Micro and Macro Economics:

The terms micro and macro were first used by the Swedish economist Rognar Frisch in 1920.
It represented the level of aggregation of economic variables.
Micro means small and macro means large.

Micro Economics:

(a) Under this variables are not integrated but pertain to individual units.
(b) It studies the behavior of individual economic units.
(c) In this we use "bit by bit" approach which means breaking a big problem into small parts and then study one bit at a time.
(d) It deals with the problem of allocation of resources.
(e) It is also known as the price theory.
(f) Some of the components of micro economics are
theory of consumer behavior
theory of a firm
theory of an industry
theory of production
theory of product pricing
theory of pricing of factors of production
theory of welfare of individuals as compared with each other.

Macro Economics:

(a) Under this variable are aggregated and relate to large groups of economic units
(b) It studies economy as a whole
(c) Macroeconomics is also known as income theory or aggregative economics (d) Some components of macroeconomics are :
National Income
Labour force and population
Unemployment
Balance of payment
Structure of economic systems etc **Example:**

1. Micro - Determination of individual price Macro - Determination of general price level.
2. Micro - Determining income of an individual.
Macro - Determination of national income.

C **Why a distinction between Micro and Macro Economics should be made?**

(a) There are certain laws/rules/conclusions which are applicable at a micro level but not effective at a macro level.
(b) Certain problems of the economy like poverty unemployment etc can be solved only at a macro level.
(c) The conclusions of micro and macroeconomics are supplementary to each other and hence studying only one aspect will lead to an incomplete study of economics.
(d) A change in a variable at a macro level does not affect all individual economic units therefore these problems are overcome by dealing with aggregates.

C **Summary of Micro and Macro Economics:**

(a) Micro economics is used to study activities of individual economic units.

(b) The conclusions of micro economics can be used for formulating policy at a macro level.

(c) Macroeconomics helps to study the reasons for faulty performance of the economy and remedial measures taken for it.

Central Problems of an Economy-

Q. Which goods should be produced and in how much quantity?

Q. What techniques should be adopted for production?

Q. For whom goods should be produced?

(a) Which goods are to be produced?

Consumer goods, producer goods, capital goods, civil goods or defence goods.

(b) What technologies are to be used for production?

Labour intensive techniques or capital intensive

(c) For whom to produce?

For those who have an ability to pay.

Basic Problems or Central Problems:

(i) What to produce?

(ii) How to produce?

(iii) For whom to produce?

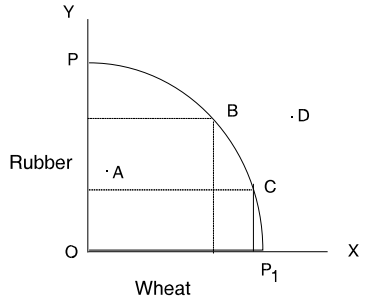
Production Possibility Curve-

PPC is used to explain the economic problems of the economy.

It was devised by Prof. Paul A. Samuelson

A production possibility curve shows the various combinations of two commodities that can be produced using the given resources.

A production possibility curve is the **locus** of all such combinations of two commodities which can be produced in a country with its given resources and technology.



In the above PPC curve-

The producer can prefer to produce any combination of Rubber and Wheat that lies on the PP_1

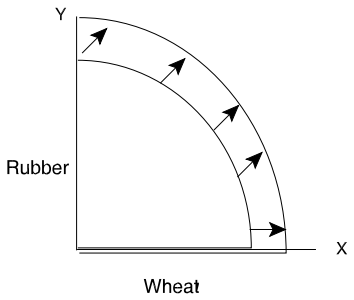
PPC curve is convex to the origin because of increasing opportunity cost.

Opportunity cost is the cost of the forgone opportunity. It is the next best alternative forgone. Since the resources are limited hence growing more of rubber will require foregoing some units of wheat and vice-versa.

The point A inside the PPC shows that the resources are under utilised and more production is possible by employing efficient technology.

The point D outside the PPC indicates that the economy does not have sufficient resources to reach that point. Hence it is unattainable with the given resources.

If the technology is improved, the production will increase and hence PPC will shift rightward.



Economic Systems:

- The system through which the economy operates is known as the economic system
- There are three types of economic systems- Capitalistic, Socialistic and mixed C **Types of Economic Systems:**

(a) Capitalistic system - it is a free economy where government interference is not found

Features of Capitalist Economy:

(a) Right to private property
(b) No government interference (Laissez faire)
(c) Profit Motive
(d) Price determination through price/market mechanism
(e) Competition
(f) Use of money and credit (capitalism necessitates an elaborate system of financing its economic activities which involves the use of money and credit. (g) Consumer sovereignty.

Working of Capitalist Economy:

(a) Capitalist economy is guided by market forces and hence price mechanism is used to solve Central Problems.
(b) As a consumer, he will buy only that commodity in which his consumer surplus is maximum. [Consumer surplus = What we are ready to pay - what we actually pay]
(c) A producer will produce only that good which maximizes his profit
(d) The goods should be produced for those who want to pay for what they demand.
(e) The problem of distribution of income is solved by comparing the satisfaction from current consumption and future consumption.

Merits

(a) Self regulated (No government interference)
(b) Profit motive leads to faster economic growth
(c) Optimum allocation of productive resource
(d) Capitalist system provides incentives in the form of profit for efficient decision making.
(e) It ensures a high degree of operative efficiency.

Demerits:

(a) Heads to inequalities of income and wealth
(b) Law of inheritance leads to difference in economic opportunities
(c) Wastage of productive resources on account of competition (like advertising) (d) Less production of merit goods.
(e) Production based on profit motive may lead to production of harmful goods.

(b) Socialist Economy:

The economy in which material means of production are owned by state i.e. the Government.

Features:

(a) Ownership of factors of production is in the hands of Government.
(b) Absence of market mechanism
(c) Existence of centralised economic planning.
(d) The use of money and credit is restricted to minimum
(e) Economic equalities and social welfare

Working of Socialist Economy: Due to the absence of market mechanism, the central economic problems are solved by the Central Planning Authority.

Merits:

(a) Distributive justice (Income inequalities)
(b) Social welfare and social security
(c) Lack of competition
(d) Elimination of exploitation of resources (e) Centrally Planned decision making.

Demerits:

(a) No incentives/motivation for hard work
(b) Low rate of economic growth, poor productivity of labour and low per capita income.
(c) Lack of competition
(d) Emergence of State Monopoly.

Mixed Economy: An economic system which contains elements of both private and public sector.

Features:

(a) Co existence of both private and public sector
(b) Existence of both market mechanism and planning authority.
(c) Balanced Regional Development (d) Income inequalities are minimized.

Working of Mixed Economy: In mixed economy both market mechanism and planning authority operates.

Mixed Economy in India:

(a) In India certain sectors are reserved for government whereas in others market mechanism is allowed to operate freely.
(b) In India both private and public sector operate
(c) In a mixed economy like India public sector undertakings find a prominent place because of :

C they help in accelerating capital formation and economic growth C they help in correcting imbalances in the economy.

Economic Cycles:

Economic cycles refer to the fluctuations in the economy of a country.

These are also known as business cycles.

They can occur in the form of–

(i) Rapid economic growth (boom or expansion)
(ii) Stagnation or decline (contraction/recession or depression)

Business cycles are measured by considering the growth rate of real gross domestic product.

Stages of Economic Cycles:

(i) Economic boom/ inflation
(ii) Economic slowdown
(iii) Economic recession

(iv) Economic recovery

Economic Boom:

It is a situation when national output rises at a faster rate than trend rate of growth (of about 2.5% per year)

! It leads to:

(i) Rising demand
(ii) Rising employment and output
(iii) Rising demand for imports
(iv) Rise in profits and revenue
(v) Danger of demand pull and cost push inflation

Economic Slowdown: -

It is a situation when national output rises but at a slower growth rate.

If slowdown continues without reaching recession, it is called as soft landing.

Economic Recession:

It is a situation when output starts falling and economic growth is negative

It leads to:

(i) Decline in output and employment
(ii) Fall in business profits
(iii) De stocking (selling articles at heavy discounts)
(iv) Falling demand for imports
(v) Fall in average living standards

Note:
When recession continues for a long period it becomes depression.
The last stage of economic recession is depression.

Economic Recovery:

After reaching the lowest point when the output starts increasing it is known as the stage of economic recovery.

The speed of recovery depends upon–

(i) how quickly aggregate demand rises
(ii) how quickly producers can raise output