Macro-Economics and basic concepts

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INTRODUCTION

Macroeconomics may be defined as that branch of economic analysis which studies the behaviour of not one particular unit, but of all the units combined together. Macroeconomics is a study in aggregates. Hence, it is often called Aggregative Economics. It is the study of the economic system as a whole. It is the study of the overall conditions of an economy, say, total production, total consumption, total saving and total investment. Prof. Kenneth E. Boulding puts it, "Macroeconomics deals not with individual quantities as such, but with aggregates of these quantities; not with individual incomes but with the national income; not with individual prices but will the price level; not with individual outputs but with the national output."1 It, thus, deals not with one family but all the families taken together; not with one firm but all the firms in an economy; not with one industry but the entire industrial structure of an economy. *Macroeconomics deals with the great averages and aggregates of the system rather than with particular units in it.* It studies the behaviour of *macro-quantities* or *macro-variables.* Since macro-economics splits up the economy into big lumps (or sectors) for the purpose of study, it is also called the *Method of Lumping*. John Maynard Keynes' famous work, *General Theory of Employment, Interest and Money*, published in 1936, it an outstanding example of macroeconomics., The Keynesian economists had developed macroeconomics to "full flower" by the' sixties.

The study of microeconomics can be defended on the ground that it is indispensable for the proper and accurate knowledge of the behaviour-patterns of the aggregative variables. As already pointed out above, it is not possible to discover the behavour –pattern of the aggregates simply by generalizing from the character and behaviour of the individual constitutes. Prof. Boulding has driven home the point by giving an apt simile. The forest, as he points out, though an aggregation of trees, does not exhibit the characteristics and behaviour –patterns of the forest trees. Such an attempt would be highly misleading. As we know, there are clear differences between an individual tree and the forest as a whole:

Difference between individual Tree and Forest:

	Individual Tree	***Forest***
1.	An individual tree germinates, grows and decays.	While a forest goes on for ever which exactly the same internal composition in regard to character of trees that compose it.
2.	An individual tree may not burn so easily.	But forests are very often subject to fires.
3.	An individual tree cannot affect the climate of the vicinity in which it grows.	A forest can.

The aggregate and its individual components are, thus, entirely two different things and the characteristics of one do not necessarily pertain the other. If once this truth is grasped, the necessary and justification of macroeconomics become self – evident.

Unfortunately, this truth has not been recognized even by some of the leading economics in the past, and the failure to recognize this truth has been responsible for some of the gravest errors in economic thinking. Several economics has endeavoured to apply in the past propositions derived from individual experience to the economy as a whole, and such attempts have brought nothing but confusion and muddled thinking in their wake. thus, observing that 'depression' in a particular industry may be cured by a restriction of output ; some half-backed economists argue the all that is necessary to

cure depression in the economy should be *general* restriction of output as a whole. We, however, know how fallacious and crude such a reasoning can be. To give another instance: Wage-cutting in a particular firm may promote employment, but general wage-cutting or wage-cutting in the economy as a whole may actually result in diminishing the volume of employment. So what is true of a single firm cannot necessarily be true of the economy as a whole. Prof. Boulding calls such paradoxes as *Macroeconomic Paradoxes,* and defines them as those "propositions which are true when applied to a single individual, but which are untrue when applied to the economic system as a whole."[1] And he further observes, "It is these paradoxes, more than any other factor, which justify the separate study of the system as a whole, not merely as an inventory or list of particular items, but as a complex of aggregates." So, it is the existence of these macroeconomic paradoxes, which necessitate the separate study of macroeconomics. We should, thus, duly note the differences between the *individual* and *group* characteristics, because failure to do so would be attended with dire consequences not only in economics, but also in other social sciences, though the dangers of generalizing from individual experience arc not so great in other social sciences as in Economics. Hence, there is perfect justification for evolving and developing macroeconomics as a branch of economic analysis. Macroeconomics has been growing so rapidly during the last three decades that it has, to quote Prof. R. G. D. Allen, "involved a considerable upheaval in the structure of economic theory." As already pointed out, the publication of Keynes' *General Theory,* in 1936, gave a strong impetus to the growth and development of modern macroeconomics. Since 1936; certain additional- factors have contributed to the development of macroeconomics. For example, the Great Depression of 1929 and the subsequent attempts of various governments to control the business cycle, the Great Inflation of the post-war years and the efforts of several backward countries of Asia and Africa to develop their economies in a planned manner are some of the factors which have contributed to the growing popularity of macroeconomics during the last five decades.

Macroeconomics has afforded an inconsiderable help to governments all over the world in formulating and implementing appropriate economic policies. *With their knowledge of the functioning of the economy, the governments are now in a better*

position to control the business cycle, i.e., inflation and deflation, than they could do formerly. Macroeconomics also helps governments to achieve uninterrupted economic growth and full employment with the help of suitable economic policies. It also lies at the basis of all the present day plans of economic policies. It also lies at the basis of all the present day plans of economic development of underdeveloped countries. Social accounting is another field where macroeconomics has made valuable contributions to economic policy.

*T*he study of macroeconomics is very important for evaluating the overall performance of the economy in terms of national income. National income data help in forecasting the **level** of **economic** activity and in understanding the distribution of income **among** different groups of people in the economy.

The popularity of macroeconomics has greatly **increased** an recent years on account of the fact that it deals **with most of** be controversial and challenging issues of the day, **namely,** those **of** unemployment, deficit financing, inflation, taxation, planning **and** economic development. No economist worth **his salt can** afford **to** neglect or overlook the study and **analysis** of such burning **problems of** the modern world.

Limitations of Macroeconomics:

Although macroeconomics is gaining in popularity **and** strength, yet there are certain inherent pitfalls or dangers which must be avoided if it is to serve as handmaid of public policy.

The greatest danger, as already hinted upon, **is the danger** of excessive generalization from individual experience to **the** system **as a** whole. What is true of an individual component **may not necessarily be** true of the aggregate. There is nothing wrong **in an** individual withdrawing deposits from the bank, but if all the people rush to withdraw their deposits simultaneously, the bank would surely collapse We must, therefore, be on our guard against generalizing too much from individual experience although individual experience, **in the** ullimaic analysis, is too important to be ignored or omitted **altogether.**

The second danger of macroeconomics is **the** danger **of excessive** thinking in terms of aggregates which are **by** no **means homogeneous.** We should always endeavour to take into account aggregative variables which are homogeneous in nature. That alone can lead to accurate results. But do we always have aggregates, which **are homogeneous** in nature? Sometimes, we may have to take into account aggregates which are rather heterogeneous in character. Our attempt in such cases **should** be to have aggregates which are homogeneous in **nature.** As Prof. Boulding points out :

(1) 6 apples + 7 apples = 13 apples, which **constitute** a **meaning** aggregate.

(2) 6 apples + 7 oranges = 13 fruits, which constitute **a** fairly meaningful aggregate.

(3) 6 apples + 7 skyscrapers constitute a meaningless aggregate.

It is the last type of aggregate that we should avoid, because on the very face of it, it is a fantastic or grotesque aggregate. Macroeconomics would lose its savour and also utility if we were to resont no such fantastic and foolish aggregates.

An aggregate tendency may not influence all the sectors of I he economy in the *same* manner. A general rise **in** prices, **for** example, may not affect all the sections of

the community **in** a similar Some sections may be affected more adversely than others. Some industries may be benefitted more than other industries.

A study of aggregates may lead us to believe that no change has taken place and as such no new policy is called for. For example, if agricultural prices fall by 50 per cent, the general price level will remain unchanged, because the two types of price changes neutralize each other. If one were to be guided by macroanalysis alone, then obviously in such a situation no new policy would be called for. But actually the government needs to adopt a new policy to help the agriculturists, the prices of whose products have fallen. Aggregative results may, thus, be misleading.

Besides the micro and macroeconomics, there is also an intermediate level of aggregation which does not fall clearly into either of them, such as, the study of agricultural economics or international trade.

The measurement of aggregates itself presents serious problems in certain cases.

Despite several improvements in statistical techniques in recent years, it has not been possible to obtain reliable measures of aggregates and averages that constitute the staple diet of macroeconomics.

Difference between Microeconomics and Macroeconomics The difference between microeconomics and macroeconomics may be summarised as under:

Difference between Microeconomics and Macroeconomics:

Basis	***Microeconomics***	***Macroeconomics***
1. Origin	It has been derived from the Greek word 'Micros' which means small.	It is the study of economic actions of individuals and small group of individuals.
2. Base	The basis of microeconomics is the price mechanism which operates with the help of demand and supply forces.	The basis of macroeconomics is national income output and employment which are determined by aggregate demand and aggregate supply.
3. Main Objects	To maximize utility.	The main objectives is full employment, economic growths and price stability.
4. Assumptions	It is based on rational behaviour of individuals.	It is based on such variables as the aggregate volume of the output of the economy.
5. Analysis	It is based on partial equilibrium analysis	It is based on general equilibrium analysis.
6. Relation	It is considered as a static analysis.	It includes a changing analysis.

The above distinction between microeconomics and macroeconomics is not very rigid because what is microeconomics in one situation might become macroeconomics in another situation. For example, a study of national income in one country is a study of macroeconomics. But, if we are studying international income or the income of the world as a whole, then the study of the national income of a country becomes a study in microeconomics.

CONCLUSION

We have outlined above the two seemingly alternative approaches to economic analysis, viz., the *micro* and the *macro* approaches. They may seem to be competitive approaches but at bottom they are complementary to each other. In fact, they are so interdependent that neither approach is complete without the other. We cannot attain a complete understanding of the functioning of the economic system unless we *integrate* the two approaches in a judicious manner. The costs of a particular firm, such as, labour and raw materials, etc. arc determined, not by the demand of that particular firm, but by the demand of the entire economy for these things. The sales of

the firm, too, are determined not by its own prices, but also, and to a very large extent, by the total purchasing power available to the community. The firm may go the farthest in lowering down its prices, but if the community lacks the purchasing power, it shall hardly have any effect on its sales. The aggregative or macro-factors cannot, thus, be ignored even in a microanalysis of the firm.

In a like manner, the price of an individual product is determined, not only by its own supply and demand, but also by the prices of other products. It is thus difficult, nay impossible, to isolate any economic phenomenon and call it as self-determined. We must study macroeconomics, because it deals with aggregative variables, such as, national output and national income. We must study microeconomics, because national output and national income are ultimately the result of the decisions of millions of business firms and individuals. As such, it will be necessary for us to examine the principle governing the economic conduct of individuals, individual firms and individual industries.

The fact of the matter is that micro and macroeconomics are *interdependent.* Microeconomics contributes to macroeconomics; macroeconomics, in its turn, contributes to microeconomics. For example, the theory of investment belongs to microeconomics. It is derived from the behaviour of the individual entrepreneur who is governed, on the one side, by the marginal efficiency of capital, and, on the other side, by the rate of interest. Now this theory of investment.

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