Macroeconomics

History of Macroeconomics

The use of "micro-" and "macro-" seems to date back to the work of Ragnar Frisch in 1933, but he referred to micro-dynamics and macro-dynamics.
Frisch used the words ‘micro-dynamic’ and ‘macro-dynamic’, albeit in a way closely related to the current usage of the terms ‘microeconomic’ and ‘macroeconomic’
The term 'macro' was first used in economics by Ragner Frisch in 1933.
But as a methodological approach to economic problems, it originated with the Mercantilists in the 16th and 17th centuries. They were concerned with the economic system as a whole. In the 18th century, the
Physiocrats adopted it in their *Table Economique* to show the 'circulation of wealth' (*i.e.*, the net product) among the three classes represented by farmers, landowners and the sterile class. Walras, Wicksell and Fisher were the modern contributors to the development of macroeconomic analysis before Keynes. Certain economists, like Cassel, Marshall, Pigou, Robertson, Hayek and Hawtrey, developed a theory of money and general prices in the decade following the First World War. But credit goes to Keynes who finally developed a general theory of income, output and employment in the wake of the Great Depression.
Macroeconomics, the analysis of economic aggregates, became a recognized field with Keynes’s *General Theory* (1936) and its mathematical and diagrammatic reformulations, and the macroeconometric modelling pioneered by Tinbergen and Frisch. Macroeconomics grew out of two long-standing traditions: business cycle analysis from Jevons and Juglar to Mitchell, and monetary theory, building on the work of Hume, Thornton, Ricardo, Wicksell, and Fisher, supplemented by the circular flow analysis of Quesnay and Marx.
Modern macroeconomics can be said to have begun with Keynes and the publication of his book *The General Theory of Employment, Interest and Money* in 1936. Keynes expanded on the concept of liquidity preferences and built a general theory of how the economy worked. Keynes's theory brought together both monetary and real economic factors for the first time, explained unemployment, and suggested policy achieving economic stability.

What is Macroeconomics?

Macroeconomics is a branch of economics that studies how an overall economy—the markets, businesses, consumers, and governments—behave. Macroeconomics examines economy-wide phenomena such as inflation, price levels, rate of economic growth, national income, gross domestic product (GDP), and changes in unemployment.

Macroeconomics is the study of aggregates or averages covering the entire economy, such as total employment, national income, national output, total investment, total consumption, total savings, aggregate supply, aggregate demand, and general price level, wage level and cost structure.

According to **Shapiro** – "Macroeconomics deals with the functioning of the economy as a whole.

Ackley Gardner's words - "Macroeconomics concerns with such variables as the aggregate volume of the output of on economy, with the extent to which its resources are employed, with the size of national income and with the general prize level."

In words of **M.H. Spence** – "Macroeconomics is concerned with the economy as a whole or large segments of it, in macroeconomics attention is focused on such problems as the level of unemployment, the rate of inflation, the nation's total output and other matters of economy wide significance."

Scope and Importance of Macroeconomics

As a method of economic analysis macroeconomics is of much theoretical and practical importance.

(1) To Understand the Working of the Economy

The study of macroeconomic variables is indispensable for understanding the working of the economy. Our main economic problems are related to the behaviour of total income, output, employment and the general price level in the economy. These variables are statistically measurable, thereby facilitating the possibilities of analyzing the effects on the functioning of the economy. As Tinbergen observes, macroeconomic concepts help in "making the elimination process understandable and transparent". For instance, one may not agree on the best method of measuring different prices, but the general price level is helpful in understanding the nature of the economy.

(2) In Economic Policies

Macroeconomics is extremely useful from the point of view of economic policy. Modern governments, especially of the underdeveloped economies, are confronted with innumerable national problems. They are the problems of overpopulation, inflation, balance of payments, general underproduction, etc. The main responsibility of these governments rests in the regulation and control of overpopulation, general prices, general volume of trade, general outputs, etc. Tinbergen says: "Working with macroeconomic concepts is a bare necessity *in order* to contribute to the solutions of the great problems of our times." No government can solve these problems in terms of individual behaviour.

(i) **In General Unemployment.** The Keynesian theory of employment is an exercise in macroeconomics. The general level of employment in an economy depends upon effective demand which in turn depends on aggregate demand and aggregate supply fuctions. Unemployment is thus caused by deficiency of effective demand. In order to eliminate it, effective demand should be raised by increasing total investment, total output, total income and total consumption.
Thus, macroeconomics has special significance in studying the causes, effects and remedies of general unemployment.

(ii) **In National Income.** The study of macroeconomics is very important for evaluating the overall performance of the economy in terms of national income. With the advent of the Great Depression of the1930s, it became necessary to analyse the causes of general overproduction and general unemployment. This led to the construction of the data on national income. National income data help in forecasting the level of economic activity and to understand the distribution of income among different groups of people in the economy.

(iii) **In Economic Growth.** The economics of growth is also a study in macroeconomics. It is on the basis of macroeconomics that the resources and capabilities of an economy are evaluated. Plans for the overall increase in national income, output, employment are framed and implemented so as to raise the level of economic development of the economy as a whole.

(iv) **In Monetary Problems.** It is in terms of macroeconomics that monetary problems can be analysed and understood properly. Frequent changes in the value of money, inflation or deflation, affect the economy adversely. They can be counteracted by adopting monetary, fiscal and direct control measures for the economy as a whole.

(v) **In Business Cycles.** Further macroeconomics as an approach to economic problems started after the Great Depression. Thus its importance lies in analysing the causes of economic fluctuations and in providing remedies.

(3) <u>For Understanding the Behaviour of Individual Units</u>

For understanding the behaviour of individual units, the study of macroeconomics is imperative. Demand for individual products depends upon aggregate demand in the economy. Unless the causes of deficiency in aggregate demand are analysed, it is not possible to understand fully the reasons for a fall in the demand of individual products. The reasons for increase in costs of a particular firm or industry cannot be analysed without knowing the average cost conditions of the whole economy. Thus, the study of individual units is not possible without macroeconomics.

Circular Flows in the Market Economy or Macroeconomic Activity

Households and firms make economic choices and markets coordinate these choices. Households choose the quantities of labor, land, capital, and entrepreneurial services to sell or rent to firms in exchange for wages, rent, interest, and profits.

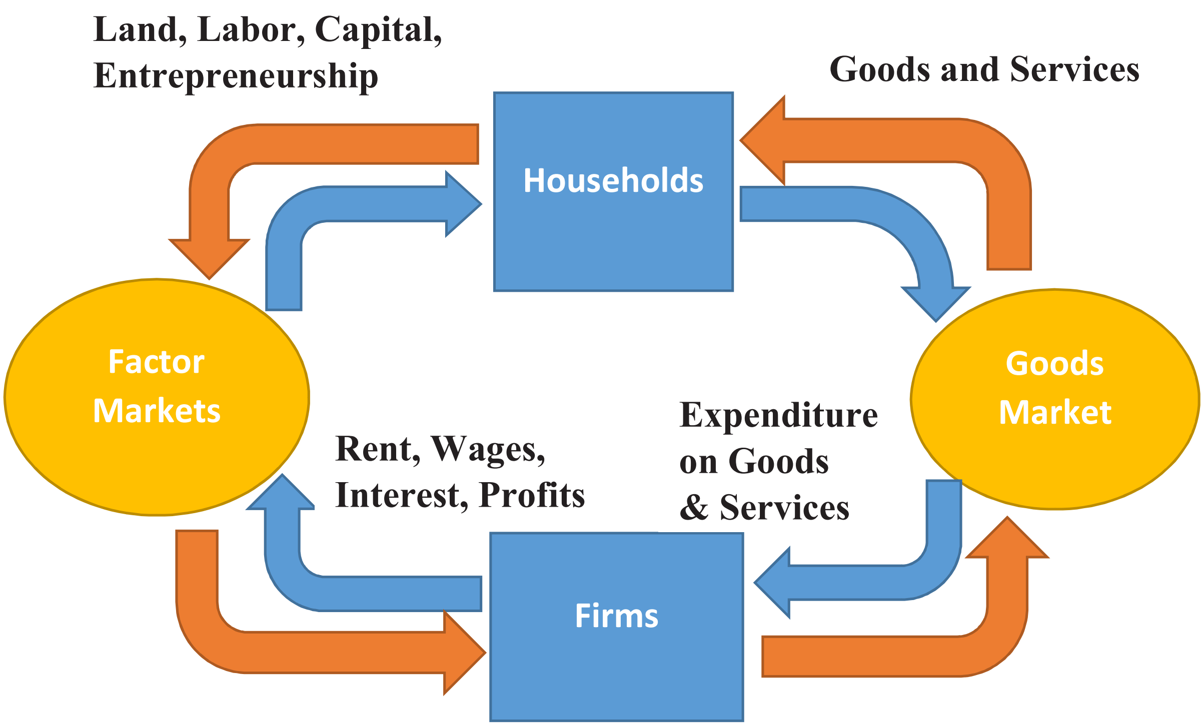

Figure: Circular Flows in the Market Economy Or Macroeconomic Activity

Households also choose how to spend their incomes on the various types of goods and services available. Firms choose the quantities of factors of production to hire and the quantities of goods and services to produce. Goods markets and factor markets coordinate these choices of households and firms.

The counterclockwise orange flows are real flows—the flow of factors of production from households to firms and the flow of goods and services from firms to households.

The clockwise blue flows are the payments for the red flows. They are the flow of incomes from firms to households and the flow of expenditure on goods and services from households to firms.

Difference or Comparison between Microeconomics and Macroeconomics

SL	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.
8.	Microeconomics does not try to answer or explain what forces should take place in a market. Rather, it tries to explain what happens when there are changes in certain conditions.	Macroeconomics analyzes how an increase or decrease in net exports impacts a nation’s capital account, or how gross domestic product (GDP) is impacted by the unemployment rate

9.	Microeconomics focuses on supply and demand and other forces that determine price levels in the economy. It takes a bottom-up approach to analyzing the economy. In other words, micro-economics tries to understand human choices, decisions, and the allocation of resources.	Macroeconomics focuses on aggregates and econometric correlations, which is why governments and their agencies rely on macroeconomics to formulate economic and fiscal policy. Investors who buy interest-rate-sensitive securities should keep a close eye on monetary and fiscal policy.
10.	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.