Macroeconomics is the study of the behavior of the entire economy: It analyzes long-run growth as well as the cyclical movements in total output, unemployment and inflation, and international trade and finance. This contrasts with microeconomics, which studies the behavior of individual markets, prices, and outputs.

Nature, Scope and Limitations of Macroeconomics

Economics is the study of how people choose to allocate their scarce resources to meet their unlimited wants and involves the application of certain principles like scarcity, choice, and rational self-interest, in a consistent manner. The study of economics is usually divided into two separate branches, namely Micro Economics and Macro Economics. In this course, you will study the concepts of Macro Economics. Macro economics is the branch of economics which deals with economic aggregates. It makes a study of the economic system in general. It is the study of the entire economy in terms of the total amount of goods and services produced, total income earned, the level of employment of productive resources, and the general behavior of prices. Macro Economics perceives the overall dimensions of economic affairs of a country. It looks at the total size, shape and functioning of the economy as a whole, rather than working of articulation or dimension of the individual parts. To use Marshall's metaphorical language, Macro Economicsviews the forest as a whole, independently of the individual tress composing it. Macro Economics is, in fact, a study of very large, economy- wide aggregate variables like national income, total savings, total consumption, total investment, money supply, general price level, unemployment, economic growth rate, economic development, etc. Macroeconomics can be used to analyze how best to influence policy goals such as economic growth, price stability, full employment and the attainment of a sustainable balance of payments

Scope of Macro Economics

Macro Economics is the study of the aggregate modes of the economy, with specific focus on problems associated with those modes - the problems of growth, business cycles, unemployment and inflation. The Macro Economic theory is designed to explain how supply and demand in the aggregate interact to concern with these problems: Economic growth takes place when both the total output and total income are increasing. GNP is the basic measure of economic activity. Gross National Product (GNP) is the value of all final goods and services produced in the economy in a given time period. Nominal GNP measures the value of output at the prices prevailing in the period, during which the output is produced, while Real GNP measures the output produced in any one period at the prices of some base year. Inflation rate is the percentage rate of increase of the level of prices during a given period. Unemployment rate is the fraction of the labour force that cannot find jobs. Business cycle is the upward or downward movement of economic activity that occurs around the growth trend. The top of a cycle is called the peak. A very high peak, representing a big jump in output, is called a 'boom'. When the economy starts to fall from that peak, there is a downturn in business activity. If that downturn persists for more than two consecutive quarters of the year, that downturn becomes a recession. A large recession is called a depression. In general, latter is much longer and more severe than a recession. The bottom of a recession or depression is called the trough. When the economy comes out of the trough, economists say it is an upturn. If an upturn lasts two consecutive quarters of the year, it is called an expansion. The output gap measures the gap between actual output and the output the economy could produce at full employment given the existing resources. Full employment output is also called Potential output.

Okun's rule of thumb determines the relation between the unemployment rate and income. It states that a 1 per cent change in the unemployment rate will cause income in the economy to change in the opposite direction by 2.5 per cent.

The Phillips curve suggests a trade off between inflation and unemployment. Less unemployment can always be obtained by incurring more inflation or inflation can be reduced by allowing more unemployment. However, the short and long run tradeoffs between inflation and unemployment are a major concern of policy making. The basic tools for analyzing output, price level, inflation and growth are the aggregate supply and demand curves. Aggregate demand is the relationship between spending on goods and services and the level of prices. The aggregate supply curve specifies the relationship between the amount of output firms produce and the price level. Shifts in either aggregate supply or aggregate demand will cause the level of output to change – thus affecting growth – and will also change the price level - thus affecting inflation.

Limitations

1. Fallacy of Composition In Macro economic analysis the "fallacy of composition" is involved, i.e. aggregate economic behaviour is the sum total of the economy of individual activities. But what is true of individuals is not necessarily true to the fiscal entirely. For instance, savings are a private virtue but a public vice. If total savings in the economy increases, they may initiate a depression unless they are invested. Again, if an individual depositor withdraws his money from the bank, there is no risk. But if all depositors simultaneously do this, there will be a run on the banks and the banking system will be affected adversely.

2. To Regard the Aggregates as Homogenous The main defect in macro analysis is that it regards the aggregates as homogenous without caring about their internal composition and structure. The average wage in a nation is the sum total of wages in all professions, i.e. wages of clerks, typists, teachers, nurses etc. But the volume of aggregate employment depends on the relative structure of wages rather than on the average wage. If, for instance, wages of nurses increase but of typist rises much aggregate employment would increase

. 3. Aggregate Variables may not be Important Necessarily The aggregate variables which form the economic system may not be of much significance. For instance, the national income of a country is the total of all individual income. A hike in national income does not mean that individual incomes have risen. The increase in national income might be the result of the increase in the incomes of a few rich people in the nation.Thus a rise in the national income of this type has little significance from the point of view of the community.

4. Indiscriminate Use of Macro Economics Misleading An indiscriminate and uncritical use of macro economics in analysing the complexities of the real world can frequently be misleading. For instance, if the policy measures needed to achieve and maintain full employment in the economy are applied to structural redundancy in individual firms and industries, they become irrelevant. Likewise, measures aimed at controlling general prices cannot be applied with much advantage for controlling prices of individual products.

5. Statistical and Conceptual Difficulties The measurement of macro economics concepts involves a number of statistical and conceptual complexities. These problems relate to the aggregation of micro economic variables. If individual units are almost similar, aggregation does not present much difficulty. But if micro economic variables relate to dissimilar individual units, their aggregation into one macroeconomic variable may be incorrect and hazardous.