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CHAPTER

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Macroeconomics

1.1 INTRODUCTION TO MACROECONOMICS

In order to understand the micro and macro approaches to economics, it is necessary to begin with the subject matter of economics.

The subject matter of economics can be studied under three significant aspects:

1. The behavioural aspect
2. The technical aspect
3. The institutional aspect

Behavioural Aspect

Economics is a study of the economic behaviour of individual units and the economy as a whole.

At the level of individual households, economics studies how individuals earn their income, their expenditures, savings, investments, the household budget and all related economic decisions.

Economics also deals in detail about the economic behaviour of firms and industries which would involve the decisions related to production, consumption, costing, pricing of products, market structures, equilibrium and so on. At the level of the economy, economics is concerned with the economic behaviour of the economy as a whole. It analyses major macro aggregates like national income, expenditure, aggregate demand, supply, savings, investments, employment, and related variables.

The point to be noted is that economics is a study of economic behaviour at both the individual level as well at the level of an economy.

Technical Aspect

The Technical aspect mainly deals with the three basic problems of economics:

1. What to produce?
2. How to produce?
3. For whom to produce?

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- (i) **What to Produce?** This problem in economics concerns itself mainly with what are the goods and services to be produced—not only at the level of individual firms and industries—but also, at the level of an economy. This issue is mainly related to deciding the production pattern and Product-Mix.
- (ii) **How to Produce?** The question of 'how to produce?' deals with the technique or technology of production, basically emphasising on the choice between labour and capital-intensive technology.

Further, the question of technology of production has to be tackled at the individual as well as the economy level.

- (iii) **For Whom to Produce?** The question of for whom to produce is related to the distribution of income and determination of wages, rent, interest, profits or the various factor shares and this problem has also to be tackled for the individual units as well as the economy as a whole.

Institutional Aspect

In addition to the above two aspects, economics also studies the various institutions involved in the economic process like the government, banks, financial institutions and other infrastructural and institutional aspects.

In addition, there are a number of aspects like international trade, economic welfare, economic growth, economic development etc. which are also a part of economics.

1.1.1 Definitions of Economics

'Economics' has its origin in the ancient Greek word "oikonomikos" or "oikonomia". which means *the task of managing a household*. The definition of economics has evolved over time.



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The entire focus of economics is on the problem of scarcity. In fact, the most accepted definition of economics was given by Lord Lionel Robbins “Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses.”¹ All economic activity concentrates on how to allocate the scarce resources of a country among alternative uses to optimise benefits to individuals as well as to the economy and society as a whole.

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1.2 MEANING AND NATURE OF MACROECONOMICS

As stated earlier, since the subject matter of economics is very vast, and since economic problems have to be tackled at different levels, it was for the sake of convenience and for the sake of providing a systematic analysis to solve the economic problems at different levels that the subject matter of economics was divided into two approaches.

1. Microeconomic approach
2. Macroeconomic approach

An economic system may be looked at *as a whole or in parts* as many decision-making units such as consumers, households, firms, etc. When we analyse the problems of an economy as a whole, it is a macroeconomic study. Macroeconomics is thus a study of *aggregates* in an economy while the analysis of the behaviour of any *particular decision-making unit*, like a firm, an industry, a consumer, is covered by the microeconomic study.

The microeconomic theory explains issues related to the allocation of resources and distribution of production, whereas, the macroeconomic theory explains issues concerning the level of total production, employment, income, the general level of prices and so on.

1.2.1 Background of Macroeconomics

The term macroeconomics was first used by Ragnar Frisch in 1933. Macroeconomic theory, as a formal theory, gained significance specially after the great depression of 1929–33. Prior to this period there was a strong belief in the working of the **Purely Capitalist Economy**. It was felt that the **Free Market Mechanism** would ensure the smooth functioning of the system. Therefore, what was more relevant during this time were the microeconomic issues like resource allocation, determination of equilibrium of firms and industries, individual welfare etc. For the first time in 1929–33, aggregate problems like mass unemployment, falling investment, falling output, falling prices, low national income began to emerge on a large scale.

There was an almost total collapse of the capitalist system the world over, and the belief in the smooth functioning of the capitalist system came into doubt. It was at this time that John Maynard Keynes presented his *General Theory of Employment, Interest*

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As stated earlier, since the subject problems have to be tackled at different levels and for the sake of providing a systematic approach, the subject is studied at two different levels that the subject matter is:

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