Economics
Class-12
Chapter -1

Introduction to Micro and Macro Economics

Introduction:

- Microeconomics and Macroeconomics are the main branches of modern economics.
- The term micro is derived from the Greek word ‘Micros’ means small or millointh part.
- The term macro is derived from the Greek word ‘Macros’ and it means large.
- There terms are created by Norwegian Economist Ragnar Frisch of Oslo University in 1933.

Meaning & Definitions of Microeconomics:

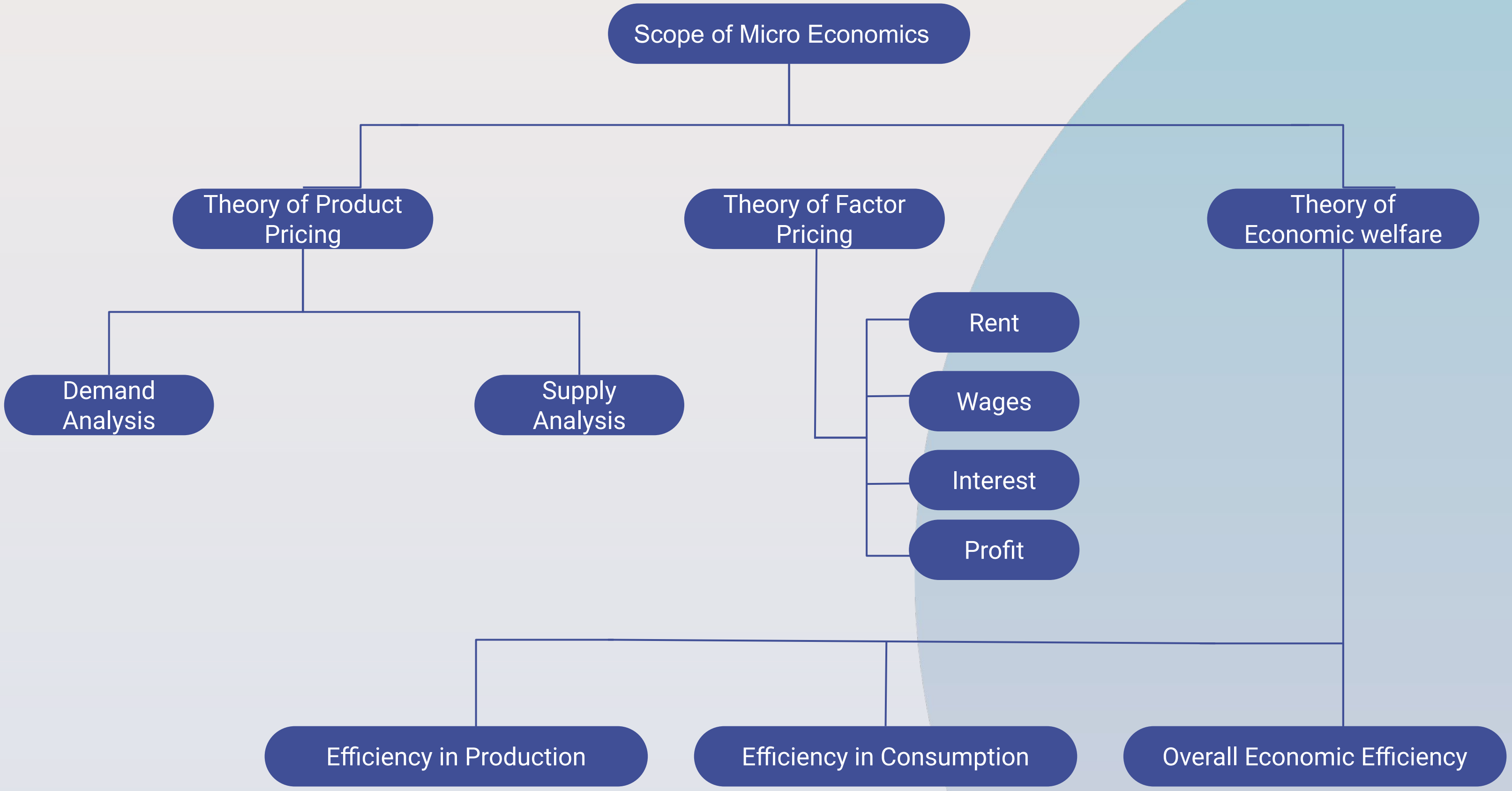
Micro means tiny or small. It therefore deals with the small part of the national economy. It considers the individual behaviour such as individual consumer, individual producer, single firm, price of single commodity etc. To make it simple, we can conclude that it is the examination of the tree and not the forest.

Definitions:

Maurice Dobb: “ Microeconomics is in fact a microscopic study of the economy.”

Prof. A.P. Lerner: “Microeconomics consists of looking at the economy through a microscope, as it were, to see how the millions of cells in the body of economy - the individuals or households as consumers and individuals or firms as producers play their part in the working of the whole economic organism.”

Scope of Microeconomics:



a) **Theory of Product Pricing**:

Market forces of supply and demand determine the price of a commodity. Microeconomics is concerned with demand analysis i.e. individual consumer behaviour and supply analysis i.e. individual producer behaviour.

b) **Theory of Factor Pricing**:
Land, labour, capital and entrepreneur are the factors of production which contribute to the production process. They receive the rewards in the form of rent, wages, interest and profits respectively. Microeconomics helps to decide these rewards.

c) **Theory of Economic Welfare**:

Basically, this theory deals with the efficiency in allocation of resources. The efficiency in allocation of resources attains when there is maximization of satisfaction of people. This efficiency includes the following:

- Efficiency in production: It refers to production of maximum possible amount of goods and services from the given amount of resources.
- Efficiency in consumption: It aims at distribution of produced goods and services among the people for consumption in such a way that there is maximum total satisfaction of the society.
- Overall economic efficiency: Overall efficiency means production of those goods which are most desired by the people.

Features of Micro Economics:

1. Study of Individual Units:

   Micro Economics studies the behaviour of individual units such as individual firm, individual price, individual household etc.

2. Price Theory:

   Micro Economics deals not only with the determination of prices of goods and services but also with the factors of production. Hence, it is known as Price Theory.

3. Partial Equilibrium:

Equilibrium means balance between two factors. Micro Econoimics is the study of behaviour of individual economic units such as individual firm, individual consumer, individual household etc. While doing so, it isolates the individual unit from other forces and studies its equilibrium independently.

4. Based on Certain Assumptions:

Micro Economic theories are based on assumption which begins with “other things being constant,” in other words, ‘Ceteris Paribus’. So, micro economics assumes perfect competition, laissez-faire policy (i.e. minimum government intervention), pure capitalism, full employment etc. which are unrealistic. These assumptions make the analysis simple.

5. Slicing Method:

   Micro Economics divides or splits the whole economy into small individual parts and then analyses the each unit or part separately in detail. For eg, study of individual income out of national income, study of individual demand out of aggregate demand etc.

6. Use of Marginalism Principle:

   The concept of ‘marginalism’ is the key tool in the microeconomic analysis. The term ‘marginal’ means a change brought about in the total by an additional unit. Not only producers but also consumers take economic decisions using this principle as marginal analysis helps to study a variable through the changes.

7. Analysis of Market Structure:

   Microeconomics analyses and studies the different market structures such as perfect competition, monopoly, oligopoly, monopolistic competition etc.

8. Limited Scope:

   The scope of microeconomics is limited to the extent of individual units only. It does not deal with the nationwide economic problems such as inflation, deflation, balance of payments, poverty, unemployment, population, economic growth etc.

Importance of Micro Economics:

1. Price Determination:

   Micro economics explains how the prices of different products and various factors of production are determined.

2. Free Market Economy:

   In the free market economy, the economic decisions regarding i) what to produce? ii) how much to produce? iii) how to produce etc. are taken at individual level. There is no intervention of government or any other agency in this decision making process. So, the micro economics helps in understanding the working of a free market economy.

3. Foreign Trade:

   Micro Economics is useful in understanding the various aspects of foreign trade such as effects of tariff, determination of exchange rate, gains from international trade etc.

4. Economic Model Building:

   Micro economics helps in understanding various complex economic situations with the help of simple economic models. It has played vital role in developing various terms, concepts, terminologies, tools of economic analysis etc. Economic models are built using various economic variables.

5. Business Decisions:

The theories of micro economics are very useful for businessman in taking critical business decisions. These decisions includes determination of cost of production, determination of prices of goods, maximization of output and profit etc.

6. Useful to Government:

Micro economics is very useful to the government in formulating economic policies such as taxation policy, public expenditure policy, price policy etc. These policies help the government in attaining the goal of efficient allocation of resources and promoting economic welfare of the society.

7. Basis of Welfare Economics:

Micro economics explains the conditions of the economic welfare. As resources are scarce, the government should allocate these resources in very efficient manner to achieve maximum social welfare. So, micro economics helps the government in this regard.

Meaning and Definitions of Macro Economics:

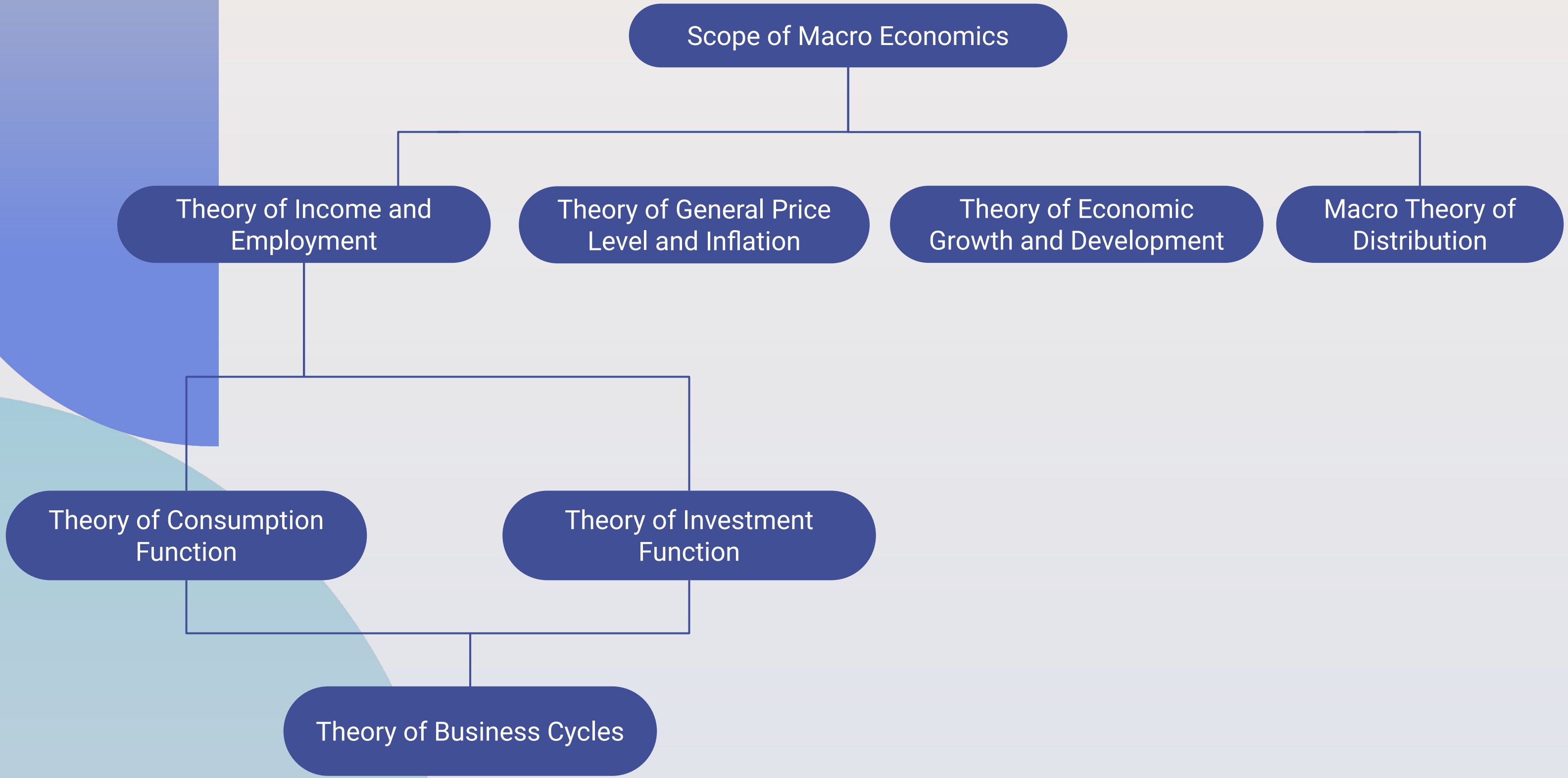
Macro Economics analyses the entire economy. It is the another branch of economics. It studies and analyses total employment, national income, national output, aggregate demand, aggregate supply, aggregate consumption, aggregate savings and total investment etc.

Definitions:

J.L. Hansen: “Macro Economics is that branch of economics which considers the relationship between large aggregates such as the volume of employment, total amount of savings, investment, national income etc.

Prof. Carl Shapiro: “Macro economics deals with the functioning of the economy as a whole.

Scope of Macro Economics:



a) **Theory of Income and Employment**:

Macro economics analyses and explains the factors determining the level of national income and employment and the causes of the fluctuations in the level of income, output and employment. In order to understand the factors determining the employment level in the country, one needs to study the Consumption Function and Investment Function. Theory of Business Cycles is also a part and parcel of Theory of Income and employment.

b) **Theory of General Price Level and Inflation**:

Macro Economics analyses and shows how the general price level is determined and further explains the causes of fluctuations in it. The study of general price level is very important because of the problems created by inflation and deflation.

c) **Theory of Growth and Development**:

Macro Economics includes theory of economic growth and development. It describes the causes of underdevelopment and poverty. It also proposes the strategies for accelerating the growth and development.

d) **Macro Theory of Distribution**:

This theory includes relative share of rent, wages, interest and profit in the total national income.

Features of Macro Economics:

1. Study of Aggregates:

   Macro economics studies the economy as a whole. It studies the aggregate concepts such as nationals income, national output, national employment, general price level, business cycles etc.

2. Income Theory:

   Macro economics studies the concept of national income, its different elements, methods of measurement and social accounting. Also, it explains the causes of fluctuations in national income which are responsible for business cycles such as inflation and deflation.

3. <u>General Equilibrium Analysis</u>:

   Macro economics studies the behaviour of large aggregates and their functional relationship. General Equilibrium analyses the behaviour of demand, supply and prices of the whole economy.

4. <u>Interdependence</u>:

   Macro analysis considers the interdependence between aggregate economic variables, such as income, output, employment, investments, price level etc. For instance, changes in the level of investment will finally result into the changes in the levels of income, levels of output, employment and ultimately the level of economic growth.

5. Lumping Method:

   Lumping Method refers to study of a whole economy rather than its part. Prof. Boulding says, “Forest is an aggregation of trees but it does not reveal the properties of an individual tree.” This statements explains the difference between micro economics and macro economics.

6. Growth Models:

   Macro economics is the study of different factors contributing to economic growth and development. It is helpful in developing growth models. These growth models are used to study the economic development. For eg, Mahalanobis growth model concentrates on the basic heavy industries.

7. General Price Level:

Macro economics determine the general price level and also observes the changes in the same. General price level refers to average of all prices of goods and services currently being produced in the economy.

8. Policy-oriented:

As per Keynes opinion, macro economics is a policy oriented science. It recommends appropriate economic policies to encourage economic growth, generate employment, control of inflation and depression etc.

Importance of Macro Economics:

1. Functioning of an Economy:

   Macro Economic Analysis gives the idea how does the economic system work. It enables us to understand the behaviour pattern of aggregative variables in a large and complex economic system.

2. Economic Fluctuations:

   Macro economics helps to examine the causes of rise and fall in income, output, and employment. It also make an effort to control the fluctuations or try to minimize their severity.

3. National Income:

Study of macro economics has promoted the great importance of the study of national income and social accounts. It is impossible to develop the correct economic policies without the study of national income.

4. Economic Development:

Advanced studies in macro economics enables to understand the obstacles of developing countries such as poverty, inequalities of income and wealth, deviations in the standards of living of the people etc. It recommends the crucial steps to attain the economic development.

5. Performance of an Economy:

Macro economics guides us to analyse the performance of an economy. National Income (NI) estimates are used to evaluate the performance of an economy with comparison of production og goods and services in one period with that of the other period.

6. Study of Macro economic Variables:

Macro economic variables are important to understand the functioning of the economy. Major economic issues are related to the economic variables such as behaviour of total income, output, employment and general price level in the economy.

7. Level of Employment:

Macro economics helps to examine the general price level of employment and output in an economy.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