

Introduction to Micro and Macro Economics

Exercise | Q 1.1 | Page 7

Choose the correct option:

The branch of economics that deals with the allocation of resources.

- a) Micro economics
- b) Macro economics
- c) Econometrics
- d) None of these

- 1. a, b and c
- 2. a and b

3. **only a**

- 4. None of these

Solution: only a

Exercise | Q 1.2 | Page 7

Choose the correct option:

Concepts studied under Micro economics.

- a) National income
- b) General price level
- c) Factor pricing
- d) Product pricing

- 1. b and c
- 2. b, c and d
- 3. a, b and c

4. **c and d**

Solution: c and d

Exercise | Q 1.3 | Page 7

Choose the correct option:

Method adopted in micro economic analysis.

- a) Lumping method
- b) Aggregative method

- c) Slicing method
- d) Inclusive method

1. a, c and d
2. a, b and d
3. **only c**
4. only a

Solution: only c

The method adopted in micro economic analysis is **Slicing method**. Microeconomics is the study of behaviour of individual units in the economy. For this purpose, the entire economy is sliced, i.e. divided into several smaller/individual units, and each unit is then analyzed in detail.

Exercise | Q 1.4 | Page 7

Choose the correct option:

Concepts studied under Macro economics.

- a) Whole economy
- b) Economic development
- c) Aggregate supply
- d) Product pricing

1. **a, b and c**
2. b, c and d
3. only d
4. a, b, c and d

Solution: a, b and c

Exercise | Q 2.1 | Page 7

Complete the correlation:

Micro economics : Slicing method : : Macro economics : _____.

Solution: Micro economics : Slicing method : : Macro economics : **Lumping Method**

Exercise | Q 2.2 | Page 7

Complete the correlation:

Micro economics : Tree : : Macro economics : _____

Solution: Micro economics : Tree : : Macro economics : **Forest**

Exercise | Q 2.3 | Page 7

Complete the correlation:

Macro economic theory : Income and employment : : Micro economics : _____

Solution: Macro economic theory : Income and employment : : Micro economics : **Price theory**

Exercise | Q 2.4 | Page 7

Complete the correlation:

Makros : Macro economics : : Mikros : _____

Solution: Makros : Macro economics : : Mikros : **Micro economics**

Exercise | Q 2.5 | Page 7

Complete the correlation:

General equilibrium : Macro economics :: _____ : Micro economics

Solution: General equilibrium : Macro economics :: **Partial equilibrium** : Micro economics

Exercise | Q 3.1 | Page 7

Identify and explain the concept from the given illustration:

Gauri collected the information about the income of a particular firm.

Solution: Micro economics (study of individual units)

Explanation:

Micro economics is the study of the behaviour of small individual economic units, like individual firm, individual price, individual household etc.

Exercise | Q 3.2 | Page 7

Identify and explain the concept from the given illustration:

Ramesh decided to take all decisions related to production, such as what and how to produce?

Solution: Concept: Free market Economic

A free market economy where the economic decisions regarding the production of goods, such as 'What to produce? How much to produce? How to produce? ect.,' are taken at individual levels. There is no intervention by the Government or any other agency.

Exercise | Q 3.3 | Page 7

Identify and explain the concept from the given illustration:

Shabana paid wages to workers in her factory and interest in her bank loan.

Solution: Concept: Theory of factor pricing

In micro economics land, labour, capital, entrepreneur are the factors that contribute to the production process, micro economics helps in determining the factors rewards for land, labour, capital and entrepreneur in the form of rent, wages, interest, and profit respectively.

Exercise | Q 4.1 | Page 7

Answer in detail:

Explain the features of Micro Economics.

Solution: The following are the features of microeconomics.

- i. **Individual units** - Microeconomics is a study that basically focuses on the behaviour of individual units such as individual consumers and producer.
- ii. **Price theory** - Microeconomics is also called the price theory, as it helps in determining the prices of both the commodities and factors of production in their respective markets.
- iii. **Slicing method** - Microeconomic analysis adopts the slicing method. Under this method, the entire economy is divided into smaller units and then each unit is analyzed individually in detail.
- iv. **Partial equilibrium** - Microeconomics uses a partial equilibrium approach. The equilibrium points are identified assuming “other things remain constant” (ceteris paribus). It ignores the interdependence of economic variables.
- v. **Microscopic approach** - Just as a microscope enables us to see a larger view of smaller things, microeconomics shows a magnified view of an individual unit. It analyses small units in detail. It examines how these individual units perform economic activities and reach equilibrium.
- vi. **Marginalism principle** - Marginal means change in the total due to an additional unit. The additional unit is known as the marginal unit. Microeconomics is based on the principle of marginalism as important economic decisions are based on the marginal unit.
- vii. **Analysis of market** - Microeconomic studies deals in the study of different market structure namely, perfect competition, monopoly, monopolistic competition, oligopoly. It analyses how prices and output are determined in the market.
- viii. **Based on assumptions** - Microeconomic analysis is based on certain assumptions such as laissez-faire, full employment, perfect competition, ceteris paribus, etc. Such assumptions although make the analysis simple, but may not exists in reality.

Exercise | Q 4.2 | Page 7

Answer the following:

Explain the importance of Macro economics.

Solution: The importance of Macro economics is explained follows:

1. **Functioning of an Economy:** Macro economic analysis gives us an idea of the functioning of an economic system. It helps us to understand the behaviour pattern of aggregative variables in a large and complex economic system.
2. **Economic Fluctuations:** Macro economics helps to analyse the causes of fluctuations in income, output, and employment and makes an attempt to control them or reduce their severity.
3. **National Income:** Study of macro economics has brought forward the immense importance of the study of national income and social accounts. Without a study of national income, it is not possible to formulate correct economic policies.
4. **Economic Development:** Advanced studies in macro economics help to understand the problems of developing countries such as poverty, inequalities of income and wealth, differences in the standards of living of the people etc. It suggests important steps to achieve economic development.
5. **Performance of an Economy:** Macro economics helps us to analyse the performance of an economy. National Income (NI) estimates are used to measure the performance of an economy over time by comparing the production of goods and services in one period with that of the other period.
6. **Study of Macro economic Variables:** To understand the working of the economy, a study of macro economic variables is important. Main economic problems are related to the economic variables such as behaviour of total income, output, employment, and general price level in the economy.
7. **Level of Employment:** Macro economics helps to analyse the general level of employment and output in an economy.

Exercise | Q 4.3 | Page 7

Answer the following:

Explain the scope of Macro economics.

Solution: The scope of Macro economics is explained follows:

1. **Theory of Income and Employment** - Macro economic analysis explains which factors determine the level of national income and employment and what causes fluctuations in the level of income, output, and employment. To understand, how the level of employment is determined, we have to study the consumption function and investment function. Theory of Business Cycles is also a part and parcel of the Theory of Income and Employment.
2. **Theory of General Price Level and Inflation** - Macro economic analysis shows how the general price level is determined and further explains what causes fluctuations in it. The study of general price level is significant on account of the problems created by inflation and deflation.

3. **Theory of Growth and Development** - Macro economics consists of the theory of economic growth and development. It explains the causes of underdevelopment and poverty. It also suggests strategies for accelerating growth and development.
4. **Macro Theory of Distribution** - Macro theory of distribution deals with the relative shares of rent, wages, interest, and profit in the total national income.

Exercise | Q 5.1 | Page 7

State with reason whether you agree or disagree with the following statement:

The scope of micro economics is unlimited.

1. Agree
2. **Disagree**

Solution:

I **disagree** with the above statement.

Explanation:

The scope of micro economics is limited.

The scope of micro economics is limited to only individual units. It doesn't deal with nationwide economic problems such as inflation, deflation, the balance of payments, poverty, unemployment, population, etc.

micro economics is mainly confined to price theory and resource allocation. It does not study the aggregates relating to the whole economy. This approach does not study national economic problems such as unemployment, poverty, inequality of income, etc. Theory of growth, the theory of business cycles, monetary and fiscal policies etc. are beyond the limits of micro economics.

Exercise | Q 5.2 | Page 7

State with reason whether you agree or disagree with the following statement:

Macro economics deals with the study of individual behaviour.

1. Agree
2. **Disagree**

Solution:

I **Disagree** with the above statement.

Explanation:

Macro economics does not deals with the study of individual behaviour it deals with the **whole economy**.

Macro economic analysis gives us an idea of the functioning of an economic system. It helps us to understand the behaviour pattern of aggregative variables in a large and complex economic system.

Exercise | Q 5.3 | Page 7

State with reason whether you agree or disagree with the following statement:

Macro economics is different from micro economics.

1. **Agree**
2. Disagree

Solution:

Yes, I **agree** to it. Reasons :

- (i) Macroeconomics is the study of entire economy whereas on the other hand, microeconomics is a study of the particular segment of an economy.
- (ii) Macroeconomics studies aggregate demand, aggregate supply, national income, general price level, etc. On the other hand, micro economics studies individual demand, individual supply, individual income, price determination of particular product, etc.
- (iii) Macroeconomics follows general equilibrium analysis. On the other hand, microeconomics follows partial equilibrium analysis.
- (iv) Macroeconomics uses lumping method. On the other hand, microeconomics uses slicing method. Therefore, macroeconomics is different from microeconomics.

Exercise | Q 5.4 | Page 7

State with reason whether you agree or disagree with the following statement:

Micro economics uses slicing method.

1. **Agree**
2. Disagree

Solution:

Yes, I **agree** with the statements.

Microeconomics: It is that part of economics that deals with the individual units of the economy. It takes into account the demand and supply of individual units. It uses a slicing method because it divides the economy into slices, parts or individual units for the purpose of in-depth study.

Exercise | Q 5.5 | Page 7

Do you agree with the following statement? Give reason.

Micro Economics is known as income theory.

1. Agree

2. Disagree

Solution:

Disagree

No, microeconomics is not known as the income theory, rather, it is known as the price theory, as it focuses on determining the prices of commodities and factors of production in the market.

Exercise | Q 6.1 | Page 7

Write short note:

Importance of micro economics ?

Solution:

Importance of micro economics.

Micro economics is a branch of economics that is concerned with the analysis of the behaviour of an individual economic unit or variable. Micro economics plays a vital role in the study of modern economic theory. It is important in the following ways as described below:

Price Determination: It explain how prices of individual commodities are determined and how rewards of factors of production are determined and distributed.

Business Decision Making: Micro economic theory help businessman to determine their price policy, a maximum level of output, and achievement of maximum productivity from factors combination.

Business and Production planning: Micro economic policy helps in preparing and planning of business policy, expansion of business, and making investment decisions to achieve maximum output and productivity.

To understand the working of the economy:

It helps us in understanding the working of a free enterprise economy. It gives us an idea about how major economic decisions are taken in a market economy.

Helpful in the efficient employment of resources:

It suggests economizing, that is how efficiently the scarce available resources can be utilized in the production process in an economy.

Helps in International Trade:

Micro economics is used to explain gains from internal trade, external trade, foreign exchange, balance of payment, disequilibrium and in the determination of exchange rate.

Basis of welfare economics:

The entire structure of micro economics has been built on the basis of price theory which is an important constituent of micro economics. It suggests the conditions of efficiency and explains how it can be achieved. It helps in improving the standard of living of population.

Helpful in understanding the consequences of taxation:

Imposition of tax leads to reallocation of resources from one place to another. Micro economics explains how imposition of different types of direct and indirect taxes leads to the attainment of social welfare.

Tool for evaluating economic policies:

It helps the states and central government to frame economic policies like price policy, taxation policy etc. It also explains the condition of efficiency in production and consumption.

Construction and use of models:

Micro economics construct and uses simple models in order to understand the actual economic phenomenon. It uses abstract models to explain the economic phenomenon.

Exercise | Q 6.2 | Page 7

Answer in detail:

Explain the concept of Macro economics and its features.

Solution:

Meaning: -

The term Macro is derived from Greek word “Makros” which means large. It is the branch of economics, which studies the behaviour of all economics units combined together. Macroeconomics is a study of aggregates. It is the study of the economic system as a whole. Therefore, it is also called as Aggregate Economics.

Definition: -

“Macroeconomics deals not with individual quantities as such, but with aggregates of these quantities; not with individual incomes but with the national incomes; not with individual prices but with the price level; not with individual outputs but with the national output’.

Features of Macro-Economics:-

1. Study of aggregates:-

Macro-Economics deals with the study of nations economy as a whole. It is a study of very large, economy, wide aggregates such as national output or income, total employment, aggregate demand, aggregate supply, total investment, total consumption, general price level etc.

2. Lumping method:-

Macro analysis deals with the behaviour of aggregates i.e. total values of economic variables related to whole economy. It uses method of lumping to deal with macro variables, such as aggregate demand, aggregate supply, national output etc.

3. A General equilibrium analysis:-

Macro-Economics analysis is based on General Equilibrium Analysis. This analysis deals with entire economy in the context of equilibrium. It studies the behaviour of number of economic variables at a time and takes into consideration their functional relationship and interdependence in doing so.

This approach assumes "Everything depends on everything else."

Since this approach deals with whole economy, it has to explain how aggregate supply and aggregate demand are brought into equality, and how equilibrium between these forces determine, not only price level, but also level of income and employment. This whole analysis involves the study of number of variables and their interactions.

4. Income analysis:-

Macro-Economics is also known as the theory of income and employment or simply income analysis. Because, basic subject matter of Macro-Economic analysis is to explain what determines the level of national income and employment and what causes fluctuations in them. Further, it explains the growth of national income over a long period of time.

5. Policy-oriented:-

Macro-Economics, according to Keynes is a policy-oriented science. Macro-Economics analysis helps in formulating suitable economic policies to promote economic growth, to generate employment, to control inflation, to pull the economy out of depression etc.

6. Dynamic science:-

Macro-Economics studies the changes in aggregate economic variables and analyses dynamic nature of the economy. It enables us to study progress of an economy over a period of time.