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An Overview on Macroeconomics: Ideas, Approaches and Importance

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Abstract

This article includes various topics related macroeconomics. In the beginning the nature of macroeconomics are described. Then the article turns describing many terms of this macroeconomics. The utility of macroeconomics will be explained in this article. Besides; scope of macroeconomics are also described in this article. The practical appliance of this Part of economics are described here.

Keywords: Idea; Scope; Origin; Utility; Terms.

1. Introduction

Macroeconomics is the study of the structure and performance of national economies and of the policies that governments use to try to affect economic performance. What determines a nation’s long-run economic growth?

a) What causes a nation’s economic activity to fluctuate?
b) What causes unemployment?
c) What causes prices to rise?
d) How does being a part of a global economic system affect nations’ economies?
e) Can government policies be used to improve economic performance?
f) Through macroeconomics we an answer these questions.

2. Idea of This

Microeconomics examines the behavior of individual decision-making units—business firms and households. Macroeconomics (from the Greek prefix micro- meaning "large" + economics) is a branch of economics dealing with the performance; structure; behavior; and decision-making of an economy as a whole. This includes regional; national; and global economies. Macroeconomists study aggregated indicators such as GDP; unemployment rates; national income; price indices; and the interrelations among the different sectors of the economy to better understand how the whole economy functions. They also develop models that explain the relationship between such factors as national income; output; consumption; unemployment; inflation; saving; investment; international trade; and international finance.

While macroeconomics is a broad field of study; there are two areas of research that are emblematic of the discipline: the attempt to understand the causes and consequences of short-run fluctuations in national income (the business cycle); and the attempt to understand the determinants of long-run economic growth (increases in national income). Macroeconomic models and their forecasts are used by governments to assist in the development and evaluation of economic policy.

Macroeconomics deals with the economy as a whole; it examines the behavior of economic aggregates such as aggregate income; consumption; investment; and the overall level of prices. Aggregate behavior refers to the behavior of all households and firms together.

Macroeconomics and microeconomics; a pair of terms coined by Ragnar Frisch; are the two most general fields in economics. In contrast to macroeconomics; microeconomics is the branch of economics that studies the behavior of individuals and firms in making decisions and the interactions among these individuals and firms in narrowly-defined markets.

3. Importance

When we study the consumption behavior or equilibrium of a consumer; the production pattern & equilibrium of a firm; the entire analysis is 'micro' in nature……because

We study a UNIT and not the SYSTEM in which it is operating.

3.1 Study of Macroeconomics

a) The economic wellbeing of consumers rich or poor is affected by movement in interest rates; exchange rates; inflation etc.

b) Businesses stand to gain or lose considerable amounts of money when their economic environment changes; regardless of how well they are managed.

c) The economic wellbeing of consumers rich or poor is affected by movement in interest rates; exchange rates; inflation etc.

d) Businesses stand to gain or lose considerable amounts of money when their economic environment changes; regardless of how well they are managed.

e) Being prepared for such changes in fortunes can have considerable value; more generally; it makes us all better citizens able to grasp the complex challenges that our societies face.

f) Macroeconomics is relevant to voters who wonder what their governments are up to.

g) Study of Macroeconomics also help governments avoid the worst economic crises that have afflicted modern industrial societies in the past century—depressions and hyperinflations.

h) These extreme situations can tear at a society's social fabric; yet can be prevented when policy-makers apply sound economic principles.

4. Origin of this Idea

Before the publication of Keynes "General Theory…." the distinction between Micro & Macro economic issues did not arise at all.

The need for separate study of macroeconomics was felt by Keynes while understanding and analyzing the Great Depression of 1929.

5. The Roots of Macroeconomics

The Great Depression was a period of severe economic contraction and high unemployment that began in 1929 and continued throughout the 1930s.

The accepted economic theory of the pre – Keynesian era; believed that the economy usually remains at full employment level (full utilization of resources). If there are any departures from this situation; these are purely temporary and for a short period of time.

However; these classical models failed to explain the prolonged existence of high unemployment during the Great Depression. This provided the impetus for the development of macroeconomics.

In 1936; John Maynard Keynes published *The General Theory of Employment; Interest; and Money*. Keynes believed governments could intervene in the economy and affect the level of output and employment.

During periods of low private demand; the government can stimulate aggregate demand to lift the economy out of recession. Macroeconomics encompasses a variety of concepts and variables; but there are three central topics for macroeconomic research. Macroeconomic theories usually relate the phenomena of output; unemployment; and inflation. Outside of macroeconomic theory; these topics are also important to all economic agents including workers; consumers; and producers.

6. Long-Run Economic Growth

We can explain this term -

a) Rich nations have experienced extended periods of rapid economic growth.

b) Poor nations either have never experienced them or economic growth was offset by economic decline.

6.1. Total Output

Total output is increasing because of increasing population; i.e. the number of available workers. It refers increasing average labor productivity: the amount of output produced per unit of labor input.

Rates of growth of output (or output per worker) are determined by:

a) rates of saving and investment;
b) rates of technological change;
c) Rates of change in other factors.

7. Business Cycles

Business cycles are short-run contractions and expansions of economic activity.

The most volatile period in the history of Canadian output was between 1914 and 1945. The business cycle; also known as the economic cycle or trade cycle; is the downward and upward movement of gross domestic product (GDP) around its long-term growth trend. The length of a business cycle is the period of time containing a single boom and contraction in sequence. These fluctuations typically involve shifts over time between periods of relatively rapid economic growth (expansions or booms) and periods of relative stagnation or decline (contractions or recessions).

8. Recessions

Recession is the downward phase of a business cycle when national output is falling or growing slowly. In economics; a recession is a business cycle contraction when there is a general decline in economic activity. Macroeconomic indicators such as GDP (gross domestic product); investment spending; capacity utilization; household income; business profits; and inflation fall; while bankruptcies and the unemployment rate rise. In the United Kingdom; it is defined as a negative economic growth for two consecutive quarters.

a) Hard times for many people

b) A major political concern

9. Unemployment

Recessions are usually accompanied by high unemployment: the number of people who are available for work and are actively seeking it but cannot find jobs. Unemployment or joblessness is a situation in which able-bodied people who are looking for a job cannot find a job. The causes of unemployment are heavily debated.

$$\textit{Unemployment Rate} = \frac{\textit{Unemployed}}{\textit{Labour Force}} \times 100\%$$

9.1. The Unemployment Rate

a) The unemployment rate can stay high even when the economy is doing well.

b) After eight years of economic growth; in 2000; the unemployment rate in Canada was near 7%.

10. Inflation

a) When prices of most goods and services are rising over time it is inflation. When they are falling it is deflation.
b) The inflation rate is the percentage increase in the average level of prices.
c) Effects of Inflation
d) When the inflation rate reaches an extremely high level the economy tends to function poorly. The purchasing power of money erodes quickly; which forces people to spend their money as soon as they receive it.
e) Inflation is a sustained increase in the general price level of goods and services in an economy over a period of time. When the general price level rises; each unit of currency buys fewer goods and services; consequently; inflation reflects a reduction in the purchasing power per unit of money – a loss of real value in the medium of exchange and unit of account within the economy. The measure of inflation is the inflation rate; the annualized percentage change in a general price index; usually the consumer price index; over time. The opposite of inflation is deflation.

9.1 The International Economy

An economy which has extensive trading and financial relationships with other national economies is an open economy. An economy with no relationships is a closed economy.

International trade and borrowing relationships can transmit business cycles from country to country.

9.2 Exports and Imports

Exports are one component of international trade. The other component is imports. They are the goods and services bought by a country's residents that are produced in a foreign country. Combined; they make up a country's trade balance. When the country exports more than it imports; it has a trade surplus. When it imports more than it exports; it has a trade deficit. As example; Canadian exports are goods and services produced in Canada and consumed abroad. Canadian imports are goods and services produced abroad and consumed in Canada. An import is a good brought into a jurisdiction; especially across a national border; from an external source. The party bringing in the good is called an importer. An import in the receiving country is an export from the sending country. Importation and exportation are the defining financial transactions of international trade. In international trade; the importation and exportation of goods are limited by import quotas and mandates from the customs authority.

9.4 Trade Imbalances

Trade imbalances (trade surplus and deficit) affect output and employment.

a) Trade surplus: exports exceed imports.

b) Trade deficit: imports exceed exports.

c) The balance of trade; commercial balance; or net exports is the difference between the monetary value of a nation's exports and imports over a certain time period. Sometimes a distinction is made between a balance of trade for goods versus one for services. The balance of trade measures a flow of exports and imports over a given period of time. The notion of the balance of trade does not mean that exports and imports are "in balance" with each other.

10.5 The Exchange Rate

a) The trade balance is affected by the exchange rate: the amount of Canadian dollars that can be purchased with a unit of foreign currency. Exchange rates are determined in the foreign exchange market; which is open to a wide range of different types of buyers and sellers; and where currency trading is continuous.

11. Macroeconomic Policy

A nation's economic performance depends on:

a) natural and human resources;

b) capital stock;

c) technology

d) economic choices made by citizens;

e) Macroeconomic policies of the government.

f) Fiscal policy: government spending and taxation at different government levels.

g) Monetary policy: the central bank's control of short-term interest rates and the money supply.

11.1. Budget Deficits

a) The economy is affected when there are large budget deficits: the excess of government spending over tax collection.

b) The large budget deficits of the 1980s and early 1990s are unusual.

c) Borrowing from the public might divert funds from more productive uses.

d) Federal budget deficits might be linked to the decline in productivity growth. A budget deficit occurs when expenses exceed revenue and indicate the financial health of a country. The government generally uses the term budget deficit when referring to spending rather than businesses or individuals. Accrued deficits form national debt.

In cases where a budget deficit is identified; current expenses exceed the amount of income received through standard operations. A nation wishing to correct its budget deficit may need to cut back on certain expenditures; increase revenue-generating activities; or employ a combination of the two. The opposite of a budget deficit is a budget surplus. When a surplus occurs; revenue exceeds current expenses and results in excess funds that can be allocated as desired. In situations where the inflows equal the outflows; the budget is balanced. The opposite of a budget deficit is a budget surplus. When a surplus occurs; revenue exceeds current expenses and results in excess funds that can be allocated as desired. In situations where the inflows equal the outflows; the budget is balanced.

11.2. Aggregation

a) Macroeconomists ignore distinctions between individual product markets and focus on national totals.

b) The process of summing individual economic variables to obtain economy wide totals is called aggregation.

c) Aggregation in the futures markets is a principal involving the combination of all future positions owned or controlled by a single trader or group of traders. Aggregation in financial planning is a time-saving accounting method that consolidates an individual's financial data from various institutions. It is increasingly popular with advisers for servicing clients' accounts.

12. What Macroeconomists Do

Most important acts are-

a) Macroeconomic forecasting

b) Macroeconomic analysis

c) Macroeconomic research

d) Data development

Macroeconomic forecasting – prediction of future economic trends - has some success in the short run. In the long run too many factors are highly uncertain.

Macroeconomic analysis - analyzing and interpreting events as they happen – helps both private sector and public policymaking.

Macroeconomic research - trying to understand the structure of the economy in general – forms the basis for macroeconomic analysis and forecasting.

e) Economic theory: a set of ideas about the economy to be organized in a logical framework.

f) Economic model: a simplified description of some aspects of the economy.

Economists can disagree on normative issues because of differences in values.

Economists disagree on positive issues because of different schools of thought.

The invisible hand of Economics: General welfare will be maximized (not the distribution of wealth) if:there are free markets; individuals act in their own best interest

To maintain markets' equilibrium – the quantities demanded and supplied are equal:

- Markets must function without impediments.
- Wages and prices should be flexible.

Thus; according to the classical approach; the government should have a limited role in the economy.

13. The Keynesian Approach

a) Keynes (1936) assumed that wages and prices adjust slowly.

b) Thus; markets could be out of equilibrium for long periods of time and unemployment can persist.

c) Therefore; according to the Keynesian approach; governments can take actions to alleviate unemployment.

d) The government can purchase goods and services; thus increasing the demand for output and reducing unemployment.

e) Newly generated incomes would be spent and would raise employment even further.

f) After stagflation – high unemployment and high inflation – of the 1970s; a modernized classical approach reappeared.

g) Substantial communication and cross-pollination is taking place between the classical and the Keynesian approaches.

13.1. Unified Approach to Macroeconomics

a) Individuals; firms and the government interact in goods; asset and labor markets.

b) The macroeconomic analysis is based on the analysis of individual behavior.

c) Keynesian and classical economists agree that in the long run prices and wages adjust to equilibrium levels.

d) The basic model will be used either with classical or Keynesian assumptions about flexibility of wages and prices in the short run.

14. Importance of Macroeconomics

a) To understand the working of the economy

Macroeconomic variables like Total Income; Total Output; Employment and General Price level help us in analyzing the functioning of the economy.

In Economic Policies –

Macroeconomic study helps us to find a solution to complex economic problems of modern times.

i. General Unemployment;
ii. National Income data helps in forecasting the level of economic activity & to understand the distribution of income among different groups of people in the economy.

b) In Economic Growth –

To plan for economic growth; it is necessary that the macro economic variables like income; output and employment are evaluated.

In Monetary Problems –

Frequent changes in the value of money (?) affects the economy adversely!!

c) In Business Cycles –

Macroeconomics began to be studied only after the Great Depression. Thus; its importance lies in analyzing the causes of economic fluctuations and in providing remedies.

15. Conclusion

Thus we can discuss about all the spheres of macroeconomics. We can understand importance of this macroeconomics by this article. This article introduces the importance of this course. The main functions of macroeconomics are the collection; organizing; and analysis of data; determining national income; and formulating appropriate economic policies to maintain economic growth and full employment in a developing country.

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