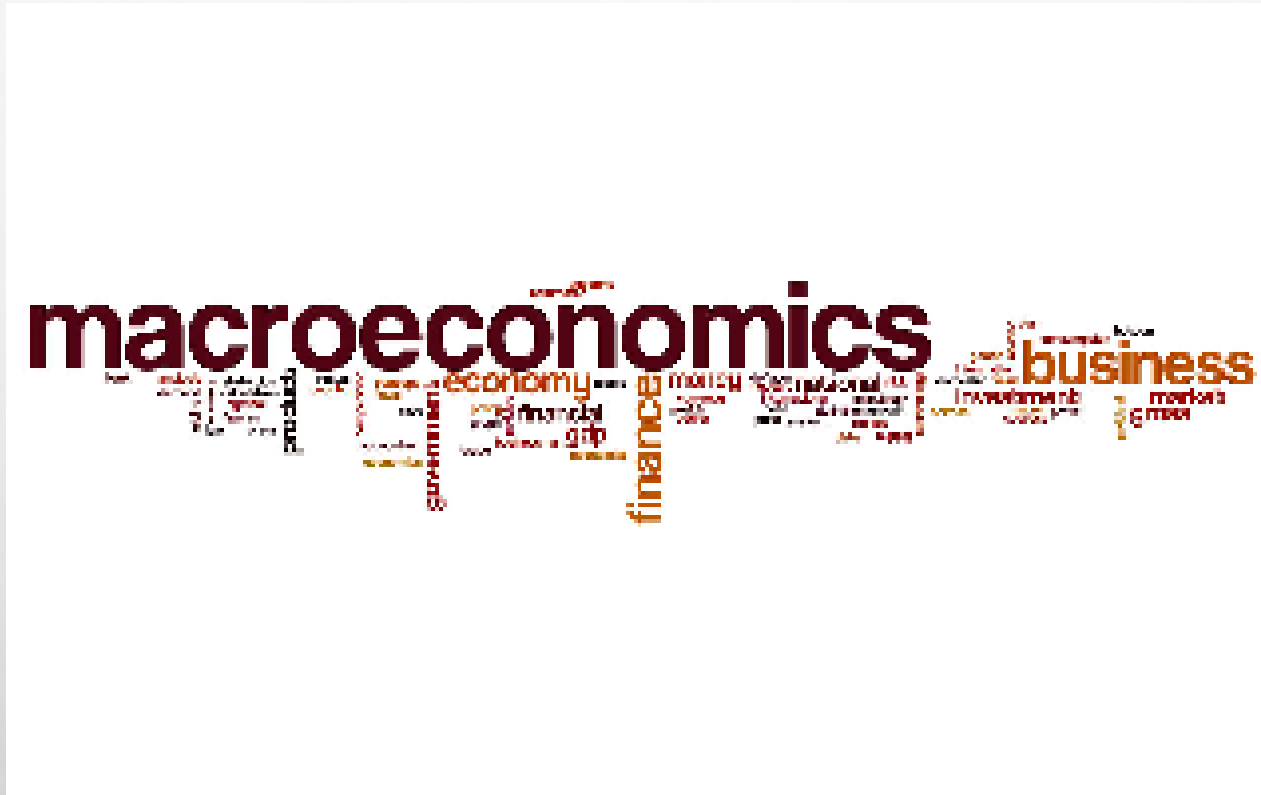
• **MERITS:**

- **1. RAPID ECONOMIC GROWTH** - BOTH PUBLIC AND PRIVATE NEEDS ARE TAKEN CARE.
- **2. BALANCED ECONOMIC GROWTH** - BETWEEN AGRICULTURE AND INDUSTRY, CONSUMER GOODS AND CAPITAL GOODS, RURAL AND URBAN ETC.
- **3. PROPER UTILISATION OF RESOURCES** - GOVERNMENT CONTROLS IMPORTANT ACTIVITIES DIRECTLY AND PRIVATE SECTOR INDIRECTLY.
- **4. ECONOMIC EQUALITY** - GOVERNMENT USES PROGRESSIVE TAX TO BRING EQUALITY.
- **5. SPECIAL ADVANTAGE TO THE SOCIETY-** (SAFEGUARD THE INTEREST OF WORKERS AND WEAKER SECTION, RATIONING, FAIR PRICE SHOP AND SOCIAL WELFARE MEASURES.

• DEMERITS:

- 1. LACK OF COORDINATION - DIVERGENT MOTIVES OF BOTH THE SECTORS LEAD TO COORDINATION PROBLEM.
- 2. COMPETITIVE ATTITUDES - NO COMPLEMENTARY SPIRIT ONLY COMPETITIVE ATTITUDE.
- 3. INEFFICIENCY - LATHARGIC BUREAUCRACY, RED TAPISM AND LACK OF MOTIVATION.
- 4. FEAR OF NATIONALIZATION - THIS DISCOURAGES PRIVATE BUSINESS OF RATIONS AND INNOVATIVE INITIATIVES.
- 5. WIDENING INEQUALITIES - THE GAP BETWEEN THE RICH AND POOR WILL INCREASE.
- 6. COMPARISON OF DIFFERENT ECONOMIC SYSTEM - (REFER BOOK).

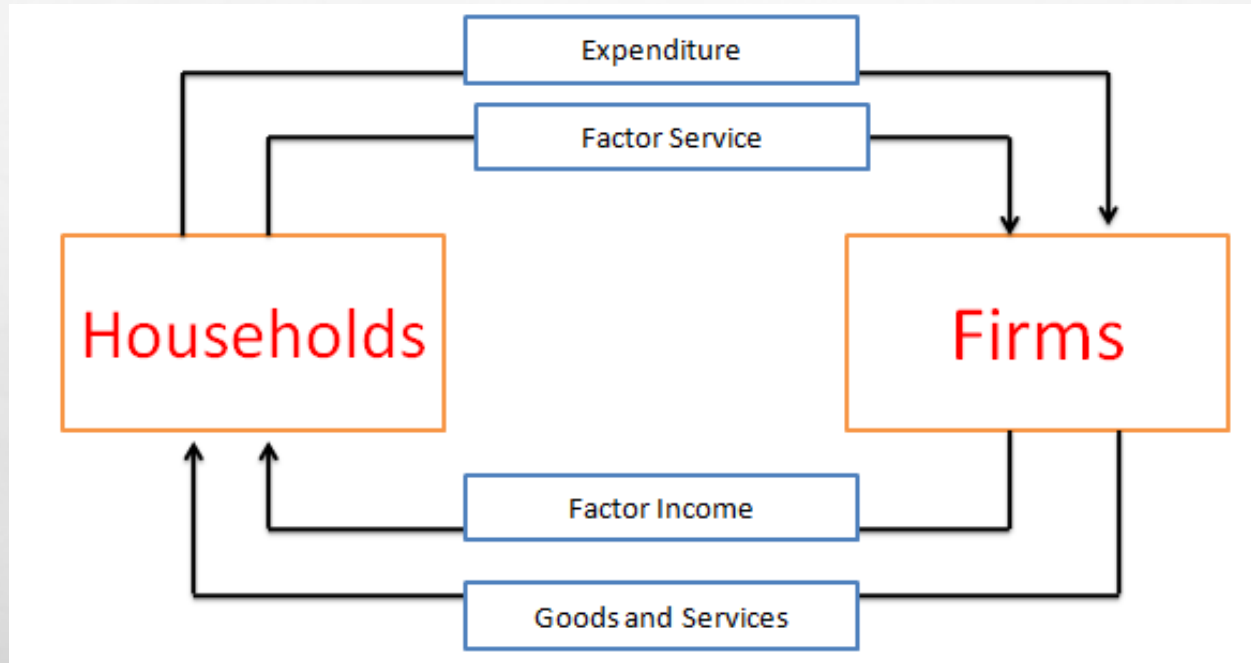
CONCEPTS OF MACRO ECONOMICS



- **STOCK-** QUANTITY OF A COMMODITY MEASURED AT A POINT OF TIME. EG: MONEY SUPPLY, UNEMPLOYMENT, CAPITAL ETC.
- **FLOW-** MEASURED OVER A PERIOD OF TIME. EG: NATIONAL INCOME, IMPORTS, EXPORTS, CONSUMPTION, ETC.
- **ECONOMIC MODELS-** SIMPLIFIED REPRESENTATION OF REAL SITUATION. ECONOMISTS USE MODELS TO DESCRIBE ECONOMIC ACTIVITIES, THEIR RELATIONSHIPS AND THEIR BEHAVIOUR. MATHEMATICS, GRAPHS AND EQUATIONS EXPLAIN ECONOMIC VARIABLES.

- **CIRCULAR FLOW OF INCOME** - ECONOMIC AGENTS SUCH AS FIRMS, HOUSEHOLDS, GOVERNMENT, AND NATIONS AND THEIR OPERATIONS FOR HIRING FACTORS AND BUYING GOODS AND SERVICES.
- **TWO SECTOR MODEL**- HOUSEHOLD AND FIRM.
- **THREE SECTOR MODEL**- HOUSEHOLD FIRM AND GOVERNMENT.
- **FOUR SECTOR MODEL**- HOUSEHOLD FIRM, GOVERNMENT AND REST OF THE WORLD.

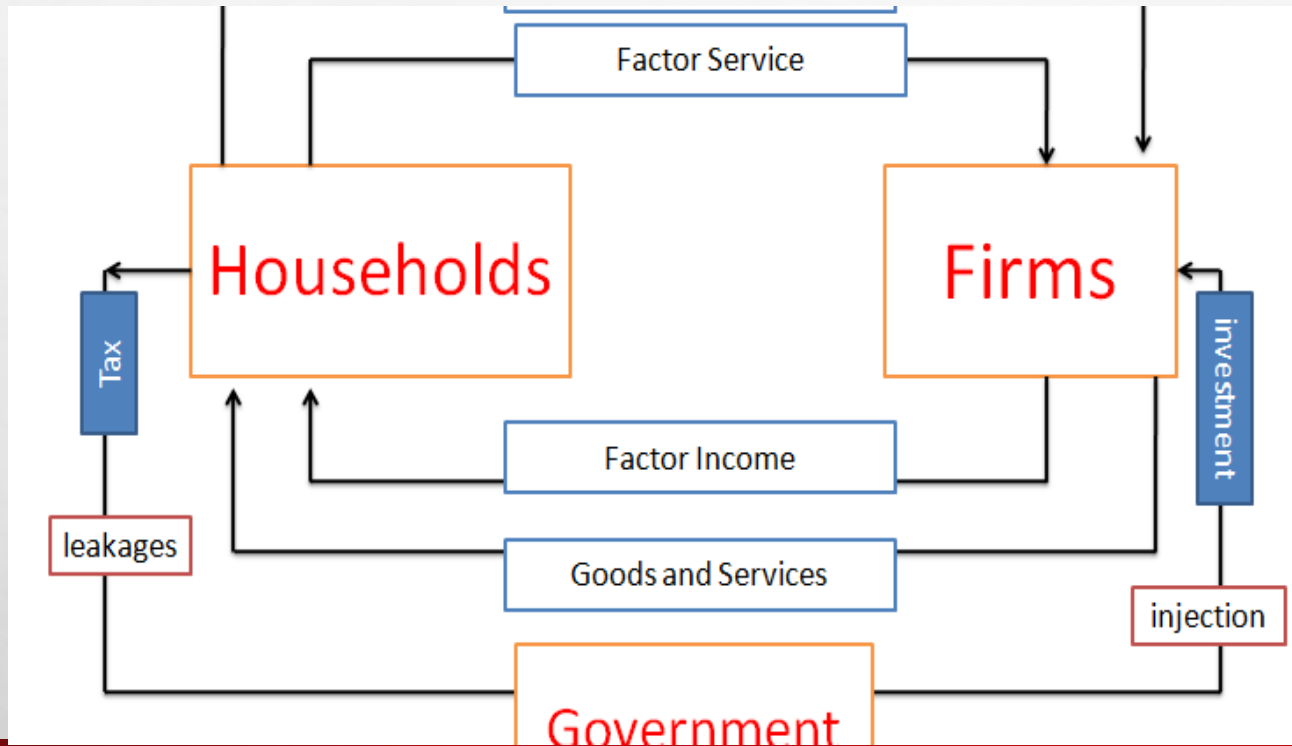
TWO SECTOR ECONOMY.



• **TWO SECTOR ECONOMY:**

- **HOUSEHOLD SECTOR**- THEY ARE THE SOLE BUYER OF GOODS AND SERVICES AND SOLE SUPPLIER OF FACTORS OF PRODUCTION.
- **FIRMS**- FIRMS SELL GOODS AND SERVICES TO THE HOUSEHOLD. IT HIRES FACTORS FROM HOUSEHOLDS AND MAKE PAYMENTS TO THE HOUSEHOLD.
- IN A TWO SECTOR ECONOMY OUTER CIRCLE REPRESENTS REAL FLOW (FACTOR SERVICE FROM HOUSEHOLD TO FIRM AND GOODS AND SERVICES FLOW FROM FIRM TO HOUSEHOLD) AND INNER CIRCLE REPRESENTS MONEY FLOW.
- $Y=C+I$

THREE SECTOR ECONOMY.

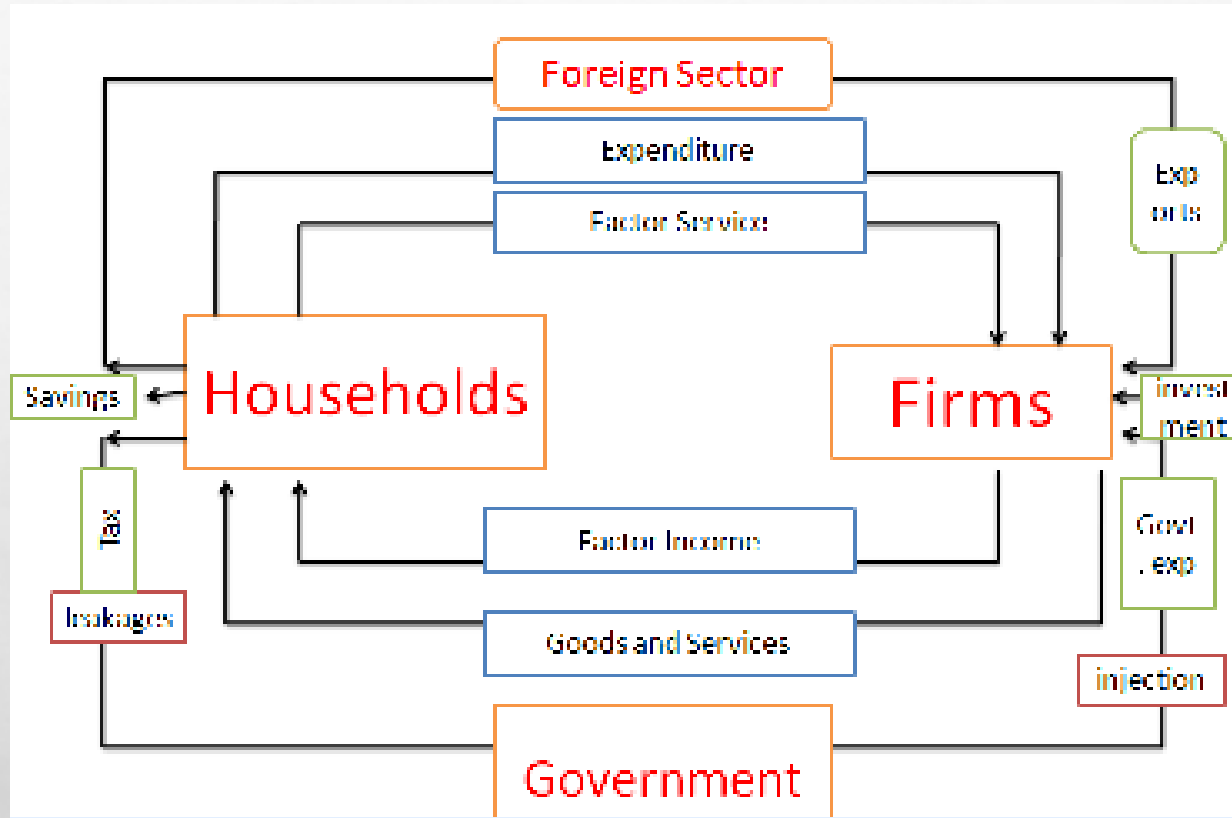


- **THREE SECTOR ECONOMY:**

- Government levies taxes on household and firm purchase goods and services from firm and receives factors from household. Government also makes social transfer (pension, subsidies etc.) Government also make payment to the firm for buying goods.

- $Y=C+I+G$

FOUR SECTOR ECONOMY.



- **FOUR SECTOR ECONOMY:**

- External sector comprises of exports and imports. Expenditure for the entire economy includes domestic expenditure (C+I+G) and net exports (X-M).

- $Y=C+I+G+(X-M).$
