

## MACROECONOMICS AND MICROECONOMICS: AN OVERVIEW

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### **ABSTRACT**

*Microeconomic theory deals with the study of individual units of an economy, such as, the demand of a single consumer and the behaviour of a single firm. Macroeconomics deals with the study of the economy as a whole. It studies variables like national income and employment. In microeconomics, the assumption is that there is the full employment of resources. While in macroeconomics there is no such assumption. Microeconomics deals with a pricing of different factors of production while macroeconomics deals with economic growth and development. Microeconomics makes use of partial equilibrium analysis while macroeconomics makes use of general equilibrium analysis. This paper endeavors to identify the differences and similarities between microeconomics and macroeconomics, outline the scope of microeconomics and macroeconomics, and examine the role of each in policymaking.*

**KEYWORDS:** *Micro, Macro, Partial Equilibrium, General Equilibrium*

### **INTRODUCTION**

The words micro and macroeconomics were first coined by Ragnar Frisch. The term micro is derived from the Greek word “mikros” meaning small and the term macro is derived from the Greek word “makros” meaning large. Microeconomics mainly makes use of partial equilibrium analysis, where we analyze the equilibrium of an individual economic unit while assuming other things remaining the same. It is also known as “ceteris paribus”. Macroeconomics mainly makes use of general equilibrium analysis which deals with the simultaneous equilibrium of all markets in the economy. “Microeconomic theory explains the composition or allocation of total production, why more of some things are produced than of others” –D.S. Watson. Macroeconomics is a study of aggregates. Therefore it is also called ‘aggregative economics’. Macroeconomics concerns itself with those aggregates which relate to the whole economy. It also deals with sub aggregates like the total production of consumer goods and capital goods. If we add sub aggregates of macroeconomics it leads to aggregate for the whole economy. For example, in a two-sector economy, if we add total production of capital goods and total production of consumer goods, we get the national product. The classical economic theory was mainly macroeconomics in nature whereas in neoclassical economics it was mainly microeconomics. Microeconomics is also called price theory because it deals with the pricing of different factors of production such as land, labour, capital and organization. Macroeconomics is also called income theory because it deals with the distribution of national income.

### **Objectives of the Study**

- To understand the differences and similarities between microeconomics and macroeconomics.
- To understand the scope of microeconomics and macroeconomics.

- To study the role of micro and macroeconomics in policymaking.

## RESEARCH METHODOLOGY

The study is based on secondary data collected from various books of national and international authors. The study is purely a descriptive one because it explains in detail the various prospects related to the two disciplines microeconomics and macroeconomics and their role in the economy.

### Microeconomics

According to K.E. Boulding, "Microeconomics is the study of particular households, individual prices, wages, incomes, individual industries, particular commodities." In other words, microeconomics deals with how households and firms make decisions and how these decision makers interact in the marketplace. The microeconomic theory studies resource allocation, product and factor pricing. This theory takes the total quantity of resources as given and also explains how they are allocated to the production of specific goods. The theory of product pricing and the theory of factor pricing fall within the domain of microeconomics. The product pricing theory explains how the relative prices of cotton cloth, food grains, jute, kerosene oil and thousands of other goods are determined. The theory of distribution explains how wages, rent, interest and profits are determined. Therefore, product pricing theory and factor pricing theory are the two important branches of microeconomics.

A microeconomics deals with economic efficiency. Besides analyzing the pricing of products and factors and the allocation of resources based upon the price mechanism, microeconomics also seeks to explain whether the allocation of resources determine is efficient. Efficiency in the allocation of resources is achieved when the resources are so allocated that the satisfaction of people is maximized.

### Economic Efficiency Involves Three Efficiencies. They Are

- Efficiency in production
- Efficiency in distribution
- Allocative economic efficiency

A microeconomic theory explains the conditions under which these efficiencies are achieved. Microeconomics also explains what factors can lead to the departure from these efficiencies and can lead to the decline of social welfare. Economic efficiency in production includes minimization of cost for producing a given level of output. Efficiency in distribution means that there should be justice in the distribution of goods and services among the people. Allocative economic efficiency implies that the pattern of production should correspond to the desired pattern of consumption of the people. Microeconomics also analyses the implications of alternative choices made for the welfare of the society. Microeconomics occupies an important place in economics and it has both theoretical and practical significance. It is highly helpful in the formulation of economic policies that will promote the welfare of the masses.

Microeconomics is that branch of economics which deals with the economic decision making of individual units such as the seller and the buyer. It takes into consideration the small components of the whole economy. It also deals with the process of price determination in the case of individual products and factors of production. It is concerned with the optimization goals of individual consumers and producers. It studies the flow of economic resources from one individual

owner to another. The microeconomic theory takes into account the aggregates over homogeneous products.

## **IMPORTANCE OF MICROECONOMICS**

### **To Understand the Working of the Economy**

Microeconomics is of great significance in understanding the working of a free enterprise. In such an economy, there is no agency that determines that plan and co-ordinates the working of the economic system. The basic decisions such as how to produce, what to produce, how to distribute and what to consume are taken by sellers and buyers without any external intervention. The government cannot ensure efficient working of the economy in the absence of the free enterprise economy.

### **Points out the Drawbacks of Monopoly**

The power of giant firms over the output and price of a product are the elements of problems coming under monopoly. Microeconomics shows how a monopoly can lead to misallocation of resource and can lead to a loss of economic efficiency.

### **Explains that Price Mechanism Fails Under the Presence of Externalities**

Externalities are said to exist when the production or consumption of a good affects other people than those who produce, sell or buy it. It can be in the form of external economies or diseconomies. Microeconomics reveals that when externalities are present, the free working of the price mechanism fails.

### **Helps Businessmen**

Microeconomics helps businessmen in the attainment of maximum productivity with existing resources so that they can make decisions regarding consumer demand and the cost of the product.

### **Helpful for Other Branches**

The analysis of microeconomics is frequently applied to the different applied branches of economics such as public finance and international economics. It also helps in understanding problems connected with taxation.

## **LIMITATIONS OF MICROECONOMICS**

### **Full Employment Assumption**

Microeconomics is based on the assumption of full employment of resources in the economy. This is unrealistic in the real world where there exists unemployment of resources.

### **Laissez-Faire Policy**

Microeconomics is based on the assumption of laissez-faire policy, which means "Let alone the individual". But this policy is no longer practiced. This policy ended with the Great Depression of the 1930s.

### **Incomplete Picture of the Economy**

Microeconomics is only concerned with individual units. It neglects the economy as a whole.

### **Misleading Use of Microeconomics**

Microeconomics can be misleading in analyzing various economic problems. For example, measures aimed at controlling prices of individual goods cannot be applied with much advantage for controlling general price level.

## **MACROECONOMICS**

Macroeconomics is that branch of economics which deals with aggregates and averages of the entire economy, such as, total output, national income and investments. It deals with the general price level in any economy. It is concerned with the optimization of the growth process of the entire economy. It studies the circular flow of income and expenditure between different sectors of the economy. It helps in making policies in order to control inflation. It takes into consideration the aggregates over heterogeneous products. Modern macroeconomics analyses those factors which determine the increase in productive capacity and national income in the long run. This problem is called the problem of economic growth.

### **The Major Issues and Concerns of Macroeconomics Are**

- Employment and unemployment
- Determination of national income
- General price level and inflation
- Business cycles
- Stagflation
- Economic growth
- Balance of payments and exchange rates

In modern macroeconomics, the intervention by the government to influence economic activity is well recognized. There are three main types of economic policies that are used by the government to influence the working of macroeconomy. They include fiscal policy, monetary policy and growth policies. There are three main developments in macroeconomics in the post-Keynesian period. It includes monetarism, supply-side economics and rational expectations theory. The main body of macroeconomic theory applies to a developed and capitalist economy. A capitalist economy is one where productive assets are owned either directly by individuals or firms. These employ others to work with the productive assets in order to produce output or income. Here, economic decisions are taken by individuals and firms that act independently of one another and are coordinated through the market mechanism.

The term 'Macro' was first used in economics by Ragner Frisch in 1933. But as a methodological approach, it originated with the mercantilists in the 16<sup>th</sup> and 17<sup>th</sup> centuries. They were concerned with the economic system as a whole. In the words of Prof. Ackley, "Macroeconomics deals with economic affairs in the large, it concerns the overall dimensions of economic life. It looks at the total size and shape and functioning of the "elephant" of economic experience, rather than working of articulation or dimensions of the individual parts. It studies the character of the forest, independently of the trees which compose it." Macroeconomics is also known as the theory of income and employment or simply income analysis.

## **IMPORTANCE OF MACROECONOMICS**

### **To Understand the Functioning of the Economic System**

The study of macroeconomics is very helpful for understanding the working of the economy. The main economic problems are related to the behavior of variables such as total income, output and employment. These variables can be statistically measured which facilitate analyzing the effects on the working of the economy.

### **In Economic Policies**

Macroeconomics helps in making economic policies to solve the bottlenecks that arise in the economy, especially inflation. The two main policies include fiscal and monetary policy.

### **In Economic Growth**

The resources and capabilities of an economy are evaluated on the basis of macroeconomics. Decisions and policies for the overall increase in national income, output, and employment are framed so as to raise overall economic development.

### **In Trade Cycles**

After the Great Depression, the economy witnessed high fluctuations in the trade cycle. Macroeconomics helps determine the reasons behind the fluctuations in the trade cycle. As such, the importance of macroeconomics as an approach to economic problem emerged at this time.

### **To Study and Understand Behavioural Pattern of Individual Units**

Macroeconomics helps in understanding the individual economic units. For example, demand for individual products depends upon aggregate demand in the economy.

## **LIMITATIONS OF MACROECONOMICS**

### **Fallacy of Composition**

Macroeconomics is based on the fact that aggregate economic behavior is the sum total of individual activities. But what is true of individuals is not necessarily true of the economy as a whole. For example, savings are a private virtue but a public vice.

### **To consider Aggregates as Homogenous**

The macroeconomic analysis considers the aggregates as homogenous. It does not care about their internal structure. This makes it difficult to get a proper idea of the variables.

### **Aggregate Variables may not be Important**

The aggregate variables which form the economic system may not be of much significance. For instance, the national income of a country is a total of all individual incomes. A rise in national income does not mean that individual incomes have risen.

### **Misleading Use of Macroeconomics**

Indiscriminate use of macroeconomics in analyzing the problem of the real world can be misleading. For instance, measures aimed at controlling general prices cannot be applied with much advantage for controlling prices of individual goods.

### **Statistical and Conceptual Difficulties**

The measurement of macroeconomic variables is not always simple. Use of mathematical and statistical methods makes the subject complicated.

### **CONCLUSIONS**

The discipline of economics is broadly divided into two main branches – microeconomics and macroeconomics. Both the terms micro and macro were coined by the economist Ragnar Frisch. Microeconomics deals with the economic actions and behaviors of individual units and small groups of individual units, whereas macroeconomics analyses the behavior of the economic system in totality or entirely. Microeconomics is also known as price theory and macroeconomics is also called income theory. The objectives of microeconomics and macroeconomics are different. The objective of microeconomics on the demand side is to maximize utility, whereas on the supply side is to maximize profits at the minimum cost. On the other hand, the main objectives of macroeconomics are full employment, price stability, economic growth and a favourable balance of payment. The basis of microeconomics is the price mechanism which functions with the help of demand and supply forces. These forces help to understand the equilibrium price prevailing in the market. On the other hand, the basis of macroeconomics are national income, employment, output and general price level which are determined by total demand and total supply. Both disciplines have their own uses but are not free from limitations.

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