

MACRO ECONOMICS

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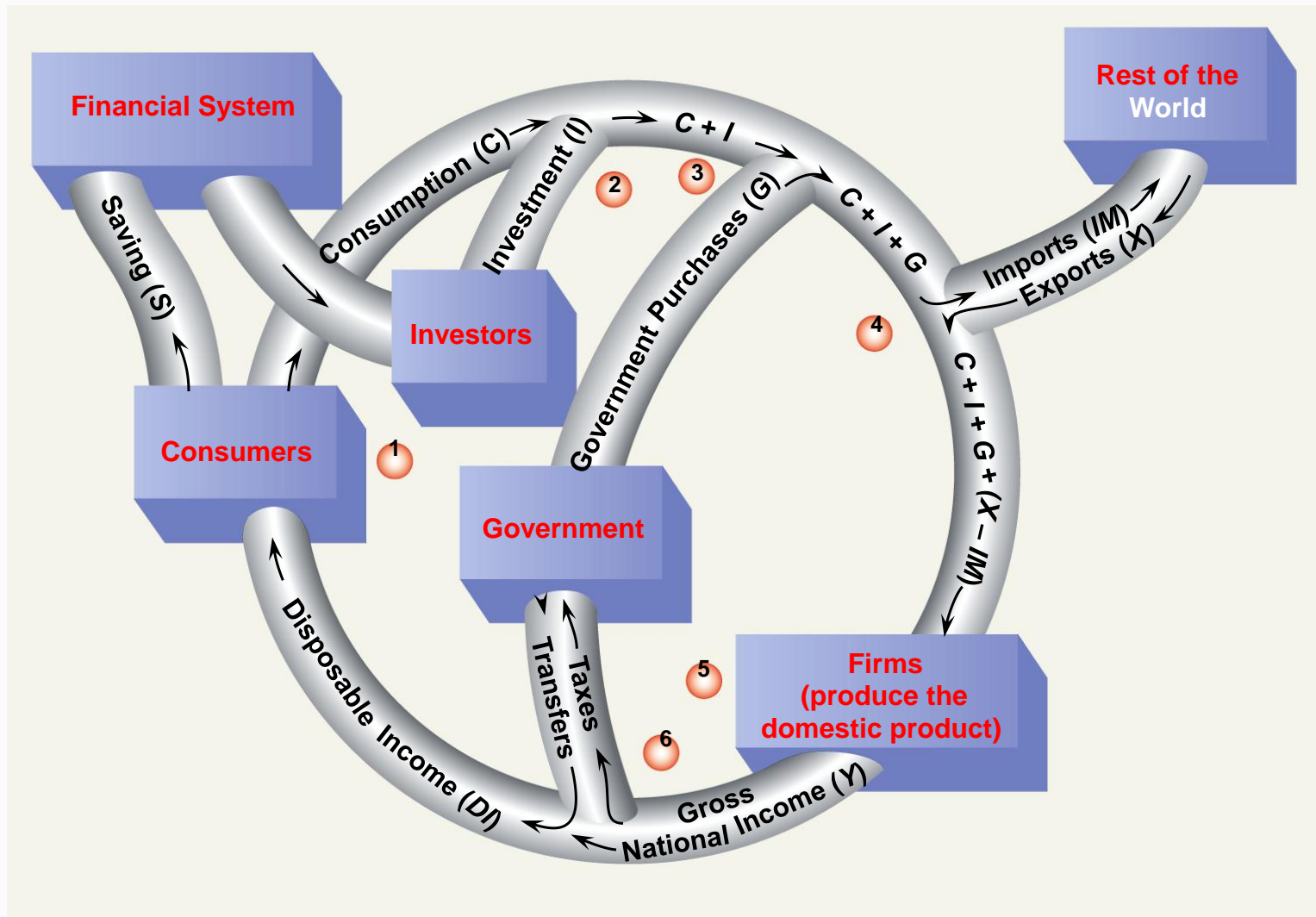
ECONOMICS

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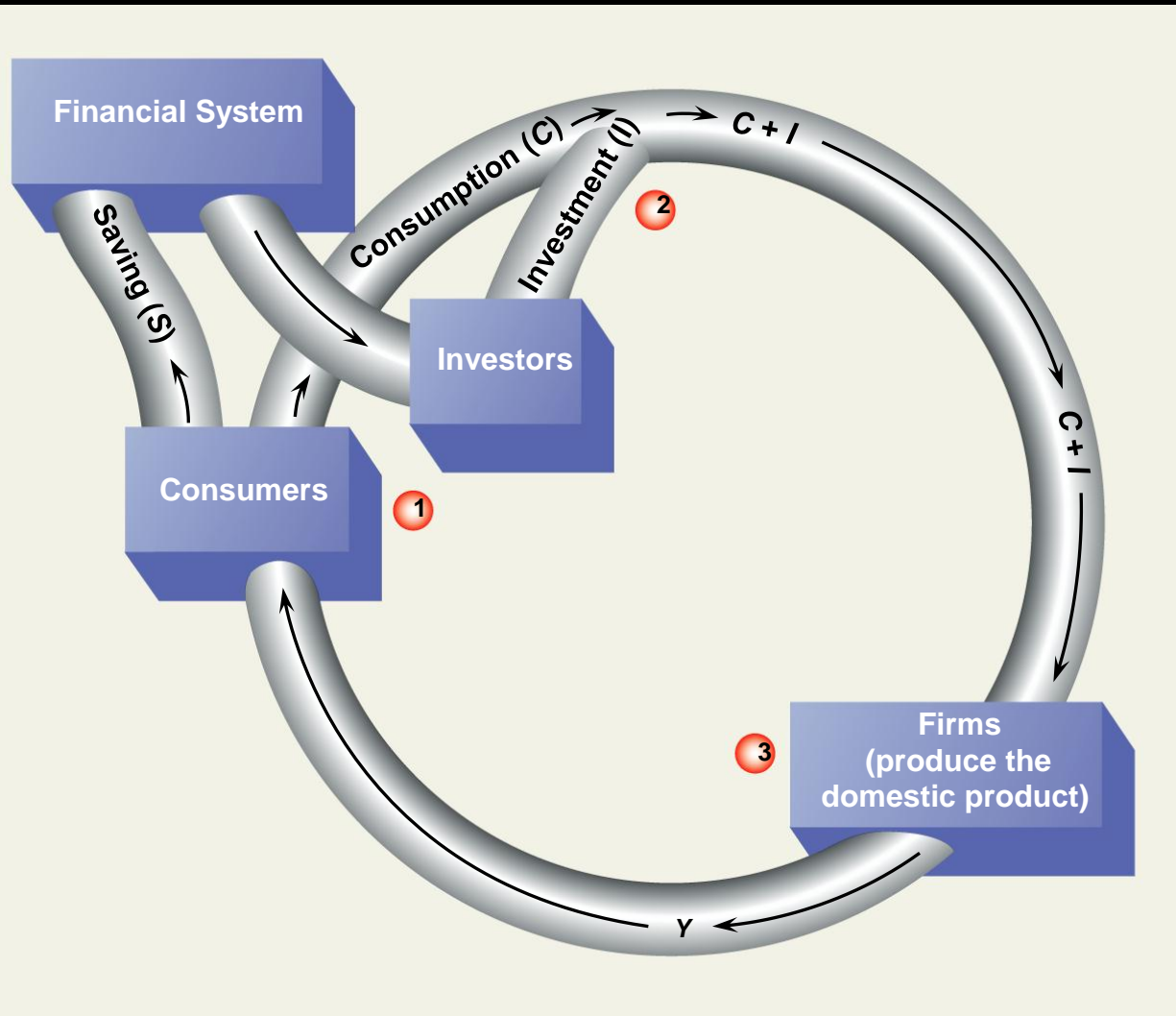
MICRO

MACRO

The Circular Flow



A Simplified Circular Flow



Even in a simple model with out Government or Trade in order to be at full employment 'S' must be equal 'I'

National Income

- □ National income accounting – a set of rules and definitions for measuring economic activity in the aggregate economy i.e., in the economy as a whole.
- □ National income accounting is a way of measuring total, or aggregate production.

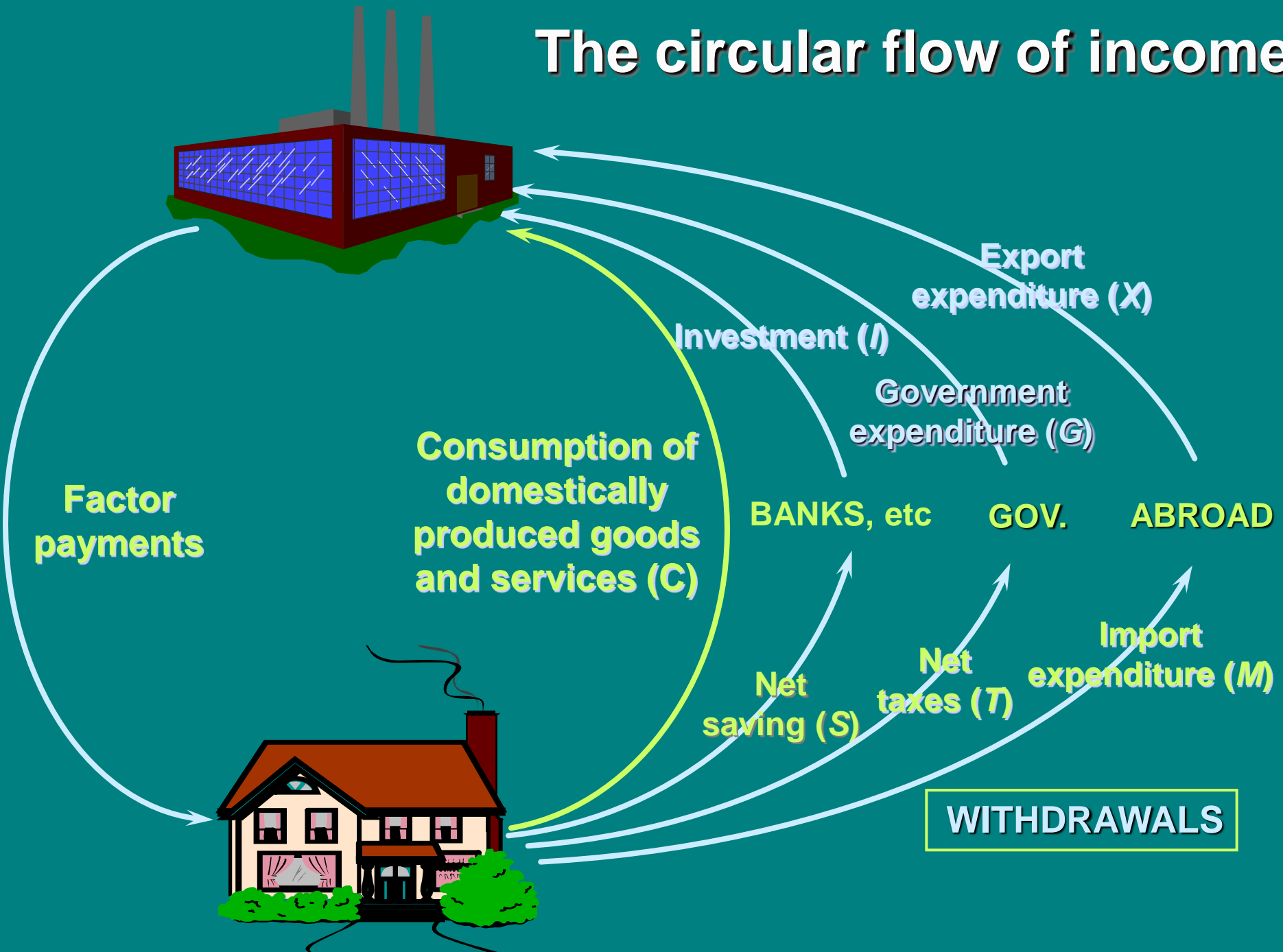
Concepts of National Income

- **Gross Domestic Product (GDP)** is the total value of all final goods and services produced in an economy in one-year period. **GDP** is output produced within a country's borders.
- **Gross National Product (GNP)** is the aggregate final output of citizens and businesses of an economy in one year. **GNP** is output produced by a country's citizens.

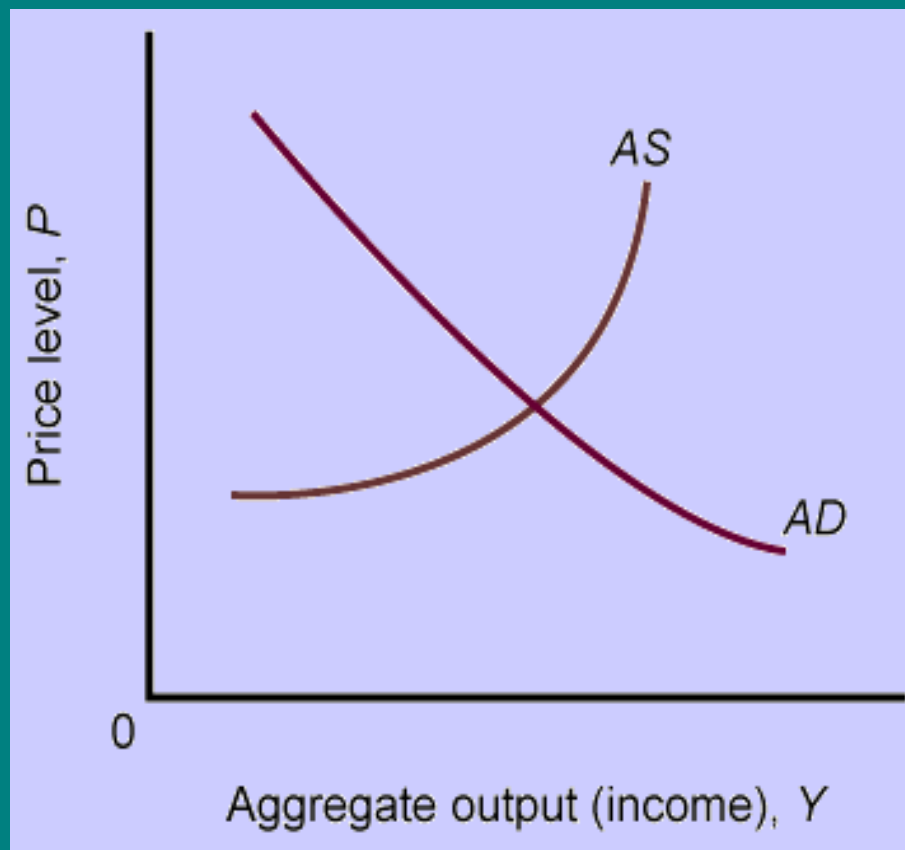
Labor Supply

- The supply of labor depends primarily on the wage rate (the cost of a unit of labor, such as an hour of work)
- The supply of labor also depends on
 - The size of the adult population
 - The skills (productivity) of the adult population
 - Households' preferences for work versus leisure

The circular flow of income



The Equilibrium Price Level



- The *equilibrium price level* is the point at which the aggregate demand and aggregate supply curves intersect.

Market Failure

- “Market failure” is possible when competitive markets fail to be optimal institutions to produce and distribute goods.

EXTERNALITIES

- **An externality is a benefit or cost to third parties who are not directly involved in a transaction.**
- **Externalities are sometimes called neighborhood effects.**

How Externalities Work

- Externalities can be either beneficial or harmful, and can originate with either consumers or producers.
- Here are some examples:
 - 1) Your consuming cigarettes imposes costs on others nearby in the form of bad smells and dangerous smoke.
 - 2) Your wearing perfume or cologne makes others near you feel better off.
 - 3) A dam built for electricity generation provides flood control to farmers and towns.

How Externalities Work

- The existence of an externality creates a difference between either
 - a) the private and social cost of production,
 - or
 - b) the private and social benefits from consumption.

External Cost and Benefit

- **Marginal external cost** is the extra social cost (over and above the private cost) of producing one more unit of the good.
- **Marginal external benefit** is the extra social benefit of consuming one more unit of a good.
- The presence of external benefits and costs means there will be a difference between the private and social consequences of production.

External Cost and Benefit Private & Social Consequences

- ***EXAMPLE 1:***
- **Suppose the market in beer is perfectly competitive. But beer production creates terrible odors, and makes people who live downwind from breweries worse off.**

PUBLIC GOODS

- A pure public good is a good or service that is consumed in its entirety by everyone.
- Public goods have two special properties compared to private consumption goods.

PUBLIC GOODS

- **Non rivalry:** When one person consumes a unit of a public good the amount available to be consumed by everyone else is not diminished.
- **Non excludability:** Once a public good is produced it is difficult or impossible to exclude people from consuming it.

PUBLIC GOODS

- If left to private market, these goods will tend to under production or not produced or produced at higher prices
- Public goods are not the same as publicly provided goods. Just because Government provides a good does not make it a public good.

Markets help to organize economic activity

- **Firms decide whom to hire and what to make**
- **Households with their incomes decides which firms to work for and what to buy**
- **These firms and households interact in the market place, where prices and self interest guide their decisions**

Government's Role

- The invisible hand can work only if the Government enforces the rules and maintains the institutions that are key to a market economy
- Markets work only if the individual interests are protected by Government policy

THANK YOU



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