

# ECONOMICS

## (Macro-Economics)

### Chapter 1: Introduction to Macroeconomics



## INTRODUCTION TO MACROECONOMICS

### Introduction and Structure of Macro Economics

Macroeconomics is the part of economic theory that studies the economy as a whole, such as national income, aggregate employment, general price level, aggregate consumption, aggregate investment, etc. Its main instruments are aggregate demand and aggregate supply. It is also called the 'Income Theory' or 'Employment Theory'.

### Structure of macro economy

As we know, Macroeconomics is concerned with economic problems at the level of an economy as a whole. Structure of Macroeconomics implies study of different sectors of the economy.

An economy may be divided into different sectors depending on the nature of study.

- ❖ Producer sector engaged in the production of goods and services.
- ❖ Household sector engaged in the consumption of goods and services.
 

**Note:** Households are taken as the owners of factors of production.
- ❖ The government sector engaged in activities like taxation and subsidies
- ❖ Rest of the world sector engaged in exports and imports.
- ❖ Financial sector (or financial system) engaged in the activity of borrowing and lending.

### Circular Flow of Income:

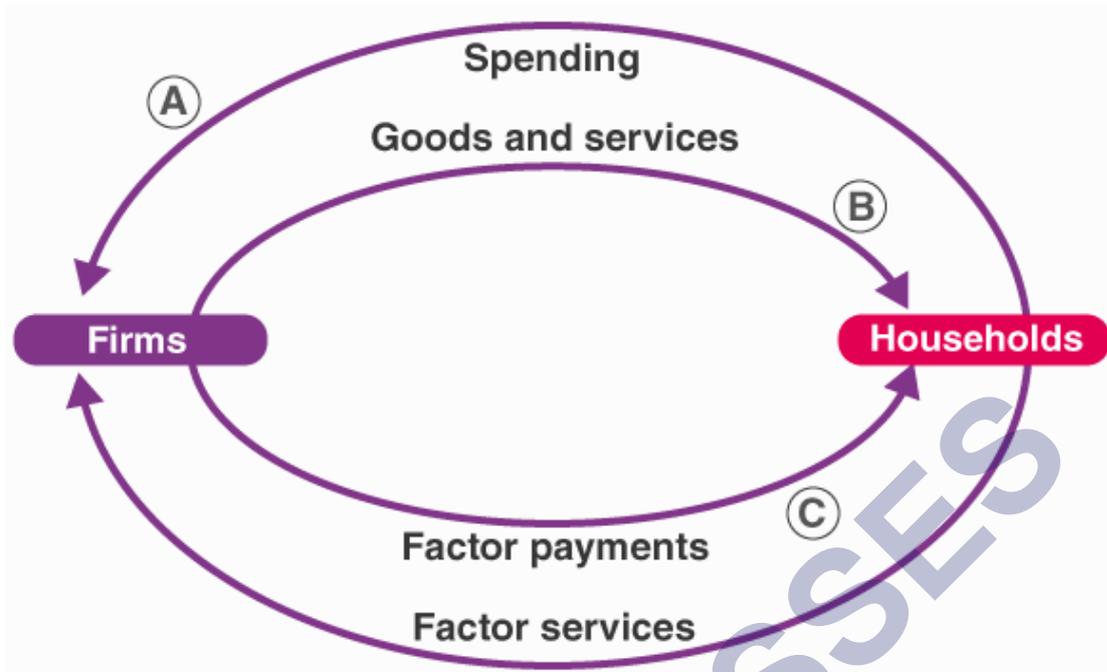
It refers to the occupation in which people work for others and get remuneration in the form of wages/ salaries. Those who are employed by others are called employees and the one who employs is called employer.

There are three phases of circular. flow

- Production.
- Income generation.
- Expenditure

### Real flow

- ❖ Real flow of income implies the flow of factor services from the household sector to the producing sector and corresponding flow of goods and services from the producing sector to the household sector.
- ❖ Let us consider a simple economy consisting only of 2 sectors
  - Producer Sector.
  - Household Sector.



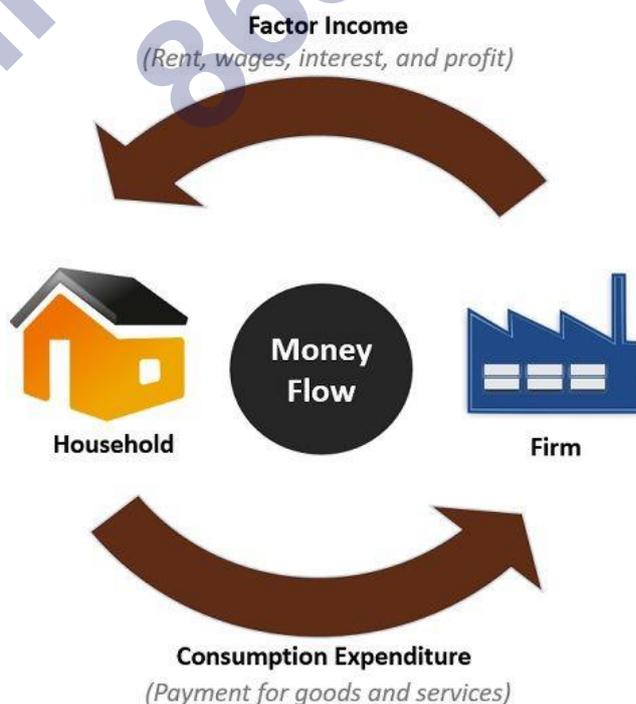
❖ These two sectors are dependent on each other in the following ways.

- Producers supply goods and services to the households.
- Household (as the owners of factors of production) supplies factors of production (or factor services) to the producers.

This interdependence can be explained with the help of the diagram given here.

### ✚ Money Flow

Money flow refers to the flow of factor income, as rent, interest, profit and wages from the producing sector to the household sector as monetary rewards for their factor services as shown in the flowchart.

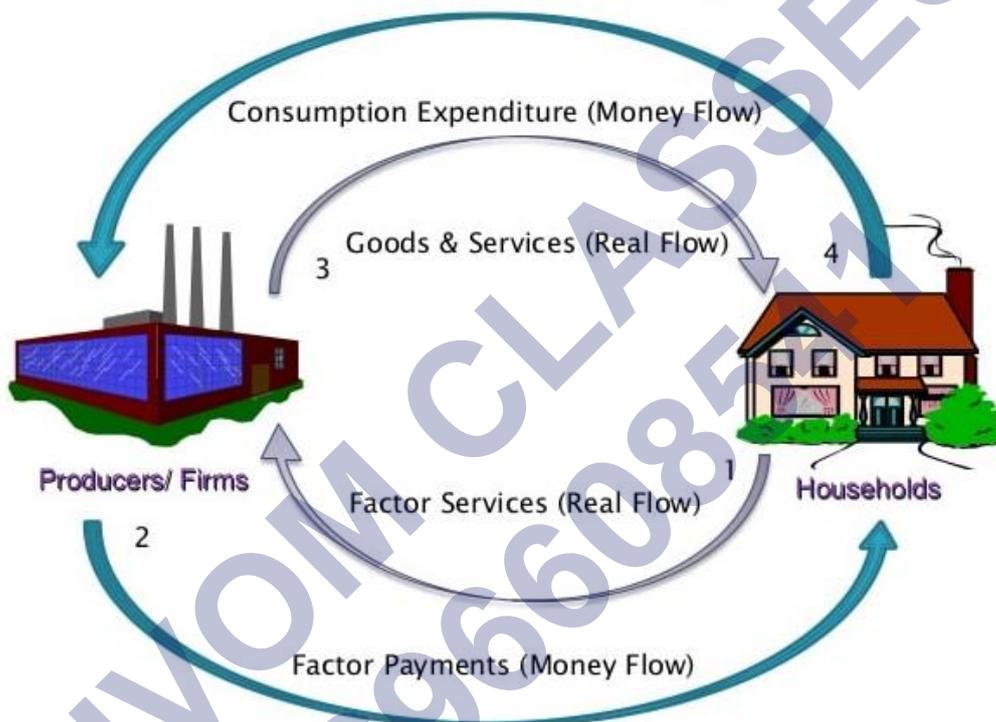


- ❖ The households spend their incomes on the goods and services produced by the producing sector. Accordingly, money flows back to the producing sector as household expenditure as shown in the flowchart.

## Circular Flow Of Income In Two Sector Model

The following assumptions with regard to a simple economy with only two sector of economics activity are:

- There are only two sectors in the economy; that is, household and firms.
- Household supply factor services to firms.
- Firms hire factor services from Households.



- Households spend their entire income on consumption.
- Firms sell all that is produced to the households.
- There is no government or foreign trade.

Such an economy described above has two types of markets.

- Market for goods and services, that is product market.
- Market for factors of production, factor market.

**As a result we can derive the following, in the case of our simple economy:**

- ❖ Total production of goods and services by firms = Total consumption of goods and services by Household Sector.
- ❖ Factor Payments by Firms = Factor Incomes of Household Sector.
- ❖ Consumption expenditure of Household sector = Income of Firm.
- ❖ Hence, Real flows of production and consumption of Firms and households = Money flows of income and expenditure of Firms and Households.

## Phases Of Circular Flow:

There are three types of phases of Circular flow.

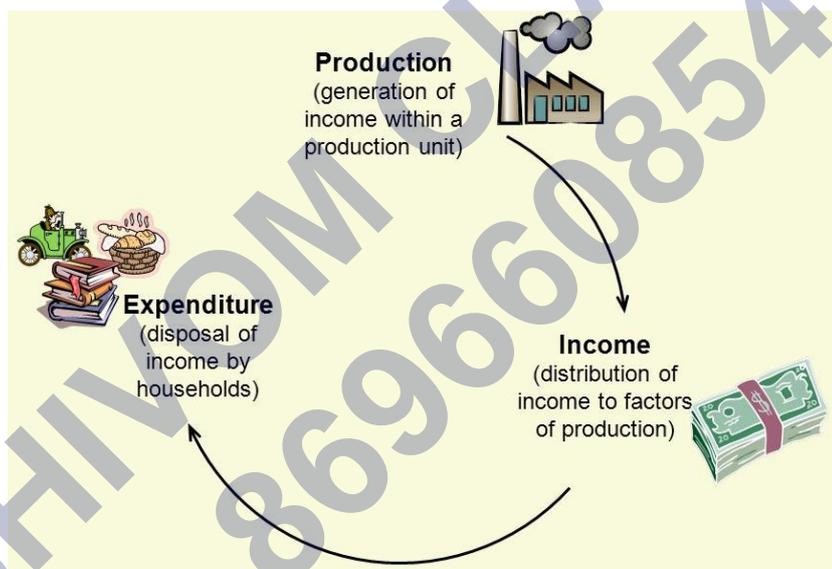
### + Production Phase:

- ❖ It deals with the production of goods and services by the producer sector.
- ❖ If we study it in term of the quantity of goods and services produced, it is a Real Flow. But, it is a Money flow, if we study it in terms of the market value of the goods produced.

+ **Distribution Phase:** It means the flow of income in the form of rent, interest, profit and wages, paid by producer sector to the household sector. It is a Money Flow.

### + Disposition Phase:

- ❖ Disposition means expenditure made. This phase deals with expenditure on the purchase of goods and services by households and other sectors.
- ❖ This is a Money Flow from other sectors to the producer sector. These phases are illustrated in the figure given here.



## Some Basic Concepts Of Macro Economics

### + Factor Income:

- ❖ Income earned by factor of production by rendering their productive services in the production process is known as Factor Income.
- ❖ It is a bilateral [Two-Sided] Concept.
- ❖ It is included in National Income as it contribute something in the flow of goods and services.

Examples: Rent, interest, wages and profit.

### + Transfer Income:

- ❖ Income received without rendering any productive services is known as transfer

income.

- ❖ It is a unilateral [one-sided] concept.
- ❖ It is not included in National Income as it does not contribute anything in the flow of goods and services.

Examples: Old Age Pension, Scholarship, Unemployment allowance.

**There are two types of transfers:**

- Current transfers
- Capital transfers
- Current Transfers

#### ✚ Current transfers:

- ❖ Transfers made from the income of the payer and added to the income of the recipient (who receive) for consumption expenditure are called current transfers.
- ❖ It is recurring or regular in nature.  
For example, scholarships, gifts, old age pension, etc.

#### ✚ Capital Transfers:

- ❖ Capital transfers are defined as transfers in cash and in kind for the purpose of investment to recipients, made out of the wealth or saving of the donor.
- ❖ It is non recurring or irregular in nature.  
For example, investment grant, capital gains tax, war damages, etc.

#### ✚ Stock:

- ❖ Any economic variable which is calculated at a particular point of time is known as stock.
- ❖ It is static in nature, i.e., it do not change.
- ❖ There is no time dimension in stock variables.

For example, Distance, Amount of Money, Money Supply, Water in Tank, etc.

#### ✚ Flow:

- ❖ Any economic variable which is calculated during a period of time is known as flow.
- ❖ It is dynamic in nature, i.e., it can be changed.
- ❖ There is time dimension in flow variables.

For example, Speed, Spending of Money, Water in River, Exports, Imports, etc.

### + Economic territory or Domestic Territory:

- ❖ According to the United Nations, economic territory is the geographical territory administered by a government within which persons, goods and capital circulate freely.
- ❖ The above definition is based on the criterion “freedom of circulation of persons, goods and capital”. Clearly, those parts of the political frontiers (or boundaries) of a country where the government of that country does not enjoy the above “freedom” are not to be included in economic territory of that country.
- ❖ One example is embassies. Government of India does not enjoy the above freedom in the foreign embassies located within India. So, these are not treated as a part of economic territory of India. They are treated as part of the economic territories of their respective countries. For example the U.S. embassy in India is a part of economic territory of the U.S.A. Similarly, the Indian embassy in Washington is a part of economic territory of India.
- ❖ International organizations like UNO, WHO, etc. located within the geographical boundaries of a country.
- ❖ In layman terms, the domestic territory of a nation is understood to be the territory lying within the political frontiers (or boundaries) of a country. But in national income accounting, the term domestic territory is used in a wider sense. Based on ‘freedom’ criterion, the scope of economic territory is defined to cover:
  - ❖ Ships and aircrafts owned and operated by normal residents between two or more countries. For example, Indian Ships moving between china and India regularly are part of domestic territory of India. Similarly, planes operated by Air India between Russia and Japan are part of the domestic territory of India. Similarly, planes operated by Malaysian Airlines between India and Japan are a part of the domestic territory of Malaysia.
  - ❖ Fishing vessels, oil and natural gas rigs and floating platforms operated by the residents of a country in the international waters where they have exclusive rights of operation. For example, Fishing boats operated by Indian fishermen in international waters of Indian Ocean will be considered a part of domestic territory of India.
  - ❖ Embassies, consulates and military establishments of a country located abroad. For example, Indian Embassy in Russia is a part of the domestic territory of India. ‘Consulate’ is an office or building used by consul (an officer commissioned by the government to reside in a foreign country to promote the interest of the county to which he belongs).

### + Citizenship/ Nationalship:

- ❖ Citizenship is basically a legal concept based on the place of birth of the person

or some legal provisions allowing a person to become a citizen.

❖ **It means, Indian citizenship can arise in two ways:**

- When a person is born in India, he acquires automatic citizenship of India.
- A person born outside India applies for citizenship and Indian Law allows him to become Indian Citizen.

✚ **Normal Resident/ Resident:**

- ❖ A Normal resident, whether a person or an institution, is one whose center of economic interest lies in the economic territory of the country in which he lives.
- ❖ **The center of economic interest implies in two things:**
  - The resident lives or is located within the economic territory for more than one year and
  - The resident carries out the basic economic activities of earnings, spending and accumulation from that location
- ❖ There is a difference between the terms normal resident (resident) and citizen (or national).
  - A person becomes a national of a country because he was born in the country or on the basis of some other legal criterion.
  - A person is treated resident of a country on the basis of economic criterion.
  - It is not necessary that a resident must also be the national of that country. Even foreigners can be the residents if they pass the above stated economic criterion.

For example, a large number of Indian nationals have settled in U.S.A., England, Australia, etc. as residents (and not as nationals) of these countries. For India, they are Non-resident Indians (NRI) but continue to remain Indian nationals.

❖ **Following are not included under the category of Normal residents:**

- Foreign visitors in the country for such purposes as recreation, holidays, medical treatment, study tours, conferences, sports events, business etc. (they are supposed to stay in the host country for less than one year. In case they continue to stay for one year or more in the host country, they will be treated as normal residents of the host country).
- Crew members of foreign vessels, commercial travelers and seasonal workers in , the country (Foreign workers who work part of the year in the country in response to the varying seasonal demand for lab our and return to their households and border workers who regularly cross the frontier each day or somewhat less regularly, (i.e. each week) to work in the

neighbouring country are the normal residents of their own countries.

Example: Nepal.

- Officials, diplomats and members of the armed forces of a foreign country.
- International bodies like World Bank, World Health Organization or International Monetary Fund are not considered residents of the country in which these organizations operate but are treated as residents of international territory. However, the staffs of these bodies are treated as normal residents of the country in which the international body operates. For example, international body like World Health Organization located in India is not normal resident of India but Americans working in its office for more than a year will be treated as normal residents of India.
- Foreigners who are the employees of non-resident enterprises and who have come to the country for purposes of installing machinery or equipment purchased from their employers. (They are supposed to stay for less than one year. In case they continue to stay for one year or more, they will be treated as normal residents of the host country).

#### ✚ Final Goods:

- ❖ **These are the goods that are used for:** Personal Consumption (like bread purchased by consumer household), or (if) Investment Or Capital Formation (like building, machinery purchased by a firm)
- ❖ In other words, final goods are those, which require no further processing and are available in an economy for consumption purpose or investment. These give direct satisfaction to a consumer.
- ❖ According to production boundary, if a good crosses the imaginary line around the production unit and reaches to final consumer or investment made by a producer within the imaginary line of production unit is known as the final good.

#### ✚ Intermediate Goods:

- ❖ **These are the goods that are used for:**
  - Further processing (like sugar used for making sweets); or
  - Resale in the same year (If car purchased by car dealer for resale).
- ❖ In other words, intermediate goods are the ones, which require further processing and are not available in an economy for the purpose of consumption. These goods give indirect satisfaction to a consumer.
- ❖ According to the production boundary, if a good does not cross the imaginary line around the production unit and reaches to other firm within the production boundary, is known as intermediate good.

#### ✚ Point to Remember for Final Goods and Intermediate Goods:

❖ **Basis of Classification: If a good is used for:**

- Personal consumption
- Investment

❖ **Then it is a final good, whereas, if a good is used for:**

- Further processing
- Resale in the same year, then it is known as intermediate good.

Thus, the basis of classification between these two goods is not the commodity itself, but the use made of it.

For example, bread used by a consumer household is a final goods, but the same used by a bakery for making a sandwich is a intermediate goods.

❖ **Production Boundary:**

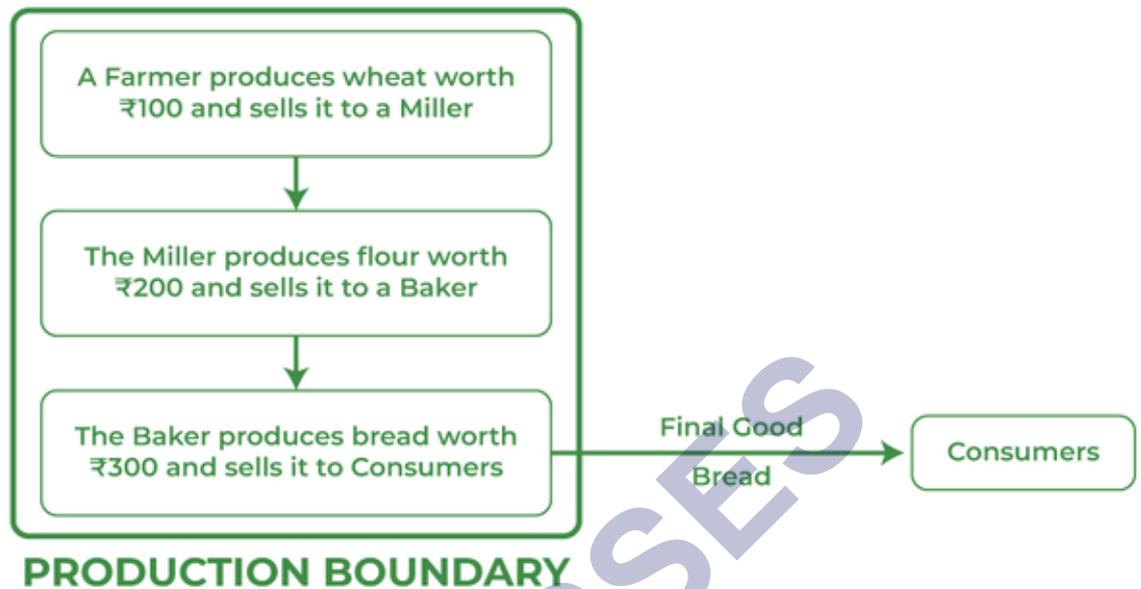
- Production boundary plays a vital role to differentiate between intermediate and final goods. The production boundary is the imaginary line around the production unit.
- According to the production boundary, if a good crosses the imaginary line around the production unit and reaches to final consumer or investment made by a producer within the imaginary line of production unit, it is known as final good.

As against it, if a good does not cross the imaginary line around the production unit and reaches to other firm within the production boundary, it is known as intermediate good.

In the given diagram, there are 3 production units. The thick border drawn around these three units is the Production Boundary.

Within this limit, wheat and flour are intermediate goods.

Bread is final good as it lies outside the purview of production boundary.



#### ✚ Important Points about:

**Intermediate Goods:** As far as intermediate consumption of general government is concerned, it's purchased goods ranges from ordinary writing paper, pencils and pens to sophisticated fighter aircrafts. The goods and services purchased include both durable goods and non-durable goods and services.

**The intermediate consumption of the general government includes the following items:**

- ❖ Value of all Non-durable Goods and Services such as petrol, electricity, lubricants, stationery, soaps, towels etc. including repair and maintenance of capital stock: Non-durable goods and services are those which have an expected life time of use of less than one year. Repair and maintenance of capital stock mean expenditure incurred for maintaining fixed assets and keep them in good working order. This includes the expenditure on new parts of the fixed assets. The life of the new parts may be around one year or slightly more and the value should be relatively small. For example, replacement of the tyres of a truck is an intermediate consumption, but not the replacement of its engine.
- ❖ Expenditure on Military Equipment missiles, rockets, bombs, warships, submarines, military aircrafts, tanks, missile carriers and rocket-launchers etc. whose function is to release weapons. Military vehicles and light weapons.
- ❖ Value of goods received from foreign governments in form of gifts or as transfers. Examples of these transfers in kind are food, clothing, medicines, vegetable oils, butter, toys sent by the government of one country to the other in times of natural calamities or as a token of goodwill and friendship between two countries. However, the goods received for distribution to consumer households without renovation or alternation should not be included in intermediate consumption as these goods go into the final consumption of consumer households.

- ❖ As we know, intermediate goods are purchased by one production unit from another production unit within the production boundary.
- ❖ However, it's not necessary that all purchases by one production unit from other production units are intermediate purchases. For example, purchases of building, machinery, etc. are not intermediate purchases (if they are not meant for resale in the same year). Rather, these purchases are meant for investment and are termed as final product.
- ❖ **Research and development:**
  - Commodities consumed. In research and exploratory activities (like oil exploration in different parts of India by the Oil and Natural Gas Commission) or improving the technology of a particular production process.
  - Commodities used in basic scientific research.
  - Advertisements, market research and public relationship meant for improving the goodwill of the business enterprises.
  - Business expenses of the employees on tours and entertainment.

#### ✚ Final goods can be classified into two groups:

Consumption Goods and Capital Goods.

#### ❖ **Consumption Goods:**

Meaning: Consumption goods are those which satisfy the wants of the consumers directly. For example, cars, television sets, bread, furniture, air-conditioners, etc.

#### ❖ **Categories of Consumption Goods:**

- **Durable goods:** These goods have an expected life time of several years and of relatively high value. They are motor cars, refrigerators, television sets, washing machines, air-conditioners, kitchen equipments, computers, communication equipments etc.
- **Semi-durable goods:** These goods have an expected life time of use of one year or slightly more. They are not of relatively great value. Examples are clothing, furniture, electrical appliances like fans, electric irons, hot plates and crockery.
- **Non-durable goods:** Goods which cannot be used again and again, i.e., they lose their identity in a single act of consumption are known as non-durable goods. These are food grains, milk and milk products, edible oils, beverages, vegetables, tobacco and other food articles.
- **Services:** Services are non-material goods which satisfy the human wants directly. They cannot be seen or touched, i.e., they are intangible in

nature. These are medical care, transport and communications, education, domestic services rendered by hired servants, etc.

#### ❖ Capital Goods:

- Capital goods are defined as all goods produced for use in future productive processes. For example, all the durable goods like cars, trucks, refrigerators, buildings, aircrafts, air-fields and submarines used to produce goods and are ready for sale in the market are a part of capital goods.
- Stocks of raw materials, semi-finished and finished goods lying with the producers at the end of an accounting year are also a part of capital goods.
- Some more examples of capital goods are machinery, equipment, roads and bridges.
- These goods require repair or replacement over time as their value depreciate over a period of time.

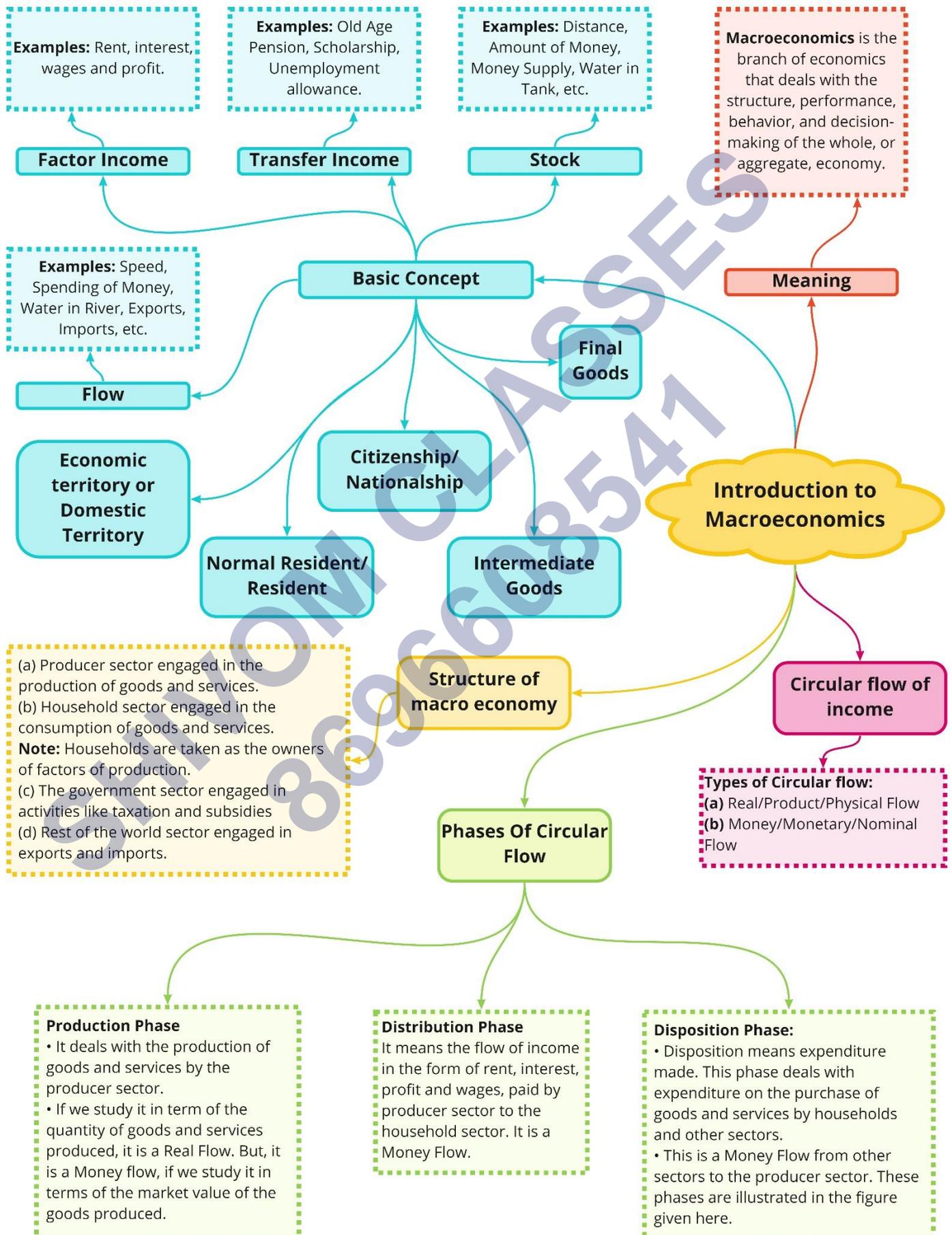
#### Words that Matter:

- ✚ **Circular flow of income:** It refers to flow of money income or the flow of goods and services across different sectors of the economy in a circular form.
- ✚ **Money flow (nominal flow):** Money flow refers to the flow of factor income, as rent, interest, profit and wages from the producing sector to the household sector as monetary rewards for their factor services.
- ✚ **Real flow or physical flow:** Real flow of income implies the flow of factor services from the household sector to the producing sector and corresponding flow of goods and services from the producing sector to the household sector.
- ✚ **Factor income:** Income earned by factor of production by rendering their productive services in the production process is known as Factor Income.
- ✚ **Transfer income:** Income received without rendering any productive services is known as Transfer Income.
- ✚ **Current transfers:** Transfers made from the current income of the payer and added to the current income of the recipient (who receive) for consumption expenditure are called current transfers.
- ✚ **Capital transfers:** Capital transfers are defined as transfers in cash and in kind for the purpose of investment to recipient made out of the wealth or saving of a donor.
- ✚ **Final goods:** These are those which are used for:
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  - ❖ Further processing (like sugar used for making sweets)
  - ❖ Resale in the same year (If car purchased by a car dealer for resale).
- + **Consumption goods:** Consumption goods are those goods which satisfy the wants of consumers directly.
- + **Capital goods:** Capital goods are defined as all goods produced for use in future productive processes.

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Class : 12th Economics (Macroeconomics)  
Chapter-1: Introduction to Macroeconomics



## Important Questions

### Multiple Choice questions-

Q1. At the time of independence, most of the land was owned by .....

- (a) farmers
- (b) zamindars
- (c) labour
- (d) all of these

Q2. What was the life expectancy in India during the British rule?

- (a) 65
- (b) 38
- (c) 32
- (d) 44

Q3. During colonial period India's demographic profile showed .....

- (a) high birth rate
- (b) low death rate
- (c) low infant mortality rate
- (d) high literacy rate

Q4. Indian economy on the eve of Independence was .....

- (a) underdeveloped
- (b) developing
- (c) stagnant
- (d) semi-feudal

Q5. Suez Canal was opened for transport in .....

- (a) 1850
- (b) 1853
- (c) 1869
- (d) 1901

Q6. Who made significant estimates about calculating national income in India during the British period?

- (a) V.K.R.V. Rao
- (b) Dadabhai Naoroji
- (c) Findlay Shirras

(d) William Digby

Q7. In which of the following sectors is manufacturing activity included?

(a) Primary

(b) Tertiary

(c) Secondary

(d) All of these

Q8. Where was the first iron and steel company established?

(a) Kolkata

(b) Jamshedpur

(c) Patna

(d) Ranchi

Q9. What is the tax or duty on imports called?

(a) Tariff

(b) Quota

(c) Export

(d) None of these

Q10. Which of the following was the major occupation on the eve of independence?

(a) Industry

(b) Services

(c) Agriculture

(d) None of these

Q11. The Tata Iron and Steel Company was incorporated in the year:

(a) 1907

(b) 1947

(c) 1908

(d) 1950

Q12. The road which was built by British in India was to

(a) Mobilizing the army within India

(b) Drawing out of raw materials from the countryside

(c) To overcome the problem of frequent famines in India

(d) Only A and B

Q13. The exports surplus during the British rule was used:

(a) To make payments for expenses incurred by an office set up by the colonial

government in Britain

- (b) To meet expenses on war fought by the British government
- (c) To import invisible items
- (d) All of these

Q14. During the British rule, high mortality rate was due to

- (a) Inadequate public health facilities
- (b) Occurrence of frequent natural calamities
- (c) Both (a) and (b)
- (d) Neither (a) nor (b)

Q15. At the time of Independence, the infant mortality rate was:

- (a) 220 per thousand
- (b) 250 per thousand
- (c) 218 per thousand
- (d) 280 per thousand

### Very Short Questions-

1. What is export?
2. What is import?
3. The term Macro is derived from
4. Who is called the 'father of modern economics'?
5. What is the name of John Maynard Keynes' celebrated book?

### Short Questions-

1. Distinguish between microeconomics and macroeconomics.
2. What is entrepreneurship?
3. Define great depression.
4. What are the features of capitalist economy?
5. What are economic agents?

### Long Questions-

1. What is Macroeconomics and microeconomics and what is the connection between the two?
2. Define and explain the importance of 'scarcity' and 'opportunity costs' in economics.
3. What are the different ways in which resources can be allocated and what are their respective advantages and disadvantages?
4. Explain the scope of Macroeconomics.

5. What are the different types of goods produced in an economy?

### Case Study Based Question-

1. Read the following hypothetical text and answer the given questions: -

2. Read the following hypothetical text and answer the given questions: -

### Assertion Reason Type Question-

1. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.

- Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A).
- Both Assertion (A) and Reason (R) are true and Reason (R) is not the correct explanation of Assertion (A).
- Assertion (A) is true but Reason (R) is False
- Assertion (A) is False but Reason (R) is true.

**Assertion:** Production Possibility Frontier (PPF) is a concave-shaped curve.

**Reason:** PPF shows all the maximum possible combinations of two goods, which can be produced with the available resources and technology.

2. In these questions, a statement of assertion followed by a statement of reason is given. Choose the correct answer out of the following choices.

- Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A).
- Both Assertion (A) and Reason (R) are true and Reason (R) is not the correct explanation of Assertion (A).
- Assertion (A) is true but Reason (R) is False
- Assertion (A) is False but Reason (R) is true.

**Assertion:** Human wants differ in priorities.

**Reason:** For every individual, some wants are more important and urgent as compared to others

### MCQ Answers-

- (b) zamindars
- (d) 44
- (a) high birth rate
- (a) underdeveloped
- (c) 1869

6. (a) V.K.R.V. Rao
7. (c) Secondary
8. (b) Jamshedpur
9. (a) Tariff
10. (c) Agriculture
11. (a) 1907
12. (d) Only A and B
13. (d) All of these
14. (c) Both (a) and (b)
15. (c) 218 per thousand

### Very Short Answers-

1. Ans: An export is a function of international trade in which items produced in one country are shipped to another for sale or trade in the future. The sale of such commodities contributes to the gross domestic product of the producing country.
2. Ans: Imports are goods or services that are brought into one country from another. Because commodities are frequently delivered by boat to foreign nations, the term "import" is derived from the word "port." Imports, together with exports, are the backbone of international trade.
3. Ans: Latin word 'Macros'.
4. Ans: Adam Smith
5. Ans: The title of the book is 'The General Theory of Employment, Interest, and Money,' and it was released in 1936.

### Short Answers-

Ans 1:

Basis	Microeconomics	Macroeconomics
Focus upon	It investigates the individual economic unit.	It investigates the aggregate economic units.
Concerned with	It is concerned with the determination of prices and output in individual markets.	It is concerned with the determination of the general price level and output in the entire economy.
Challenges	The two most important central challenges are price determination and resource allocation.	The fundamental issue in this case is determining the level of income and addressing unemployment in the economy.

Approach.	Microeconomics analyzes the economy from the bottom-up.	Macroeconomics analyzes the economy from the top-down.
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Ans 2: The ability and willingness to conceive, organize, and manage a business initiative, as well as any risks associated with it, in order to generate profit is called entrepreneurship. The establishment of new businesses is the most visible manifestation of entrepreneurship.

Ans 3: The Great Depression was the worst economic downturn in the history of the industrialized world, lasting from 1929 to 1933. Economic historians typically ascribe the commencement of the Great Depression to the abrupt and disastrous drop of US stock market prices on October 29, 1929, known as Black Tuesday. Some, however, disagree with this conclusion, viewing the stock market crash as a symptom rather than a cause of the Great Depression.

Ans 4: According to Karl Marx's 'Das Kapital,' the capitalist takes on average twelve hours of work from the worker and pays him wages equivalent to six hours of effort.

“Capitalism is a free-market form or capitalistic economy that may be regarded as an automatic self-regulating system motivated by self-interest of individuals and regulated by competitions,” writes Ferguson.

The main features are:

- Private ownership exist, and the property is owned by the private sector or individuals or companies.
- No or minimum interference from the government takes place.
- There exists the influence of the private sector in all the decisions.
- The forces of demand and supply, as well as the behaviour of economic participants determines the economy.
- The main objective is profit maximisation.
- USA, and Japan are examples of capitalist economies.
- There exists freedom of enterprise, where individuals are free to make their own economic choices.

Ans 5: Individuals or institutions that make economic decisions are referred to as economic units or economic agents.

- They could be consumers who choose what and how much to consume.
- They could be manufacturers of goods and services who decide what and how much to produce.
- They could be institutions such as the government, corporations, or banks that make economic decisions such as how much to spend, what interest rate to charge on credit, how much to tax, and so on.

## Long Answers-

Ans 1: Many books have been written about macroeconomics and microeconomics, as well as the underlying concepts that underpin them. Microeconomics is the study of decisions made by individuals and businesses regarding resource allocation and the pricing of goods and services. It focuses on supply and demand, as well as other forces that influence price levels in the economy. Macroeconomics is the branch of economics that studies the behavior of the economy as a whole, rather than just individual businesses.

While these two economics subjects appear to be distinct, they are actually interrelated and complement one another due to many overlapping concerns.

- For example: Higher inflation would raise the cost of raw materials for businesses, influencing the price of the end product charged to the public. According to Professor Ackley, "the link between macroeconomics and theory of individual behavior is a two-way street."
- Microeconomic theories should serve as the foundation for our collective ideas, but macroeconomics can also aid in microeconomic knowledge. For example, empirically stable macroeconomic generalizations that appear to contradict microeconomic theories may help us better understand individual behavior.

Ans 2: **Scarcity**

Scarcity is the condition that exists when there are insufficient resources to meet all of an individual's or society's desires. Any resource with a non-zero cost to use is rare to some extent, but relative scarcity is what matters in practice.

- Scarcity is sometimes known as "paucity."
- Economics is the study of how people use finite resources to meet their boundless desires.
- At the heart of economics is the notion that our world is afflicted by scarcity, that we do not have access to all of the resources we desire. As a result, we must make a decision.

**Importance of Scarcity:**

- It influences the level of supply and demand in the economy.
- The production of goods and services is influenced by the scarcity of input resources. If the resources are scarce, producers will find it difficult to produce the required level of goods and services.
- It affects the price of goods and services, as scarce resources are high in demand but low in supply, leading to higher price charges.
- No economy would exist if there is no scarcity. As due to scarcity of resources the problem of choice and problem of resource allocation arises.

**Opportunity cost:**

When we make a decision, it is unavoidable that we will have to give up something. The thing we give up is referred to as opportunity cost.

- Economists describe opportunity cost as the next best or highest valued alternative to the chosen option. If we choose to make a product out of a resource, the opportunity cost of making that good is the highest valued alternative use of that resource.
- Opportunity Costs are the costs incurred when the next highest valued alternative is foregone when a decision is taken. Every resource used in the economy has a limited quantity available.
- This is what leads to the existence of a price for all commodities and services. If there were no scarcity of resources, everything would be free, and there would be no opportunity cost of choosing the next best opportunity. Because neither the customer nor the producer has an infinite supply of anything, hence opportunity cost is tied to scarcity.

Ans 3: The problem of resource allocation can be settled either by free interaction of individuals or a government controlled economic system. Mainly three market systems exist that decide about the allocation of resources.

- **Centrally Planned Economy:** A centrally planned economy is one in which the government or a central authority plans all the economy's major activities. All major decisions regarding the production, exchange, and consumption of goods and services are made by the government. The central authority attempts to achieve a specific resource allocation and also the distribution of the final combination of goods and services that is deemed desirable for the society as a whole. The primary goal is social welfare.

#### **Advantages:**

- Higher economic growth and development due to social welfare objectives.
- Reduced income and social inequalities.
- Reduced duplication of resources
- Better and optimum utilisation of resources.

#### **Disadvantages:**

- Lack of individual choice.
- Restricts individual rights
- As the government makes the decisions, there is no say of individuals.
- Inefficiency is there, as the products are as per government decisions, irrespective of consumer choice.
- **Market Economy:** All economic activities in a market economy are organised through the market. Free interaction of individuals who pursue their respective economic activities takes place in a market.

In other words, a market is a collection of arrangements in which economic agents freely exchange their endowments or products with one another. Also, no interference of government takes place, and there exists the influence of the private sector. The forces of demand and supply, as well as the behaviour of economic participants determines the

economy. The main objective is profit maximisation.

**Advantages:**

- Higher efficiency due to competition between firms.
- To enable differentiation, and gain competitive advantage, firms offer wide variety of products.
- Innovation in products take place to boost consumer demand.
- Efficient production, and utilisation of resources is there

**Disadvantages:**

- Due to profit motive, no/less concern to society and environment is there.
- Exploitation of people takes place.
- Cut throat competition leads to competitive disadvantages.
- The social, economic, and income inequalities take place.
- Mixed Economy: The economy in which both the government and the private sector own and operate production factors. Profit maximisation in the private sector and social welfare in the public sector are the primary goals. The central planning authority and the price mechanism solve central problems.

**Advantages:**

- Efficient allocation of resources.
- Social welfare
- Private sector is encouraged.
- Reduction in economic differences

**Disadvantages:**

- Delay in decision making.
- High possibility of resource wastage.
- More chances of corruption and black marketing.
- Lack of proper economic planning.

Ans 4: The scope of Macroeconomics is as follows:

1. To comprehend the operation of the economy: The study of macroeconomic variables is essential for understanding how the economy works. Our key economic challenges are related to the behavior of total income, output, employment, and the economy's overall price level.
2. Economic Policies: Macroeconomics is particularly useful in terms of economic policy. Modern governments, particularly those in developing countries, face a slew of domestic issues. They are overcrowding, inflation, balance of payments, general underproduction, and so on.
3. Unemployment in General: Unemployment is thus generated by a lack of effective demand. To eradicate it, total investment, total output, total income, and total

consumption should be increased to increase effective demand. As a result, macroeconomics is especially important in investigating the origins, impacts, and treatments of general unemployment.

4. **National Income:** Understanding macroeconomics is critical for assessing the overall performance of the economy in terms of national income. With the onset of the 1930s Great Depression, it became necessary to investigate the causes of general overproduction and general unemployment.
5. **Economic Growth:** Growth economics is a branch of macroeconomics. The resources and capacities of an economy are assessed using macroeconomic principles. Plans for overall increases in national income, output, and employment are developed and implemented in order to boost the economy's overall level of economic development.

Ans 5: The following are some examples of different categories of goods:

1. **Ordinary products:** The quantity requested of such commodities rises as the consumer's income rises and falls as the consumer's income falls. Such items are referred to as regular goods.
2. **Free Products:** These are goods that have an infinite supply and are offered as a free gift from nature. These items are referred to as 'Free Goods.' For example, air, sea, water, sunlight, desert sand, and so on.
3. **Economic Goods:** Vegetables, cereals, minerals, fruits, and fish, etc. which are neither man-made nor limitless in supply from nature are referred to as 'Economic Goods.' All of these items are exclusively available for purchase and sale in the market.
4. **Substitute goods:** These are items that can be consumed or used in lieu of one another. Also, an increase in the price of one type of good leads to an increase in the demand for its replacements, and a decrease in the price leads to a decrease in the demand for its substitutes. For example, tea and coffee are substitutes.
5. **Private Goods** Private goods are all goods owned by private entities. A car, a house, a motorcycle, a mobile phone, books, a television set, and so on are examples of private commodities.
6. **Public Goods:** There are many goods that are jointly owned by society, the public, or the government. These are referred to as public or government products. Roads, bridges, hospitals, government schools, and so on are examples of public goods, social goods, or government goods.
7. **Consumer Goods:** Consumer Goods are goods that are directly used by the consumer for the purpose of consumption. Bread, biscuits, butter, jam, rice, fish, eggs, shoes, clothes, fans, books, pens, cooking gas, and so on are examples of consumer products.
8. **Capital Goods:** All that are not immediately utilized to satisfy consumption but are used in subsequent manufacturing are referred to as 'Producer Goods' or 'Capital Goods.' Examples include seeds, fertilizers, tools, machineries, raw materials, and so on.

### Case Study Answer-

1. Answer:
  1. a) absolute poverty
  2. Poverty line
  3. Consumption
  4. per capita expenditure
2. Answer:
  1. d) All of the above
  2. Casualization
  3. Gini Coefficient
  4. d) all the above

### Assertion Reason Answer-

1. b) Both Assertion (A) and Reason (R) are true and Reason (R) is not the correct explanation of Assertion (A).
2. a) Both Assertion (A) and Reason (R) are true and Reason (R) is the correct explanation of Assertion (A).

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