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college of commerce & management



# SYLLABUS

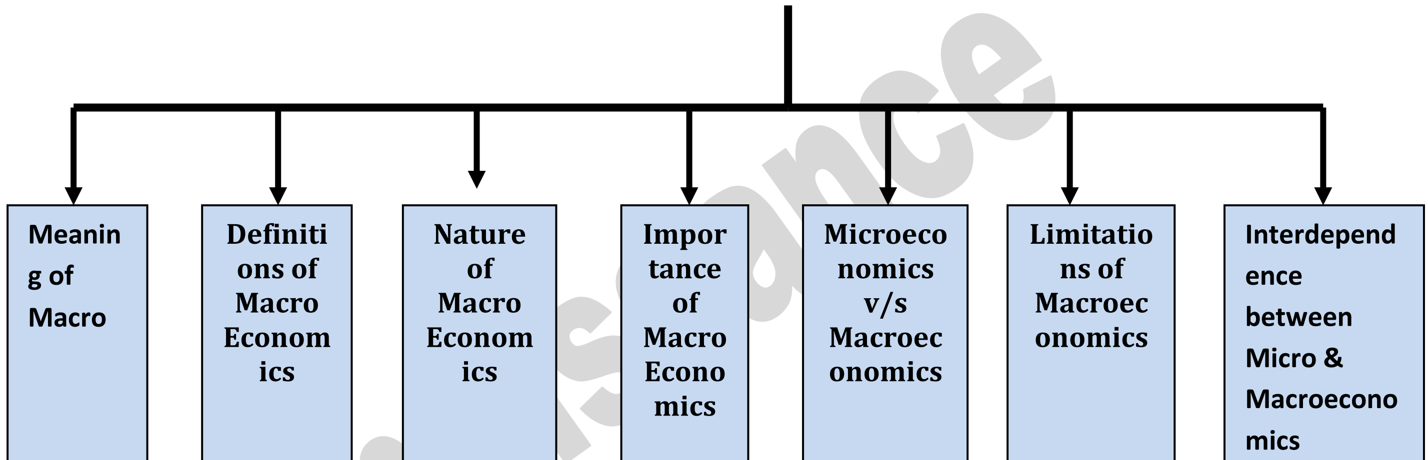
## B.Com I YEAR (Hons.)

### Subject – MACRO ECONOMICS

| | |
|---|---|
| **UNIT – I** | Macro economics – concept, nature, importance, limitations, difference between micro and macro economics. |
| **UNIT – II** | National Income – Meaning, definition, concept, Methods for measuring national income in India and its problem. |
| **UNIT – III** | Theories of wages, Interest and employment. |
| **UNIT – IV** | Monitory Theories – Quantity theory of Money, Modern theory of Money, Keynes's Theory of Money and Price. |
| **UNIT – V** | Recent Industrial Policy, Industrial Growth in Phase-II and III Disinvestments, Foreign Direct Investment. |

**UNIT-I**

**OVERVIEW OF UNIT 1**




## Macro

The term macro in English has its origin in the Greek term "macros" which means large. In the context of 'Macroeconomics' means economics of the large like economy as a whole. Macro economics deals primarily with the analysis of the relationship between broad economic aggregates like national income, level of total employment, aggregate consumption, total investment, general price level, balance of payment, the quantity of money etc. Macroeconomics is also known as the theory of income & employment as it is concerned with the problems of on employment, economic fluctuation, inflation or deflation international trade and economic growth.

## Definitions of Macro Economics

1) **According to culberton's-**"Macro Economics is the theory of income, employment, price and money."
2) **Accordingly to K.E. Boulding –**"Macro economics deals not with individuals quantities as such but with aggregate income, but with national income, not with individuals price but with price levels, not with individuals output but with national output."
3) **According to Edward Shapiro – "**Macro economics attempts to answer the truly 'big' question of economic life – full employment or unemployment, capacity or under capacity production."

## Nature of Macro Economics

1) Macro economics studies the concept of national income and its different elements and the method of measurement.
2) It studies problems relating to employment and unemployment. It studies different factors determining the level of employment.
3) Determination of general price level is also studied under macro economics. Problems relating to inflation and deflation are an important component of macro economics.
4) Change in demand and supply of money have an important impact on the level of employment. Macroeconomics studies function of money & theories relating to it.

5) Problems relating to economic growth is another important component of macro economics like plans for overall increase in national income, output, employment are framed so the economic development of economy as a whole.
6) It also studies issues relating to international trade, export, import exchange rate and balance of payments are the principal issue in this context.

## Importance of Macro Economics

1) Macro economics is helpful for getting us an idea of the functioning of an economic system. It is very essential for a proper and adequate knowledge of behavior pattern of the aggregative variable, as the description of a large and complex economic system.
2) It says about the study of national income and social accounts. It is the study of national income which enables us to know that three fourth of the world is living in object poverty without proper national difficult to formulate proper economic policies.
3) Macroeconomic approaches are of almost importance to analyze and understand the effect of inflation and deflation different sections of society are affected differently as a result of charges in the value of money.
4) Economic fluctuation is a characteristics features of the capitalist form of economy. The economic booms and depression in the level of income and employment follow one another in cyclical fashion.
5) The study of macro economics is essential for the proper understanding of Micro economics. No micro economics law could be framed without a prior study of the aggregate.

## Limitations of Macroeconomics

Following are the main limitations of macro economics:-

1.***Excessive Thinking***:-Macro economics suffers from the limitations that it always excessively thinks in the terms of aggregates and presumes circumstances to be normal and homogeneous but aggregates may result into heterogeneous character. As Prof. Boulding points:

(a) Six apples+Seven apples=Thirteen apples which constitutes a meaningful aggregate.
(b) Six apples+Seven oranges=Thirteen fruits, which constitutes a fairly meaningful aggregates.
(c) Six apples+Seven shoes constitutes a meaningless aggregates.

2.***Difference in individual items***:-Sometimes while aggregating the variables, the basic characteristics of the data or the variables is left untouched because there are important differences in the items. Sometimes, the features of individual components may not be true to the aggregate so macro suffers from the danger of excessive generalization.

3.***Unable to influnce society equally***:-An aggregative tendency may not influence the entire sectors of the economy in the same way. For example, a general rise in price as inflation may not similar effects on different sectors of the economy.

4.***Contradictory***:-In aggregates, sometime the contradictory individual aspects are neutralized as in case of the estimation, prices in agriculture fall, of industrial products rise which have different affects on individual factors but as an aggregate, there may not be any effect at all. Thus, macro aggregate results may be misleading.

5.***Role of less aggregative analysis***:-Aggregates itself suffer from certain serious problems due to

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statistical techniques. The recently introduced computational procedures and programming techniques have reduced the role of aggregative analysis.

## Microeconomics V/s Macroeconomics

| S.No. | Points | Microeconomics | Macroeconomics |
|---|---|---|---|
| 1 | **Study** | It studies individual unit | It studies aggregate or group of individual units. |
| 2 | **Assumption** | At micro level full employment is assumed which is never found in an economy. Hence this is an unreal assumption | At macro level, full employment is not assumed. Instead equilibrium employment is assumed which is a real assumption. |
| 3 | **Subject Matter** | We study demand supply, consumer behavior production, types of market, theory of cost & revenue etc. | We study national income, theory of wage, interest & employment, Theory of money, theory of international trade etc. |
| 4 | **Applicability** | It is useful in analysis of an individual unit like cost of an individual good, demand of a single good, price of a single good. | It is useful in analysis of aggregate units such as aggregate demand, aggregate prices or inflation-deflation, aggregate or national income etc. |
| 5 | **Usefulness to Govt.** | It is less useful to Govt. in formulating economic policies. | It is more useful to Govt. in formulating economic policies. |

**INTERDEPENDENCE BETWEEN MICRO AND MACRO ECONOMICS**

Micro and macro economics are the two sides of the same coin. There is close interdependence between the two. We cannot analyse the individual behaviour without the assuming to aggregate and likewise aggregate cannot be effective unless individual variables are kept under consideration.

Micro economics contributes towards macro economics in a number of ways as:-

1.***Study of economic fluctuations***:-Business cycles which are universal in every sector, are influenced by both individuals and aggregate factors. Unless we review both micro and aggregate variables, we cannot provide an appropriate solution to business cycles. Therefore to study trade cycles micro and macro economics contribute significantly.

2.***Basis of economic laws***:-Micro economics acts as a basis macro economics because macro is an aggregate of individual units. The success and accuracy of aggregates depends on the individual units. Similarly, macro theories are used by micro economists.

3.***Role in international trade***:-In international trade both the approaches are used. Economists have developed their theories on the basis of micro economics presuming full employment of resources and mobility of factors of production. However, modern economists looked on the economy as a whole and recognized the role of aggregates. So general equilibrium is nothing but an extension of equilibrium of micro economics.
4.***Balance of payments and interdependence***:-Balance of payments problem is also a burning problem for economy. An individual sector may have favorable balance of payments whereas other sectors, unfavourable balance of payments. On the other hand, the overall position of an economy is to be assessed from aggregate position of all sectors.
5.***Theory of tariffs***:-Many economists have propounded that modern macro approaches of imposing tariffs with the intention of correcting balance of payments position is virtually based on the theory of monopoly. So micro economics has influenced the modern macro economics theory.

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## UNIT-II
## DEFINITIONS OF NATIONAL INCOME

**Marshall's Definition**

"The labour and capital of a country acting on its natural resources produce annually a certain net aggregate of commodities, material and immaterial, including services of all kinds. This is the true net annual income or revenue of the country or national dividend."

**Pigou's Definition**

"National income is that part of the objective income of the community, including of course income derived from abroad, which can be measured in money."

"A national income estimate measures the volume of commodities and services turned out during a given period counted without duplication."

"The aggregate value of all final goods and services produced by the residents of a country, operating both within the national boundary and abroad, in any particular year, is called the national income of the country."

**Characteristics of National Income –**

1) National income is estimated in monetary terms. This may be expressed at current prices or some base year prices.
2) Only the value of final goods and services are taken into account for measuring national income.
3) National income is always expressed with respect to a given time period. Hence, it is a 'flow' concept.
4) All types of 'pure exchange transactions' are excluded from national income accounting. In case of pure exchange transactions, nothing new is produced in the current year. For instance, second-hand sales, purchase and sale of securities (shares and debentures), transfer payments (such as unemployment dole, pension payments) etc. are regarded as pure exchange transactions. All such transactions are not concerned with current year production. So, they are excluded from national income estimates.
5) National income is not simply the sum of all personal incomes in a country.

**Difference between Domestic Income and National Income –**

| S.No. | National Income | Domestic Income |
|---|---|---|
| 1 | It includes income earned by the residents only. | It includes income earned by the residents as well as non-residents. |
| 2 | It consists of income earned both within and outside the domestic territory of a country. | It consists of income earned only within the domestic territory. |
| 3 | It is an economic concept. | It is a geographic concept. |
| 4 | It includes net factor income from aborad. | It does not include net factor income from abroad. |
| 5 | National income = Domestic income + Net factor income from aborad. | Domestic income = National income – Net factor income from abroad. |

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**Net factor income from abroad** is the difference between the income received by the residents from abroad for rendering factor services (e.g., banking and insurance services, other financial services, engineering services, etc.) and the income paid for the factor services rendered by the non-residents in the domestic territory of a country.

## CONCEPTS OF NATIONAL INCOME

**1) Gross Domestic Product (at market prices):**

The gross domestic product at market price (GDPmp) indicates the value of all final goods and services produced within the domestic territory of a country during any particular year. These goods and services are valued at the prevailing market prices of those goods and services.

**2) Net domestic product (at market prices):**

The Net domestic product at market prices (NDPmp) refers to the value of all final goods and services at the prevailing market prices within the domestic territory of a country during any particular year after making allowance for the consumption of fixed capital or depreciation allowance.

NDPmp = GDPmp – Depreciation allowance

**3) Gross National Product (at market price) :**

The Gross National Product at market prices (GNPmp) refers to the aggregate market value of all final goods and services produced by the residents of a country during any particular year.

**4) Net National Product (at market prices):**

The net national product at market prices (NNPmp) refers to the market value of all final goods and services produced by the residents of a country after allowing for the depreciation of fixed capital during any particular year. Thus, if we deduct the consumption of fixed capital or the depreciation allowance from the GNPmp, we get NNPmp.

NNPmp = GNPmp – Depreciation allowance

**5) Gross Domestics Product (at factor cost):**

The Gross Domestic Product at factor cost (GDPfc) refers to the estimation of GDP in terms of the aggregate earnings of factors of production.

**6) Gross National Product (af factor cost):**

The Gross National Product at factor cost (GNPfc) refers to the GNP in terms of factor incomes. It is the aggregate earnings received by different factors of production (i.e., wages, rent, interest and profits) supplied by the residents of a country during any particular year.

**7) Net Domestic Product (at factor cost):**

The net domestic product at factor cost (NDPfc) estimates the NDP in terms of the aggregate factor incomes of the residents and non-residents within the domestic territory of a country during any particular year.

**8) Net National Product (at factor cost):**

The net national product at factor cost (NNPfc) to the value of the final goods and services produced by the residents of a country, whether operating within the domestic territory or outside it, at their factor costs. It is also termed as the National Income of a country.

**9) Private Income**

Central Statistical Organization defines Private Income as "the total of factor income from all sources and current transfers from the government and rest of the world accruing to private sector" or in other words the private income refers to the income from socially accepted source including retained income of corporation.

**NI+ Transfer payment + Interest on public debt +Social security + Profit and Surplus of public enterprises = Private Income**

**10) Personal Income**

Prof. Peterson defines Personal Income as "the income actually received by persons from all sources in the form of current transfer payments and factor income. In other words, Personal Income is the Total income received by the citizens of a country from all sources before direct taxes in a year.

**PI = Private Income + Undistributed Corporate Profits – Direct Taxes**

**11) Disposable Income**

Prof. Peterson defined Disposable Income as "the income remaining with individuals after deduction of all taxes levied against their income and their property by the government."

Disposable Income refers to the income actually received by the households from all sources. The individual can dispose this income according to his wish, as it is derived after deducting direct taxes.

**DI = Personal Income - Direct taxes – Miscellaneous receipt of the government.**

## Methods of calculating National Income

**A) Value added or production or output approach**

1) The output approach focuses on finding the total output of a nation by directly finding the total value of all goods and services a nation produces.

2) Problem of Double counting: Because of the complication of the multiple stages in the production of a good or service, only the final value of a good or service is included in the total output. This avoids an issue often called 'double counting', wherein the total value of a good is included several times in national output, by counting it repeatedly in several stages of production. In the example of meat production, the value of the good from the farm may be Rs10, then Rs 30 from the butchers, and then Rs 60 from the supermarket. The value that should be included in final national output should be Rs 60, not the sum of all those numbers, Rs 90. The values added at each stage of production over the previous stage are respectively Rs 10, Rs 20, and Rs 30. Their sum gives an alternative way of calculating the value of final output.

**B) Income method**

The income approach equates the total output of a nation to the total factor income received by residents or citizens of the nation. The main types of factor income are:

- Employee compensation/ salaries & wages (cost of fringe benefits, including unemployment, health, and retirement benefits);
- Interest received net of interest paid;
- Rental income (mainly for the use of real estate) net of expenses of landlords;
- Royalties paid for the use of intellectual property and extractable natural resources.
- Corporate Profits

### C) Expenditure or Consumption method

The expenditure approach is basically an output accounting method. It focuses on finding the total output of a nation by finding the total amount of money spent. This is acceptable, because like income, the total value of all goods is equal to the total amount of money spent on goods

$$GDP = C + I + G + (X - M)$$

**Where:**

**C** = household consumption expenditures / personal consumption expenditures
**I** = gross private domestic investment
**G** = government consumption and gross investment expenditures
**X** = gross exports of goods and services
**M** = gross imports of goods and services
Note: (**X - M**) is often written as $X_N$, which stands for "net exports"

**PROBLEMS OF CALCULATING NATIONAL INCOME IN INDIA**

1) **Difficulty in defining the nation** – As the world has become a global village, it is very difficult to identify the national boundaries has become difficult.
2) **Non-marketed service** – Services like love, kindness, and mercy has economic value but have no money value.
3) **Possibility of double counting** – The possibility of double counting which arises from the failure to distinguish properly between a final and intermediate product.
4) **Transfer payment** – Individual get pension, unemployment allowance and interest on public loans, but whether these should be included in national income is a difficult problem. The best way to solve the difficulty is to consider only the disposable income of individual or personal income minus all transfer payments.
5) **Capital gains or losses** – Commodity product this year is sold next year if at higher price is capital gain & at loss then capital losses e.g. other example could be selling of shares.
6) **Income earned through illegal activities** –Such as gambling or illicit extortion cannot be included in national income.
7) **Self-consumed production** – In many backward countries, substantial part of the output is not exchanged for money in market it is being either consumed directly by producer or bartered for other goods & services in the unorganized sector.
8) **Paucity of statistics** – According to the national income committee of India, the available statistics, especially for agriculture & small scale industry are extremely unreliable & incomplete.
9) **Inflation may give a false impression of growth in national income** – In a country when price rise, inflation rises even though the production falls & vice versa. It leads to mis-measurement of national income. ,
10) **Difficulties in classifying the commodities** – Coal is both household use & industrial use as well ,so is the expenditure on coal consumption , expenditure or an investment.
11) **Multiple occupations** – The production in agri-industrial, in all sectors is highly scattered and unorganized making the calculation of national income very difficult.
12) **Capital depreciation** – Depreciation is charged on profit which lowers national income. But the problem of estimating the current depreciated value of a piece of capital whose expected life is forty year is very difficult.
13) **Data problems** – There are problems of collecting reliable statistical data abort all the productive activities in the underdeveloped countries.
14) **Illiteracy** – The majority of people in the country like India are illiterate & they do not keep any accounts about the production & sole of their products.