Chapter 1: Introduction

Exercises — Exercises

Q1 What is the difference between microeconomics and macroeconomics?

Microeconomics studies individual economic agents, such as consumers maximising satisfaction and producers maximising profit, and the working of individual markets of demand and supply. It examines particular sectors while assuming the rest of the economy remains unchanged. Macro phenomena such as inflation and unemployment are taken as given, since no single buyer or seller can change them.

Macroeconomics studies the economy as a whole, dealing with aggregate variables such as total output, general price level and employment. It also considers the interlinkages between sectors. Its decision-makers are the State and statutory bodies like the RBI and SEBI, who pursue public goals rather than private profit, using policies on taxation, money supply, interest rates and wages.

Q2 What are the important features of a capitalist economy?

A capitalist economy is one in which most economic activities have these features:
(a) There is private ownership of the means of production.
(b) Production takes place for sale of the output in the market.
(c) There is sale and purchase of labour services at a price called the wage rate; labour bought and sold against wages is wage labour.
(d) Production is carried out mainly by capitalist enterprises, in which entrepreneurs bear the risk and uncertainty, and the motive is to earn profit.

Factors of production (land, labour, capital) earn their incomes as rent, wages and interest through production and sale of output in the market, and the remaining revenue is the entrepreneur's profit. Profits are often reinvested to expand productive capacity.

Q3 Describe the four major sectors in an economy according to the macroeconomic point of view.

Macroeconomics sees the economy as a combination of four sectors.
1. Households: a single individual or a group taking joint decisions on consumption. They also save and pay taxes. They earn wages, salaries, profits, rent and interest, and their demand sustains the market for firms' output.
2. Firms: production units where an entrepreneur hires labour, employs capital and land, produces output and sells it to earn profit, bearing risk and uncertainty.
3. Government: the State, which frames and enforces laws, delivers justice, imposes taxes, spends on infrastructure, schools and health services, and sometimes undertakes production.
4. External sector: trade with the rest of the world, i.e. exports (sales of goods abroad) and imports

(purchases from abroad), along with flows of capital into or out of the country.

Q4 Describe the Great Depression of 1929.

The Great Depression of 1929 and the years after it saw output and employment fall by huge amounts in the countries of Europe and North America, and it affected other countries too. Demand for goods in the market was low, many factories lay idle and workers lost their jobs. In the USA, between 1929 and 1933 the unemployment rate rose from 3 per cent to 25 per cent, and aggregate output fell by about 33 per cent.

These events forced economists to rethink how the economy functions and to explain long-lasting unemployment. Keynes's book The General Theory of Employment, Interest and Money (1936) was an attempt in this direction, and macroeconomics emerged as a separate subject.