1.1 Introduction to Economics

In general, the purpose of this chapter is to provide the basic definitions upon which the subsequent discussions of macroeconomics will be built. The specific purpose of this chapter is to define economics (and its major component fields of study), describe the relation between economic theory and empirical economics, and examine the role of objectivity in economic analysis, before examining economic goals and their relations. For those of you who have had ECN 201: Introductory Microeconomics, much of the material contained in this lecture will be similar to the introductory material contained in that course.

Definitions

Economics has been studied since sixteenth century and is the oldest of the social studies. Most of the business disciplines arose in attempt to fill some of the institutional and analytical gaps in the areas with which economics was particularly well suited to examine. The subject matter examined in economics is the behavior of consumers, businesses, and other economic agents, including the government in the production and allocation processes. Therefore, any business discipline will have some direct relation with the methods or at least the subject matter with which economists deal.

Economics is one of those words that seems to be constantly in the newspapers and on television news shows. Most people have some vague idea of what the word economics means, but precise definitions generally require some academic exposure to the subject. Economics is the study of the allocation of SCARCE resources to meet UNLIMITED human wants. In other words, economics is the study of human behavior as it pertains to the material well-being of people (as either individuals or societies).

Robert Heilbroner describes economics as a "Worldly Philosophy." It is the organized examination of how, why and for what purposes people conduct their day-to-day activities, particularly as relates to the production of goods and services, the accumulation of wealth, earning incomes, spending their resources, and saving for future consumption. This worldly philosophy has been used to explain most rational human behavior. (Irrational behavior being the domain of specialties in sociology, psychology, history, and anthropology.)
Underlying all of economics is the base assumption that people act in their own best interest (at least most of the time and in the aggregate). Without the assumption of rational behavior, economics would be incapable of explaining the preponderance of observed economic activity. Consistent responses to stimuli are necessary for a model of behavior to predict future behavior. If we assume people will always act in their best economic interests, then we can model their behavior so that the model will predict (with some accuracy) future economic behavior. As limiting as this assumption may seem, it appears to be an accurate description of reality. Experimental economics, using rats in mazes, suggests that rats will act in their own best interest; therefore, it appears to be a reasonable assumption that humans are no less rational.

Most academic disciplines have evolved over the years to become collections of closely associated scholarly endeavors of a specialized nature. Economics is no exception. An examination of one of the scholarly journals published by the American Economics Association, The Journal of Economic Literature reveals a classification scheme for the professional literature in economics. Several dozen specialties are identified in that classification scheme, everything from national income accounting, to labor economics, to international economics. In other words, the realm of economics has expanded to such an extent over the centuries that it is nearly impossible for anyone to be an expert in all aspects of the discipline, so each economist generally specializes in some narrow portion of the discipline. The decline of the generalist is a function of the explosion of knowledge in most disciplines, and is not limited to economists.

Economics is a social science which studies individuals and organizations engaged in the production, exchange and consumption of goods and services.

Economics in general seeks to develop principles, theories or models that isolate a few of the most important determinants or causes of economic events. The ultimate goal is to develop policies that might explain, prevent or correct such problems as unemployment, inflation, slow growth and waste in the economy.

There are two basic categories of economics: Microeconomics and Macroeconomics. These two divisions enabled us to study economics from a small and broad perspectives. The degree of aggregation is the key yardstick by which they are formally distinguished.

Economics can be classified into two general categories; these are (1) microeconomics and (2) macroeconomics. **Microeconomics is concerned with decision-making by individual economic agents such as firms and consumers.** In other words, microeconomics is concerned with the behavior of individuals or groups organized into firms, industries, unions, and other identifiable agents. Microeconomics is the subject matter of ECN201, Introductory Microeconomics (which many of you have recently completed).

**Macroeconomics is concerned with the aggregate performance of the entire economic system.** Unemployment, inflation, growth, balance of trade, and business cycles are the topics that occupy
most of the attention of students of macroeconomics. These matters are the topics to be examined this course (ECN202), Introductory Macroeconomics.

Macroeconomics is a course that interfaces with several other academic disciplines. A significant amount of the material covered in this course involves public policy and has a significant historical foundation. The result is that much of what is currently in the news will be things that are being studied in this course as they happen. In many respects, that makes this course of current interest, if not fun.

**Methods in Economics**

Economists seek to understand the behavior of people and economic systems using scientific methods. These scientific endeavors can be classified into two categories, (1) economic theory and (2) empirical economics. **Economic theory relies upon principles to analyze behavior of economic agents.** These theories are typically rigorous mathematical models (abstract representations) of behavior. A good theory is one that accurately predicts future behavior and is consistent with the available evidence.

**Empirical economics relies upon facts to present a description of economic activity.** Empirical economics is used to test and refine theoretical economics, based on tests of economic theory. The tests that are typically applied to economic theories are statistically based, and is generally called econometric methods.

Theory concerning human behavior is generally constructed using one of two forms of logic. Sociology, psychology and anthropology typically rely on inductive logic to create theory. **Inductive logic creates principles from observation.** In other words, the scientist will observe evidence and attempt to create a principle or a theory based on any consistencies that may be observed in the evidence. Economics relies primarily on deductive logic to create theory. **Deductive logic involves formulating and testing hypotheses.** Often the theory that will be tested comes from inductive logic or sometime informed guesswork. The development of rigorous models expressed as equations typically lend themselves to rigorous statistical methods to determine whether the models are consistent with evidence from the real world. The tests of hypotheses can only serve to reject or fail to reject a hypothesis. Therefore, empirical methods are focused on rejecting hypotheses and those that fail to be rejected over large numbers of tests generally attain the status of principle.

However, examples of both types of logic can be found in each of the social sciences. In each of the social sciences, it is common to find that the basic theory is developed using inductive logic. With increasing regularity, standard statistical methods are being employed across all of the social sciences and business disciplines to test the validity of theories.

The usefulness of economics depends on how accurate economic theory predicts behaviour. Even so, economics provides an objective mode of analysis, with rigorous models that permit the discounting of the substantial bias that is usually present with discussions of economic issues. The internal consistency brought to economic theory by mathematical models often fosters objectivity. However,
no model is any better than the assumptions that underpin that model. If the assumptions are either unrealistic or formulated to introduce a specific bias, objective analysis can still be thwarted (under the guise of scientific inquiry).

The purpose of economic theory is to describe behavior, but behavior is described using models. **Models are abstractions from reality** - the best model is the one that best describes reality and is the simplest (the simplest requirement is called Occam's Razor). Economic models of human behavior are built upon assumptions; or simplifications that allow rigorous analysis of real world events, without irrelevant complications. Often (as will be pointed-out in this course) the assumptions underlying a model are not accurate descriptions of reality. When the model's assumptions are inaccurate then the model will provide results that are consistently wrong (known as bias).

One assumption frequently used in economics is **ceteris paribus** which means all other things equal (notice that economists, like lawyers and doctors will use Latin to express rather simple ideas). This assumption is used to eliminate all sources of variation in the model except for those sources under examination (not very realistic!).

**Economic Goals, Policy, and Reality**

Most people and organizations do, at least rudimentary planning, the purpose of planning is the establishment of an organized effort to accomplish some economic goals. Planning to finish your education is an economic goal. Goals are, in a sense, an idea of what should be (what we would like to accomplish). However, goals must be realistic and within our means to accomplish, if they are to be effective guides to action. This brings another classification scheme to bear on economic thought. Economics can be again classified into positive and normative economics.

**Positive economics is concerned with what is; and normative economics is concerned with what should be.** Economic goals are examples of normative economics. Evidence concerning economic performance or achievement of goals falls within the domain of positive economics.

Most nations have established broad social goals that involve economic issues. The types of goals a society adopts depends very much on the stage of economic development, system of government, and societal norms. Most societies will adopt one or more of the following goals: (1) economic efficiency, (2) economic growth, (3) economic freedom, (4) economic security, (5) an equitable distribution of income, (6) full employment, (7) price level stability, and (8) a reasonable balance of trade.

Each goal (listed above) has obvious merit. However, goals are little more than value statements in this broad context. For example, it is easy for the very wealthy to cite as their primary goal, economic freedom, but it is doubtful that anybody living in poverty is going to get very excited about economic freedom; but equitable distributions of income, full employment and economic security will probably
find rather wide support among the poor. Notice, if you will, goals will also differ within a society, based on socio-political views of the individuals that comprise that society.

Economics can hardly be separated from politics because the establishment of national goals occurs through the political arena. Government policies, regulations, law, and public opinion will all effect goals, how goals are interpreted, and whether they have been achieved. A word of warning, economics can be, and has often been used, to further particular political agendas. The assumptions underlying a model used to analyze a particular set of circumstances will often reflect a political agenda of the economist doing the analysis. For example, Ronald Reagan argued that government deficits were inexcusable, and that the way to reduce the deficit was to lower peoples' taxes -- thereby spurring economic growth, therefore more income that could be taxed at a lower rate and yet produce more revenue. Mr. Reagan is often accused, by his detractors, of having a specific political agenda that was well hidden in this analysis. His alleged goal was to cut taxes for the very wealthy and the rest was just rhetoric to make his tax cuts for the rich acceptable to most of the voters. (Who really knows?) Most political commentators, both left and right, have mastered the use of assumptions and high-sounding goals to advance a specific agenda. This adds to the lack of objectivity that seems to increasingly dominate discourse on economic problems.

On the other hand, goals can be publicly spirited and accomplish a substantial amount of good. President Lincoln was convinced that the working classes should have access to higher education. The Morrell Act was passed 1861 and created Land Grant institutions for educating the working masses (Purdue, Michigan State, Iowa State, and Kansas State (the first land grant school) are all examples of these types of schools). By educating the working class, it was believed that several economic goals could be achieved, including growth, a more equitable distribution of income, economic security and freedom. In other words, economic goals that are complementary are consistent and can often be accomplished together. Therefore, conflict need not be the centerpiece of establishing economic goals.

Because any society's resources are limited, there must be decisions about which goals should be most actively pursued. The process by which such decisions are made is called prioritizing. Prioritizing is the rank ordering of goals, from the most important to the least important. Prioritizing of goals also involves value judgments, concerning which goals are the most important. In the public policy arena, prioritizing of economic goals is often the subject of politics.

Herein lies one of the greatest difficulties in macroeconomics. An individual can easily prioritize goals. It is also a relatively easy task for a small organization or firm to prioritize goals. For the United States to establish national priorities is a far larger task. Adam Smith in the Wealth of Nations (1776) describes the basic characteristics of capitalism (this book marks the birth of capitalism). Smith suggests that there are three legitimate functions of government in a free enterprise economy. These three functions are (1) provide for the national defense, (2) provide for a system of justice, and (3) provides those goods and services that cannot be effectively provided by the private economy because
of the lack of a profit motive. There is little or no controversy concerning the first two of these
government functions. Where debate occurs is over the third of these legitimate roles.

Often you hear that some non-profit organization or government agency should be "run like a
business." A business is operated to make a profit. If the capitalist model is correct, then the only
reason for an entrepreneur to establish and operate a business is to make profits (otherwise, the conduct
of the business is irrational and cannot be explained as self-interested conduct). A church, charity, or
school is established for purposes other than the making of a profit. For example, a church may be
established for the purposes of maximizing spiritual well-being of the congregation (the doing of good-
works, giving testimony to one's religion, worship of God, and the other higher pursuits). The purpose
of a college or a secondary/elementary school system, likewise is not to make profits, the purposes of
educational institutions is to provide access knowledge. A University is to increase the body of
knowledge through basic and applied research, professional services, and (of primary importance to
the students) to provide for the education of students. To argue that these public or charitable
organizations should be run like a business is to suggest that these matters can be left to the private
sector to operate for a profit. Inherent in this argument is the assumption (a fallacy) that the profit
motive would suffice to assure that society received a quality product (spiritual or educational or both)
and in the quantities necessary to accomplish broad social objectives. Can you imagine what religion
would become if it was reduced to worldly profitability (some argue there's too much of that sort of
thing now), can you imagine what you would have to pay for your education if, instead of the State of
Indiana subsidizing education, the student was asked to pay for the total cost of a course plus some
percentage of cost as a profit? Perhaps worse still, who would do the basic research that has provided
the scientific break-throughs that result in thousands of new products each year? Would we have ever
had computers without the basic research done in universities, what would be missing from our
medical technology?

Priorities at a national level are rarely set without significant debate, disagreements, and even conflict.
It is through our free, democratic processes that we establish national, state and local priorities. In
other words, the establishment of our economic priorities are accomplished through the political arena,
and therefore it is often impossible to separate the politics from the economics at the macro level.

**Policy**

Policy can be generally classified into two categories, public and private policy. The formulation of
public and private policy is the creation of guidelines, regulations, or law designed to effect the
accomplishment of specific economic (or other) goals. Public policy is how national economic goals
are pursued. In the private sector, policy formulation means the creation of rules, regulations and
procedures to guide the operation of the company. Therefore, to understand goals one needs to
understand something of the process of formulating policy.
Business students will have an in-depth treatment of policy making in future courses in your discipline whilst the Accounting & Finance programmes require similar course(s) in some of its degree programmes. For our general knowledge, the brief treatment here will suffice for present purposes.

The following diagram outlines the steps in formulating policy (in sufficiently general terms to be applicable to both the public and private sectors):

Steps in formulating policy:

1. Stating goals - must be measurable with specific stated objective to be accomplished.

2. Options - identify the various actions that will accomplish the stated goals & select one, and

3. Evaluation - gather and analyze evidence to determine whether policy was effective in accomplishing goal, if not re-examine options and select option most likely to be effective.

Both the public and private policy formulation process are dynamic processes. Economic goals change with public opinion and with the achievement or failure of certain elements of policy. Step 1 involves the setting of goals. Often this is based on little more than stating value judgments, but the statement of goals should be based on informed opinion (which requires the gathering and analyzing of evidence concerning the effects of the goal on other economic activities, and the expected results of the goal). Step 2 involves selecting the appropriate model and the options associated with that model to accomplish the specified goal. The final step involves the implementation of the policies designed to accomplish the goal and the monitoring of progress toward accomplishing that goal. The monitoring of progress involves the gathering of evidence and the appropriate analysis to determine whether the policy is doing what was anticipated or whether the policy needs revision. The process of formulating policy is, therefore, a loop, and requires continuous monitoring and revising.

The major difference between public policy and private policy is that private policy is not subject to democratic processes. The Board of Directors or management of a company will decide what goals are to be accomplished and what policy options are best used to do so. Often private policy is made behind closed-doors without public accountability. Public policy is created in the open with free debate and has the force of law (and not just company rules and regulations).

Objective Thinking

Most people bring many misconceptions and biases to economics. After all, economics deals with people's material well-being. Because of political beliefs and other value system components rational,
objective thinking concerning various economic issues fail. Rational and objective thought requires approaching a subject with an open mind and a willingness to accept whatever answer the evidence suggests is correct. In turn, such objectivity requires the shedding of the most basic preconceptions and biases -- not an easy assignment.

What conclusions an individual draw from an objective analysis using economic principles, are not necessarily cast in stone. The appropriate decision based on economic principles may be inconsistent with other values. The respective evaluation of the economic and "other values" (i.e., ethics) may result in a conflict. If an inconsistency between economics and ethics is discovered in a particular application, a rational person will normally select the option that is the least costly (i.e., the majority view their integrity as priceless). An individual with a low value for ethics or morals may find that a criminal act, such as theft, as involving minimal costs. In other words, economics does not provide all of the answers; it provides only those answers capable of being analyzed within the framework of the rational behavior that forms the basis of the discipline.

There are several common pitfalls to objective thinking in economics. After all, few things excite more emotion than our material well-being. It should come as no surprise that bias and less than objective reasoning is common when it comes to economic issues, particularly those involving public policy... Among the most common logical pitfalls that affect economic thought are: (1) the fallacy of composition, and (2) post hoc, ergo prompter hoc. Each of these will be reviewed, in turn.

**The fallacy of composition is the mistaken belief that what is true for the individual must be true for the group.** An individual or small group of individuals may exhibit behavior that is not common to an entire population. In other words, this fallacy is simply assuming a small, unscientifically selected sample will predict the behavior, values, or characteristics of an entire population. For example, if one individual in this class is a Manchester United Football Club (Man-U) fan then everyone in this class must be a Man-U fan is an obvious fallacy of composition. Statistical inference can be drawn from a sample of individual observations, but only within confidence intervals that provide information concerning the likelihood of making an incorrect conclusion (ECN205 & ECN 206 are courses on Statistics, provides a more in-depth discussion of confidence intervals and inference).

**Post hoc, ergo prompter hoc means after this, hence because of this, and is a fallacy in reasoning.** Simply because one event follows, another does not necessarily imply there is a causal relation. One event can follow another and be completely unrelated. All of us have, at one time or another experienced a simple coincidence. One event can follow another, but there may be something other than a direct causal relation that accounts for the timing of the two events. For example, during the thirteenth century people noticed that the black plague occurred in a location when the population of cats increased. Unfortunately, some people concluded that the plague was caused by cats so they killed the cats. In fact, the plague was carried by fleas on rats. When the rat population increased, cats were attracted to the area because of the food supply (the rats). The people killed the predatory cats, and
therefore, rat populations increased, and so did the population of fleas that carried the disease. This increase in the rat population also happened to attract cats, but cats did not cause the plague, if left alone they may have gotten rid of the real carriers (the rats, therefore the fleas). The idea that cats were observed increasing in population gave rise to the conclusion that the cats brought the plague is a post hoc, ergo prompter hoc fallacy, but this example has an indirect relation between cats in the real cause. Often, even this indirect relation is absent.

Many superstitions are classic examples of this type of fallacy. Broken mirrors causing seven years bad luck, or walking under a ladder bring bad luck are nothing but fallacies of the post hoc, ergo prompter hoc variety. There is no causal relation between breaking glass and bad luck or walking under ladder (unless something falls off the ladder on the pedestrian). Deeper examination of the causal relations are necessary for such events if the truth of the relations is to be discovered. However, more in-depth analysis is often costly, and the cost has the potential of causing decision-makers to skip the informed part and cut straight to the opinion.

Economic history has several examples of how uniformed opinion resulted in very significant difficulties for innocent third parties, in addition, to those responsible for the decisions. The following box presents a case where policy was implemented based on the failure to recognize that there is a significant amount of interdependence in the U.S. economy.

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**Unintended Consequences**

Many a cliché seems to center on pork. The head of the household is supposed to " put bacon on the table," "pork barrels," and politicians are frequently accused of being in too close a proximity. It only seems fitting that one more story concerning pork should be brought to your attention.

During World War II, farmers in the corn belt argued that regulation of the price of pork had no effect on the war effort, and that they should be permitted to sell their commodities without government interference. The farmers brought political pressure to bear on the Congress and our representatives to deregulate the price of pork. The end result was to shut down the steel mills in Gary.

Shut down our steel mills? How could this be?

Since it is not intuitively obvious how this happened, I'll explain. In 1942, there had been a change in management in the Philippines. And, as luck would have it, we didn't have good trade relations with the new management -- the Japanese. Therefore, we did not have access to Manila fibre, necessary in making everything from rope to battleships. We had not yet developed synthetic fibre and therefore has to rely on the fibre previously available. That fibre was hemp.

Now hemp grows in the same places, under the same climatic conditions as does corn. Corn is what hogs eat. And because corn was not being grown in the Midwest, the farmers sought alternative feed for the increased number of hogs they were raising. (Remember, increased price results in a larger quantity supplied.) oats, wheat and barley were available from the Great Plains region. The problem was shipping it to where the hogs were raised in the Corn Belt of the Lower Midwest.
In their search for transportation, the farmers found that railroads were regulated and reserved for military and heavy industry; trucks needed gasoline and rubber, both in short-supply; and airplanes were being built almost exclusively for military purposes.

This left the farmers without a ready source of domestic transportation for the needed grain. But they eventually found a source of shipping that was neither regulated nor controlled, because it was international in nature -- the iron-ore barges on the Great Lakes.

They bid up the price and the barges started hauling oats to the pigs and stopped hauling ore to the Gary steel mills. And there you have it: Without the requisite iron ore the steel mills could not produce; they were actually shut down for a period as a direct result of deregulating the price of pork.

U.S. Economy

This story shows fairly conclusively that private interests can damage society as a whole. While our economic freedom is one of the prime ingredients in making our economy the grandest in the world, such freedom requires that it be exercised in a responsible fashion, lest the freedom we prize becomes a source of social harm. Like anything else, economic freedom for one group may mean disaster for another, through no fault of the victims. Government and the exercise of our democratic responsibilities is supposed to provide the checks on the negative results of the type portrayed in the above box.

Statistical Methods in Economics

The use of statistical methods in empirical economics can result in errors in inference. Most of the statistical methods used in econometrics (statistical examination of economic data) rely on correlation. **Correlation is the statistical association of two or more variables.** This statistical association means that the two variables move predictably with or against each other. To infer that there is a causal relation between two variables that are correlated is an error. For example, a graduate student once found that Pete Rose's batting average was highly correlated with movement in GNP during several baseball seasons. This spurious correlation cannot reasonably be considered path-breaking economic research.

On the other hand, we can test for causation (where one variable actually causes another). **Granger causality states that the thing that causes another must occur first, that the explainer must add to the correlation, and must be sensible.** As with most statistical methods Granger causality models permit testing for the purpose of rejecting that a causal relation exists, it cannot be used to prove causality exists. These types of statistical methods are rather sophisticated and are generally examined in upper division or graduate courses in statistics.
As is true with economics, statistics are simply a tool for analyzing evidence. Statistical models are also based on assumptions, and too often, statistical methods are used for purposes for which they were not intended. Caution is required in accepting statistical evidence. One must be satisfied that the data is properly gathered, and appropriate methods were applied before accepting statistical evidence. Statistics do not lie, but sometimes statisticians do!

**Objectivity and Rationality**

Objective thinking in economics also includes rational behavior. The underlying assumptions with each of the concepts examined in this course assumes that people will act in their perceived best interest. Acting in one's best interests is how rationality is defined. The only way this can be done, logically and rigorously, is with the use of marginal analysis. This economic perspective involves weighing the costs against the benefits of each additional action. In other words, if benefits of an additional action will be greater than the costs, it is rational to do that thing, otherwise it is not.

**KEY CONCEPTS**

Economics,
Microeconomics,
Macroeconomics,
Empirical economics v. Theoretical economics,
Inductive logic v. Deductive logic,
Model Building,
Assumptions,
Occam’s Razor,
Normative economics v. Positive economics,
Policy formulation,
Public v. Private,
Objective Thinking,
Fallacy of Composition,
Cause and effect,
Bias
Correlation v. causation,
Cost-benefit analysis.
1.2 Introduction to Macroeconomics

As stated earlier, Economics is a social science which studies individuals and organizations engaged in the production, exchange and consumption of goods and services.

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There are two basic categories of economics: Microeconomics and Macroeconomics. These two divisions enabled us to study economics from a small and broad perspectives. The degree of aggregation is the key yardstick by which they are formally distinguished.

Macroeconomics is the study of aggregate units and relationships between the units. Our concern here is with Macroeconomics. It attempts to analyze the causes of unemployment, inflation, slow growth and consequently attempts to find remedies to cure them. Moreover, it applies to such areas as monetary, development and international economics. The solving of macroeconomic problems requires the application of policies based on an understanding of the complex individual decisions that affect the general level of economic activity in an economy.

The central theme of macroeconomic analysis is the national income, also referred to as the Gross Domestic Product (GDP) or Gross National Product (GNP).

DEFINITIONS OF MACROECONOMICS

1. Macroeconomics can simply be referred to as the study of the economy as a whole.
2. Macroeconomics is the study of the economy as a whole and is concerned with aggregates.
3. Macroeconomics studies the aggregate level of economic activity, such as the total level of output, the level of national income, the total level of employment and the general price level for the economy viewed as a whole.
4. Macroeconomics studies the behavior of economy-wide measures such as the Gross Domestic Product (i.e. the value of the final output that the economy produces in a given year) as well as categories that cut across many markets, such as the total employment in the telecom or oil industry.

Economy

An economy is an area in which people make, or produce goods and services. This area can be of any size, with any number of people involved. For example, we can talk of a local economy, such as the production activities that take place in a village, town or city. We can also talk of a national economy, such as the Nigerian economy. In turn, the Nigerian economy is part of the African economy along with other countries like South Africa, Egypt, Ghana and Cote d’Ivoire amongst others. Indeed, every country in the world can be considered an economy as long as it is involved in the production of goods
and services. Similarly, all countries together make up the world economy, otherwise known as the global economy.

Thus, an economy is a mechanism that allocates scarce resources among competing uses. And in allocating scarce resources among uses competing for them, an economy operates through a system of inter-related working parts.

**Key Regional and Economic Groups**

1. Group of Two (G2)
2. Group of Seven (G7)
3. European Union (27 countries)
4. Organization for Economic Cooperation and Development (OECD, 36 countries)
5. North American Free Trade Agreement (NAFTA) [pending replacement by USMCA]
6. Organization of Petroleum Exporting Countries (OPEC)
7. African Union (55 Countries)
9. Sub-Saharan Africa (45 countries)
10. Economic Commission of West African States (ECOWAS, 16 countries)
11. Common Market for Eastern and Southern Africa (COMESA)
12. Commonwealth of Independence States (former USSR, 15 countries), etc.

**Distinction between Microeconomics and Macroeconomics**

In Microeconomics, the focus of analysis is the individual. In other words, microeconomics is concerned with the study of economic behavior of the individual agent(s) in the economy. In macroeconomics, however, the focus shifts to the aggregate. The focal point then becomes the economy as a whole and not individual parts of it.

In reality, there is a thin dividing line between microeconomics and macroeconomics. However, it is still possible to make some distinctions between the two:

**General/Broad/Definitional Distinction:**

On a more general view, Macroeconomics studies the economy as a whole or in major components such as households, business and government. It deals with the aggregate level of output and employment, the level of national income and the general price level. It also deals with total private expenditures, total investments, total government expenditures and total imports and export of goods and services. It seeks the causes and cures of unemployment, inflation, slow growth/recession and balance of payments deficits.

Microeconomics, on the other hand, studies the economic behavior of individual decision-making units such as consumers, resource owners and business firms in a free-enterprise system. It deals with how an individual consumer spends his incomes to maximize satisfaction,
how a business firm combines resources or factors of production to maximize profits and is determined by demand and supply. Microeconomics further studies how these individual decisions are affected by different forms of market organization.

**Specific Distinctions:** On the most basic level

1. Macroeconomics looks at the interdependency among all sectors of the economy for policy analysis. On the other hand, Microeconomics offer a detailed treatment of one aspect of economic behaviors but ignore their interaction with the rest of the economy.

2. In Macroeconomics, we are more concerned with general national issues such as the total employment, money and banking, aggregate national output and the general price level amongst others, whereas in Microeconomics we are concerned with the optimization decisions of households and firms.

3. Macroeconomics studies the total amount of employment of each of the major factors of production, with special attention to the total amount of labour employed; whilst, Microeconomics takes the total volume of employed resources as given and studies how the employed resources are allocated among their alternative uses.

4. Macroeconomics studies the total volume of output produced, and income earned in the whole economy. On the other hand, Microeconomics studies the details of this output as determined in thousands of individual markets as well as the details of the distribution of the accrued corresponding income.

5. Macroeconomics studies the average level of prices in all product markets and the average level of money wage rates in all labour markets. Microeconomics takes these level as given and studies the structure of relative product prices, as determined in all of the economy’s individual factor markets. In short, Microeconomics is concerned with the structure of the relative wages and prices, whilst Macroeconomics is concerned with the average level of absolute, or wages and prices.

6. Macroeconomics does study some allocation problems, but at a fairly high level of aggregation. For instance, Macroeconomics is concerned with the allocation of total resources and of total expenditure between consumers’ goods and capital goods. Microeconomics on the other hand, usually deals with the allocation of resources at a more disaggregated level.

7. Lastly, Macroeconomics focus on the growth of the total economy whilst Microeconomics takes a more disaggregated approach by looking at changes in output in the individual market.

In summary

The basic problem in Microeconomics is the determination of the allocation of resources, and the basic theory is that of the determination of relative prices through demand and supply.
The basic problem in Macroeconomics is the determination of total employment, output and the price level, and the basic theory is that of the determination of national income through aggregate demand and supply.

Just as we noted earlier, there is a very strong interdependency between Microeconomics and Macroeconomics. Presently, the branch of economics called General Equilibrium Theory seeks to bring together the two aspects of economics.

Interestingly also, because Macroeconomics focus more on the economy as a whole, they receive greater attention from the people and students alike since they affect their lives directly or indirectly, for example, high inflation rate, unemployment rate, recessions in the economy, balance of payment problem, and foreign exchange rate amongst others.

**SCOPE OF MACROECONOMICS/ MAIN ISSUES IN MACROECONOMICS/ MACROECONOMIC GOALS AND PERFORMANCES**

In macroeconomics, we talk about goals and evaluate the performance of an economy in terms of the goals.

An economy must efficiently produce the maximum amount of the goods and services most desired by its people if it is to attain the basic goal of satisfying as many human wants as possible. Among other desired goals of an economy are:

i. High level of employment and production. In other words, full employment of an economy’s productive factors;
ii. Stable prices;
iii. Balance of payment equilibrium; and
iv. Equitable distribution of income and wealth.

In most cases, emphasis is the first three.

**(1) High Level of Employment and Production**

Gross output in an economy is produced by a combination of labour and capital which are employed in the production process. The output of an economy would be maximized if all its factors of production are all employed and are also efficiently used. Unfortunately, this is not always obtained. Modern economics is characterized by gross unemployment and underemployment of factors of production which therefore keep level of output permanently below potential or maximum output level. It is therefore one of the goals of Macroeconomics to see how available level of output can be brought close to its potential level by minimizing unemployment and underemployment of factors of production.
Unemployment is a measure of the number of people who are not employed but who by some measure or another, are looking for a job. The unemployment rate is the percentage of the labour force that is unemployed. The labour force or the working population is the total of the employed, the self-employed and the unemployed, i.e. those who have, plus those who would like to have work.

The Unemployed figure \((U)\) is calculated thus:

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U = \frac{\text{Number of unemployed}}{\text{Working Population}} \times 100\%
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Full employment is assumed to be in existence when the unemployment rate ranges between 2 to 3%, and this occurs when the number of vacancies matches the number of unemployed.

Thus, Macroeconomics seeks to examine the causes and cures of unemployment, and thereafter being able to evaluate proposed programmes that are designed to reduce unemployment.

(2) **Stable Price Level**

Each country seeks to control rapid increases or fluctuation in price level. This is because rising or fluctuating prices may keep products out of the hands of those who would otherwise be able to obtain them and in so doing, change the distribution of the goods and services produced by the firms in the economy. Periods of rising prices is usually associated with the periods of inflation. Inflation occurs when there is a general increase in the price level. As we shall see later, Inflation produces much negative effects and only little positive effect on an economy. For instance, it reduces the purchasing power of those on fixed income like the salary earners and the pensioners. Additionally, Inflation may also reduce the levels of savings in the economy since much money would now be required by households to make their basic purchase. However, despite the debilitating effects of Inflation, many economies have found it difficult to control the rapid rate of inflation in their domestic economies.

In reality, there is no economy with zero inflation rate, as a dynamic, growing economy’s price level ranges between 1 and 2% each year. Hence, when studying macroeconomics, you will examine the causes and cure of inflation, and evaluate government policy aimed at promoting price stability.

(3) **High and Rising Economic Growth**

Economics growth refers to increases in the real output level. It occurs when an economy is producing a larger volume of goods and services. It implies a means by which the poor can be better off, without taking income away from others. Economic growth generally occurs when there’s an increase in real Gross National Product (GNP) or Gross Domestic Product (GDP).

Economic growth can occur if previously unemployed resources are employed, or there is increase in quantity and quality of economic resources. However, a major limitation of this growth is that it only recognizes changes in output level but neglects other welfare indicators, like literacy level, life
expectancy level, leisure, poverty level etc. In addition, it ignores the ever-increasing output levels. Despite its limitations, economic growth is still commonly accepted to reflect welfare level and every country desire increase in her economic growth rate.

Macroeconomic examines the causes of economic growth and its problems in the economy, especially in the developing countries.

**4) A satisfactory Balance of Payments Position and Exchange Rates**

The Balance of Payments records a country’s transaction with other countries in a particular year. It includes money which enters and leaves the country.

Major components here include balance of visible trade (value of visible imports and exports), balance of invisible trade (services such as shipping, insurance, banking, management, consulting, telecom etc.) and capital movement accounts.

**5) Equitable Distribution of Income and Wealth**

This is another area which has increasingly crept into realms of Macroeconomics. It is now a stated Macroeconomic objective of every country to promote equity in distribution of income which is associated with increasing rate of economic growth.

**6) Sustainable Development**

Government are now concerned about the natural environment and wants to improve, protect and sustain it. Hence, government strongly encourage environmentally friendly policies i.e. not harming the environment. For instance, global warming which is the increase in the earth’s atmosphere caused by the increase in particular gases, especially carbon dioxide leads to the greenhouse effect.

**The Specific Issues of Macroeconomics are also as follows:**

1. The level of resources utilization in the whole economy, particularly total labour employment, average capacity (capital stock) utilization and the extent of utilization of national savings or investible resources.

2. The determination of aggregate demand or expenditure such as national consumption, gross domestic investment, total imports, total exports, government expenditure and how these affect the national income and the level of employment.

3. The objectives and effects of government expenditure (fiscal policy) as they relate to national income, price stability and inflation, labour employment and balance of payments.
4. The general price level or average index of all major price.

5. The level and role of money supply in the economy and the average interest rate.

6. The expansion of the economy’s capacity to produce and the variables influencing such growth in output capacity of the nation.

7. International trade as it affects the whole economy in terms of national income, balance of payments, national or foreign debt and external reserves.

**REVIEW QUESTIONS**

**Question 1**

Define, Explain and Illustrate the following concepts:

(a) Microeconomics  
(b) Macroeconomics  
(c) Unemployment  
(d) Inflation  
(e) Economic growth  
(f) Balance of payment  
(g) Income distribution

**Question 2**

What are the major differences between Microeconomics and Macroeconomics?

**Question 3**

(a) Which of the two sub-divisions of Economics (Micro and Macro) is generally more appealing?  
(b) Why do you think people are more concerned with one than the other?

**Question 4**

What are the main issues and problems being addressed by Macroeconomics?