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Microeconomics Versus Macroeconomics – A Primer

Updated: Mar. 12, 2024 | By: Richard Lehman

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Microeconomics and macroeconomics are two distinct branches of economics.

Microeconomics focuses on individuals and groups, including companies, while macroeconomics looks at the behavior of national or international economies.

Microeconomics is concerned with price elasticities, economies of scale, and opportunity cost. Macroeconomics is concerned with fiscal and monetary policies, labor utilization, and international trade.



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Economics Has Two Distinct Branches: Microeconomics and Macroeconomics

Economics is broadly defined as a social science concerned with the production, distribution, and consumption of goods and services. This definition stems from the writings of people like Adam Smith in the revolutionary 1778 publication “*The Wealth of Nations*”, who described the economic behavior of people with respect to these activities in the newly industrialized societies of the late 1700s. At that time, there was a single field of economics that encompassed the behaviors of all participants: individuals, businesses, government entities and others.

But the Great Depression of the 1930s threw a monkey wrench into the early economic thinking, causing economists to realize that the economic behavior of individuals could not simply be extrapolated to large groups such as nations without considering a separate set of variables at the national level, such as government policies, international trade agreements, labor laws, and inflation. As a result, a distinction was made between microeconomics (at the individual level) and macroeconomics (at the national level).

For an analogy, physics has also evolved from in its Newtonian roots as a single science to separate branches today for astrophysics (on a planetary scale) and nuclear or particle physics (on an atomic scale).

What are the Differences Between Microeconomics and Macroeconomics?

Microeconomics concerns itself with the economic issues facing individuals or groups of people with commonality, such as the employees of a particular company. Microeconomics, for example, would study the effects of supply and demand on the production and consumption of a particular product.

Macroeconomics is concerned with large groups of people in a political or social unit, such as a sovereign nation, where overarching laws or policies, such as taxes, minimum wages, or interest rates affect the behavior of the economic entity as a whole.

What Is the Definition of Macroeconomics?

Macroeconomics studies broader trends that can affect a nationwide economy, such as inflation, gross production, price levels, and levels of unemployment, along with the various policies that governments engage in to help manage their economies.

Macroeconomic Policies

Economic policies that governments have at their disposal to manage economic growth include:

Fiscal policies & Monetary Policies — FISCAL: Government spending, MONETARY: Interest rates and money supply

Taxation policies — Taxes on individuals and corporations

Regulatory policies — Requirements or restrictions placed on businesses

International trade policies — Trade agreements and tariffs

What are the Key Drivers of Economies?

Key drivers of economic growth include:

Investment — In research, infrastructure, and human capital

Innovation — Technological or productivity advances

Education – To create a more productive workforce

Trade – With other countries for needed products, raw materials, and resources

Government Policies – To provide incentives for businesses to hire, invest, and innovate

What are the Key Measures of Economies?

Economies are measured by such factors as:

Rate of inflation (CPI)

Price levels

Rate of economic growth

National income

Gross domestic product (GDP)

Employment levels

Productivity

Levels of imports and exports

Laws of Supply and Demand

The law of supply describes a positive relationship between pricing and supply such that as the price of a good or service rises, suppliers will generally increase the amount they produce (presuming that the product is sufficiently profitable in the first place). The law of demand describes a negative relationship between price and demand such that as prices rise, demand is reduced (customers buy fewer of a product as its price rises).

Putting these two relationships together, you get a price at which they cross, which serves in theory as an “equilibrium price” that satisfies the supply and demand needs in an optimal way. In practice, however, optimally balancing supply and demand is much more complex and is often impacted by such factors as production capacity, economies of scale, the availability of substitute products, etc.

Understanding International Economies

International economics deals with issues arising from the interactions among nations, which can include:

International currency flows (forex)

Aid and assistance for developing countries

International migration

Trade agreements

Geopolitics

Investment incentives in different countries

Economic Recessions

A [recession](#) is a period of overall decline in trade and productivity for an economy as a whole. The accepted measure that constitutes a recession is a period where negative growth in Gross National Product occurs (GNP) for two successive quarters or more.

What Is The Definition of Microeconomics?

Microeconomics is concerned with the economic behavior of individuals, businesses, and single markets, rather than entire economies. It therefore focuses on the decisions of consumers, workers, and companies with regard to activities such as production, saving, investing, spending, employment, and consumption.

What are ‘Economies of Scale’?

Economies of scale describe situations where producing or distributing greater quantities of an item lead to lower production or shipping cost per item. For example, a factory producing 10,000 smartphones per day may likely have a lower production cost per unit than a factory producing only 1,000 smartphones per day.

What is ‘Elasticity’?

Elasticity in economics describes the sensitivity of one economic variable to changes in another. For example, elasticity of demand could measure the changed demand for an item following the change in the item’s price.

Per the law of the demand curve, if a certain product's price rises, people will usually buy/demand fewer units of the product. If the price falls, people will generally increase their demand for the product.

Note: Some luxury goods can have an unconventional elasticity, whereby lower product prices do not drive higher demand, but sometimes higher prices might.

What is ‘Opportunity Cost’?

Opportunity cost measures the foregone benefit from making a different choice. For example, if [deposit rates](#) are 5%, the opportunity cost of spending \$3,000 on a family vacation is the \$150/year interest that money otherwise could have earned.

Individuals, companies, governments and investors are **all** exposed to opportunity cost by the decisions they make. For an example at a company level, consider the cost of modernizing a key factory if doing so requires shutting down or reducing existing production.

What is ‘Pricing Power’?

Pricing power refers to the additional amount a company can charge for its product without reducing demand for it.

Companies/Products with a less steep demand curve have more pricing power than companies/products with a steeper demand curve.

Bottom Line

Microeconomic and macroeconomic factors are constantly at play in the world around us, and help shape our everyday lives and the decisions we make. Microeconomic factors impact companies as well as individual consumers' purchase/consumption decisions. Macroeconomic factors shape the landscape we all operate in as participants of an economy, including things like government spending and interest rate levels.

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