Importance and Uses of Microeconomics

Microeconomics occupies a vital place in economics. It has both theoretical and practical importance. It may be summarised as under :

(1) It is highly helpful in the formulation of economic policies that will promote the welfare of the masses.

(2) It is Microeconomics that tells us how a free market economy with its millions of consumers and producers works to decide about the allocation of resources among the thousands of goods and services.

(3) According to Prof. D. S. Watson, "Microeconomic theory explains the composition or allocation of total production, why more of some things are produced than of others. He further remarked that microeconomic theory has many uses. The greatest of these is the depth of understanding of how a free private enterprise economy operates.

(4) It tells us how the goods and services produced are distributed among the various people for consumption through price or market mechanism.

(5) It explains the conditions of efficiency in consumption and production and highlights the factors which are responsible for the departure from the efficiency or economic optimum. On the basis of this microeconomic theory experts suggest suitable policies to promote economic efficiency and welfare of the masses.

(6) Microeconomic theory facilitates the understanding of models of behaviour which are helpful in achieving individual and social objectives. They help not only to describe the actual economic situation but also to suggest policies that would most successfully and most efficiently bring about desired results and to predict the outcomes of such policies and other events.

(7) According to Prof. A.P. Lerner, "Microeconomics teaches us that completely direct running of the economy is an impossibility .....That a modern economy is so complex that no central planning can obtain all the information and give out all the directives necessary for its efficient operation. These would have to include directives for adjusting to continual changes in the availabilities of millions of productive resources and intermediate products...It can be achieved by the development of a decentralised system whereby the millions of producers and consumers are to be induced to act in the general interest without the intervention of anybody."

(8) The study of microeconomic theory is also usefully applied to the various applied branches of public finance and international economics.

Thus, we conclude that microeconomic analysis is most useful and important branch of modern economic theory.

Limitations of Microeconomics

Though microeconomics analysis is very useful in Economics, it has its *limitations*. *Firstly*, what is true in the case of individual units may not be true in the case of aggregates. For example, *individual* thrift may be good, but *social* thrift is definitely harmful for the community. If the entire community starts saving more, effective demand will be reduced and employment retarded. Likewise, wage-cutting in a *particular* firm may promote employment, but *general* wage-cutting may actually result in reducing the volume of employment. The results of microeconomic analysis should, therefore, be applied to the aggregates with caution.

Secondly, the microeconomic analysis assumes other things equal, and is based on the assumption of full employment in society. This is a highly unrealistic assumption. What exists in society normally is not full employment but underemployment. As Keynes pointed out, "To assume full employment is to assume our difficulties away."

Thirdly, microeconomics instead of studying the *total* economy, concentrates only on small parts of it. Consequently, it throws no light on the collective functioning of the national economy.

Fourthly, there are certain economic problems which cannot be analysed with the aid of microeconomics. For example, important problems relating to public finance, monetary and fiscal policy, etc., are beyond the purview of microeconomics.

This, however, does not imply that microeconomic analysis is not useful for macroeconomic studies. Several microeconomic studies throw light on macroeconomic problems. The study of individual family budgets, for example, can throw light on the consumption of the community.

MACROECONOMICS

Meaning

Macroeconomics may be defined as that branch of economic analysis which studies the behaviour of not one particular unit, but of all the units combined together. Macroeconomics is a *study in aggregates*. Hence, it is often called *Aggregative Economics*. It is the study of the economic system as a whole. It is the study of the overall conditions of an economy, say, total production, total consumption, total saving and total investment. Prof. Kenneth E. Boulding puts it, "Macroeconomics deals not with individual quantities as such, but with aggregates of these quantities ; not with individual incomes but with the national income ; not with individual prices but with the price level ; not with individual outputs but with the national output."[1] It, thus, deals not with one family but all the families taken together ; not with one firm but all the firms in an economy ; not with one industry but the entire industrial structure of an economy. *Macroeconomics deals with the great averages and aggregates of the system rather than with particular units in it*. It studies the behaviour of *macro-quantities* or *macro-variables*. Since macroeconomics splits up the economy into big lumps (or sectors) for the purpose of study, it is also called the *Method of Lumping*. John Maynard Keynes' famous work, *General Theory of Employment, Interest and Money*, published in 1936, is an outstanding example of *macro-economics*. The Keynesian economists had developed macroeconomics to "full flower" by the 'sixties.

Scope/Field of Macroeconomics

The scope/field covered by macroeconomics may be set forth below :

1. Theory of Income, Output and Employment with its two constituents, namely, the theory of consumption function and the theory of investment function. The theory of business cycles (or, economic fluctuations) is also a part and parcel of the theory of income, output and employment.

2. Theory of Prices with its constituents of the theories of inflation, deflation and reflation.

3. Theory of Economic Growth dealing with the long-run growth of income, output and employment as applied to developed and underdeveloped countries.

4. Macro Theory of Distribution dealing with the relative shares of wages and profits in the total national income.

Types of Macroeconomics

Like microeconomics, macroeconomics is also of three types : (i) *Macrostatics*, (ii) *Comparative Macrostatics*, and (iii) *Macrodynamics*.

1. *Macrostatics*. It is a method which is used to explain certain aggregative relations in a *stationary* state. It throws no light on the process by which the national economy reaches *final* equilibrium. Macrostatics deals with the final equilibrium of the economy at a *particular* point of time. It does not study the *path* by which the economy reaches equilibrium. It is a technique of analysing the relations between macro-variables in the final position of equilibrium without detailing the process of adjustment implicit in that position of equilibrium. This method presents a 'still' picture of the economy as a whole at a particular point of time. We can illustrate this method with the following Keynesian equation :

$$Y = C + I$$

where, Y = Total Income.

C = Total Investment.

I = Total Investment.

This equation merely tells us that Y is equal to the aggregate of C and I. But it throws no light on the process by which this equality between Y on the one side and $C+I$ on the other side has been reached. In other words, the process of adjustment (leading to the establishment of the final equilibrium) does not come into limelight at all under macrostatics.

2. *Comparative Macrostatics*. As we know, the various macro-variables in an economy, such as, total consumption, total investment and total income, etc. keep on changing with the lapse of time. As a result, the economy keeps on reaching different levels of equilibria. The method of comparative macrostatics involves a comparative study of the different equilibria attained by the economy. But the method does not detail the *process of adjustment* by which the economy moves from one equilibrium to another. In brief, comparative macrostatics presents 'still' pictures of the various equilibria reached by economy. These 'still' pictures enable us to undertake a comparative study of the various equilibria for our benefit.

For example, the quantity theory of money tells us that the price level in an economy is influenced by changes in the quantity of money. Suppose, the economy is already in equilibrium with a certain price level. Then suppose, the quantity of money is increased. Now the existing equilibrium is disturbed and after a series of disequilibria, a new equilibrium is established at

1 Boulding, K. E., *A Reconstruction of Economics* (1950), p. 3.