Chapter 1 – INTRODUCTION

MACRO ECONOMICS

1. Macro Economics: It deals with the aggregate economic variables of an economy. The word macro comes from a Greek word 'Makros' which means large. It is a branch of economics that studies the economic relationships or issues of an economy as a whole like total consumption, saving etc. It investigates the principles, problems and policies relating to achievement of full employment and expansion of productive capacity. It evolved only after the publication of Keynesian's book, 'The Theory of Employment, Interest, and Money'. Macroeconomics takes a top-down approach.

2. Capitalist Country: In a capitalist country production activity are mainly carried out by capitalist enterprises.

"Doing well is the result of doing good. That's what capitalism is all about." – Ralph Waldo Emerson

Capitalist economy is an economic system governed by capitalist i.e., where the means of production and distribution are privately or corporately owned. It is primarily run by price mechanism, without any interference of government. Government role is to maintain law and order only. This economy's main motive is to earn profit. This economic structure is also known as free market economy or laissez faire. Examples of capitalist economies are Hong Kong, Singapore, Canada, UAE, Ireland etc.

Important features of capitalist economy: -

- Role of the government.
- Profit Motive
- Central Problems
- Role of Private Sector
- Laissez Fare

3. Wage Rate: There is sale and purchase of labour services at a price which is called the v.a. go rate.

4. Wage Labour: The labour which is sold and purchased against wages is referred to as wage labour.

5. Great Depression: Great depression of 1929 and the subsequent year saw the output and employment levels in the countries of the world as well. The Great Depression was the worst economic downturn in the history of the industrialized world. It began after the stock market crash of October 1929, which sent Wall Street in panic and wiped out millions of investors. In 21st century, the Great Depression is commonly used as an example of how far an economy can decline. The main cause behind this crisis was the fall in aggregate demand due to under consumption and over investment. Aggregate supply was greater than aggregate demand which resulted into depressing activities. Due to under consumption and over investment the stock of finished goods started piling up, which resulted in low price level and consequently the low profit level. The money in the economy was converted into unsold stock of finished goods that lead to an acute fall in employment and hence income level fell drastically. The demand for goods in the economy was so low that the production was lowered leading to the unemployment. In USA, the rate of unemployment increased from 3% to 25%.

The Great depression has its own implications and importance in economics, as it leads to the failure of the classical approach of economics. Those who believed in the market forces of demand and supply, paved the way for emergence of the Keynesian approach. It was this incident that provided the economists with sufficient evidence to recognize macroeconomics as a separate branch of economics. The cause and effect relationship of the Great Depression can be summed up in this flow chart

Low demand → Overinvestment → Low level of employment → Low level of output →
Low income → Low Demand

6. Entrepreneurs: People who exercise control over major decisions and bear a large part of the risk associated with the firm / enterprise.

7. Revenue: The money that is easned is called revenue.

8. Investment Expenditure: Expensed which raise productive capacity are called inverstment expenditure.

Four Major Sectors of Economy from Macro Economic Point of View:-

The four aggregate macroeconomic sectors that form the foundation for macroeconomic analysis are the Household Sector, the Business Sector, the Government Sector and the foreign sector. These four key functions are responsible for four expenditures on Gross Domestic Product (GDP).

The four major sectors of an economy according to the macroeconomic point of view are:

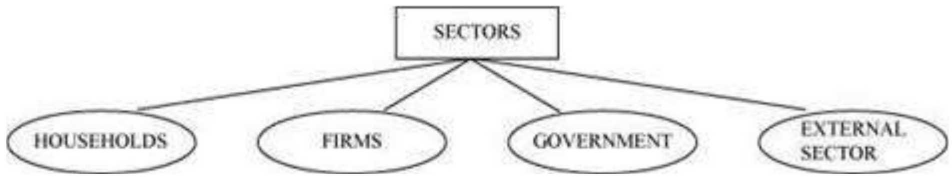
i. Households

ii. Firms / Business

iii. Government

iv. External sector / Foreign

These can be represented in the following flow chart:



i. Households: Household means a single individual or a group of individuals who independently take decisions regarding their economics activities (i.e., consumption and production). Household sector buy goods and services for consumption and also supply factors of production like land, labour, capital, and entrepreneur. Households provide the market for the output of the firms. In short, this sector includes everyone, consumers, people and every member of the society. This sector is responsible for the consumption expenditures role in GDP. ii. Firms: Firms are economic units that carry out the production. They employ and organize factors of production and undertake production process for the motive of profit making. This includes sole proprietorship, partnerships and corporations. This sector is responsible for investment expenditure role in GDP.

iii. Government: A state/government provides law and order, maintains growth and stability and provides administrative services. The main motive of a government is to undertake developmental projects such as dams, roads, heavy industries that usually have long gestation periods by imposing taxes. The government invests in education, health sector and provides these services at nominal price. The motive of a government is to serve and not to make profits. Transportation Dept., Environmental Protection agencies are its examples. This sector is responsible for government purchase role in GDP.

External sector: This sector is engaged in export and import (external trade) of goods and services. If domestically produced goods and services are sold to the rest of the world, then it is called export. If the goods and services are purchased from the rest of the world, then it is called import. Apart from export and import of goods, there can be inflow of goods (i.e., a country inviting capital from foreign countries) and outflow of foreign capital (i.e., investing in foreign countries). The expenditure on gross domestic product attributable to the foreign sector is net exports.

Main Objectives of any Macro Economic Policies:-