Macroeconomics

Introduction

MACROECONOMICS

- The term macro is derived from the Greek word ‘makros’ meaning large
- It was coined by Ragnar Frisch in1933
- Macroeconomics is the study of the behaviour and performance of the economy as a whole
- Macroeconomics deals with the aggregates and averages concerning the entire economy such as national income, price level, employment aggregate demand, total investment etc.
- John Maynard Keynes is considered as the Father of Modern Macroeconomics
- General Theory of Employment, Interest, and Money (1936)

- Why do we need a separate discipline called Macroeconomics?
- This is because, in economic system, what is true for the parts is not necessarily true for the whole
- When laws of generalizations are true of consistent individual parts but untrue or invalid in the case of the whole economy, paradox seems to exist
- Prof. Boulding calls such paradox as macroeconomic paradoxes or micro-macro paradox
- Paradox of thrift is an example of such micro-macro paradox

IMPORTANCE OF MACROECONOMICS

- To understand the working of the economy
- To understand the important nature of macroeconomic issues such as unemployment, inflation etc
- Growing complexity of economic system
- Understanding business cycles
- Accelerating economic growth
- Formulating government’s macro economic policy
- To help individuals take better decisions
- Importance in business decisions and forecasting

SCOPE OR SUBJECT MATTER OF MACROECONOMICS

- Theory of Income and Employment- Aggregate demand, aggregate supply determines equilibrium level of income and employment in the economy
- Theory of General Price Level- Inflation and deflation, theories of money, banking, and finance
- Theory of Economic Growth- Macroeconomics studies various factors, process, and theories of economic development and planning
- Macro Theory of Distribution- Macroeconomics deals with the various factors of production and their relative share in the total production or national income

MACRO STATIC

- Static is derived from ‘statikos’ which means to stand still
- But a static economy does not mean an economy in which no activity is taking place
- Static economy is an economy where normal activity goes on but there is no change in the size of the economy, national output, prices etc
- It examines the relationship between macro economic variables in the final position of equilibrium
- Relationship between variables at a particular **point of time**

MACRO DYNAMICS

- The word dynamics is derived from the Greek word ‘dynamikos’ meaning ‘cause to change’
- A dynamic economy is an economy which is in a state of continuous movement
- Dynamic economy visualizes a continuous change in the level of output
- This continuous change in output is because of some uncertain changes in the economic variables like population growth, availability of resources etc
- It analyses changes in the economic variables over a **period of time**

ECONOMIC MODELS

- A model is a simplified representation of real life situation
- An economic model is a statement of relationship between economic variables
- The purpose of developing economic models include:-

a. Analysis- examine the behavior of economic variables
b. Prediction – forecasting the effects of changes in economic variables

- Validity of a model depends on its predictive power, consistency, realism of assumptions, degree of generality, simplicity, extent of information it provides

TYPES OF ECONOMIC MODELS

- *On the basis of extent* – Aggregate model, sector model, inter sector model
- Aggregate model deals with the economy as a whole
- Sector model deals with specific sector like agriculture, industry etc.
- Inter sector model deals with two or more sectors e.g. input-output model
- *On the basis of time*- Static and dynamic model
- *Micro and macro model*

USES OF ECONOMIC MODELS

- Clarity of expressions
- Concise overall picture of the economy
- Interdependence of large number of economic variables
- Systematic study of the past and provides a rational device for forecasting the future

LIMITATIONS OF ECONOMIC MODELS

- Unrealistic and overly restrictive assumptions
- Idealized abstractions from real life situations