**Subject – Macroeconomics**

**Notes Unit 1 Part A**

**By -**

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## Microeconomics -

Microeconomics focuses on the choices made by individual consumers as well as businesses concerning the fluctuating cost of goods and services in an economy. Microeconomics covers several aspects, such as –

- Supply and demand for goods in different marketplaces.
- Consumer behaviour, as an individual or as a group.
- Demand for service and labour, including individual labour markets, demand, and determinants like the wage of an employee.

One of the main features of microeconomics is it focuses on casual situations when a marketplace experiences certain changes in the existing conditions. It takes a bottom-up approach to analyse the economy.

‘The different components of microeconomics include:

- Market demand and supply (For example Textile)
- Consumer Behavior (for example Consumer Choice Theory)
- Producers are driven by individual preferences.

- Market-specific labor markets (For example demand labor wage determination in specific markets).

## Macroeconomics -

Macroeconomics studies the economic progress and steps taken by a nation. It also includes the study of policies and other influencing factors that affect the economy as a whole. Macroeconomics follows a top-down approach, and involves strategies like –

- The overall economic growth of a country.
- Reasons that are likely to influence unemployment and inflation.
- Fiscal policies are likely to influence factors like interest rates.
- Effect of globalization and international trade.
- Reasons that affect varying economic growths among countries.

The different components of macroeconomics include:

- National Output
- Unemployment
- Inflation

## How do Microeconomics and Macroeconomics Interdependent on Each Other?

The two parts of Economics i.e., microeconomic and macroeconomics are not interrelated but are mutually exclusive. A close connection exists between the two terms. All microeconomic studies can analyze the better understanding of micro and macroeconomics variables. Such a study will help in the formulation of economic policies and programs. As we know, changes and processes in the economy are a result of both small and large-scale elements which retain the capacity to affect each other or are directly affected by each other. For example: Although the tax increase is a macroeconomic decision, its impact on firms ' savings is a microeconomics analysis.

Let us understand another example: if we know how the price of any commodity is determined and what is the role of buyer and seller in the price determination then it would help us in analyzing the changes that take place in the general price level for all commodities in the economy as a whole. A study of determining the price of a commodity and the role of buyers and sellers in this process is known as microeconomics whereas the study of the general price level in economics is a macroeconomic process. Similarly, if we want to determine the performance of an economy, we will first have to find out the performance of each sector of the economy, and to find out the performance of each sector of the economy we have to find out the performance of each sector individually or in groups. A study of each sector of a production unit or each group is a microeconomics study whereas the study of all the production units of all the sectors is a macroeconomics study. Hence, microeconomics and macroeconomics are two interrelated parts of economics. Therefore, the study of both terms is important in economics.

**Difference between Microeconomics and Macroeconomics -**

| **S.No** | **Microeconomics** | **Macroeconomics** |
|---|---|---|
| **1.** | Microeconomics studies individual economic units | Macroeconomics studies a nation’s economy, as well as its various aggregates. |
| **2.** | Microeconomics primarily deals with individual income, output, price of goods, etc. | Macroeconomics is the study of aggregates such as national output, income, as well as general price levels. |

| | | |
|---|---|---|
| **3.** | Microeconomics focuses on overcoming issues concerning the allocation of resources and price discrimination. | Macroeconomics focuses on upholding issues like employment and national household income. |
| **4.** | Microeconomics accounts for factors like the demand and supply of a particular commodity. | Macroeconomics account for the aggregate demand and supply of a nation's economy. |
| **5.** | Microeconomics offers a picture of the goods and services that are required for an efficient economy. It also shows the goods and services that might grow in demand in the future. | Macroeconomics helps ensure optimum utilization of the resources available to a country. |
| **6.** | Microeconomics helps to point out how equilibrium can be achieved at a small scale. | Macroeconomics help determine the equilibrium levels of employment and income of the nation. |
| **7.** | Microeconomics also focuses on issues arising due to price variation and income levels. | The primary component of macroeconomic problems is income. |

**Examples of Microeconomics and Macroeconomics**

Examples of Microeconomics

- Price determination of a particular commodity.
- Consumer equilibrium.
- Output generated by an individual organization.

- Individual income and savings.

Examples of Macroeconomics

- National income and savings.
- General price level.
- Aggregate demand and Aggregate Supply
- Poverty.
- Rate of unemployment

## Effect of Micro and Macro Economics -

Any changes in these categories have a direct impact on a country's economy. Several factors affect it; let's take a look

**Decision Making -**

Uncontrollable external factors such as changes in interest rate, regulations, number of competitors present in the market, cultural preferences, etc. play a key role in influencing an organization's strategies and performance. These can have a cumulative effect on a nation's economy as well.

**Economic Cycles -**

Experts consider macroeconomics as a cyclic design. Higher demand levels, personal income, etc. can influence price levels, which in turn can affect a nation's economy. Contrarily, when supply outweighs demand, the cost of daily goods reduces. This pattern continues until the next cycle of supply and demand.

**Price of Products and Services -**

The primary goal of an organization is to keep costs at the minimum and increase the profit margin. The cost of labor is one of the highest expenses incurring factors in microeconomics, thereby directly affecting the overall cost of production and retail.

## Concept of National Income -

The National Income is the total amount of income accruing to a country from economic activities in a year's time. It includes payments made to all resources either in the form of wages, interest, rent, and profits.

The progress of a country can be determined by the growth of the national income of the country

## National Income Definition -

There are two National Income Definition

- Traditional Definition
- Modern Definition

### Traditional Definition -

**According to Marshall:** "The labor and capital of a country acting on its natural resources produce annually a certain net aggregate of commodities, material and immaterial including services of all kinds. This is the true net annual income or revenue of the country or national dividend."

The definition as laid down by Marshall is being criticized on the following grounds.

Due to the varied category of goods and services, a correct estimation is very difficult.

There is a chance of double counting, hence National Income cannot be estimated correctly.

**For example,** a product runs in the supply from the producer to distributor to wholesaler to retailer and then to the ultimate consumer. If on every movement commodity is taken into consideration then the value of National Income increases.

Also, one other reason is that there are products which are produced but not marketed.

**For example,** In an agriculture-oriented country like India, there are commodities which though produced but are kept for self-consumption or exchanged with other commodities. Thus, there can be an underestimation of National Income.

**Simon Kuznets** defines national income as "the net output of commodities and services flowing during the year from the country's productive system in the hands of the ultimate consumers."

**Following is the Modern National Income definition -**

- GDP
- GNP

**Gross Domestic Product -**

The total value of goods produced and services rendered within a country during a year is its Gross Domestic Product.

Further, GDP is calculated at market price and is defined as GDP at market prices. Different constituents of GDP are:

1. Wages and salaries
2. Rent
3. Interest

4. Undistributed profits
5. Mixed-income
6. Direct taxes
7. Dividend
8. Depreciation

**Gross National Product -**

For calculation of GNP, we need to collect and assess the data from all productive activities, such as agricultural produce, wood, minerals, commodities, the contributions to production by transport, communications, insurance companies, professions such (as lawyers, doctors, teachers, etc). at market prices.

It also includes net income arising in a country from abroad. Four main constituents of GNP are:

1. Consumer goods and services
2. Gross private domestic income
3. Goods produced or services rendered
4. Income arising from abroad.

## Importance of National Income -

**Setting Economic Policy -**

National Income indicates the status of the economy and can give a clear picture of the country's economic growth. National Income statistics can help economists in formulating economic policies for economic development.

**Inflation and Deflationary Gaps -**

For timely anti-inflationary and deflationary policies, we need aggregate data of national income. If expenditure increases from the total output, it shows inflammatory gaps and vice versa.

**Budget Preparation -**

The budget of the country is highly dependent on the net national income and its concepts. The Government formulates the yearly budget with the help of national income statistics in order to avoid any cynical policies.

**Standard of Living -**

National income data assists the government in comparing the standard of living amongst countries and people living in the same country at different times.

**Defense and Development -**

National income estimates help us to bifurcate the national product between defense and development purposes of the country. From such figures, we can easily know, how much can be set aside for the defense budget.

**Sets of methods for measuring National Income -**

There are four methods of measuring national income. The type of method to be used depends on the availability of data in a country and the purpose which is attempted for.

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