

CBSE Class–12 Economics
NCERT Solutions
Chapter-01 (Macroeconomic)
Introduction

1: What is the difference between microeconomics and macroeconomics?

Ans:

S No	Points of Difference	Microeconomics	Macroeconomics
1	Origin	The word micro comes from a Greek word 'Mikros' which means small.	The word macro comes from a Greek word 'Mackros' which means large.
2	Definition	It is a branch of economics that studies the economic relationships or issues at an individual level like the households, the firms, the consumers etc.	It is a branch of economics that studies the economic relationships or issues of an economy as a whole.
3	Objective	Its main objective is to analyse the principles, problems and policies for the achievement of the goal of optimum allocation of resources.	it investigates the principles, problems and policies relating to achievement of full employment and expansion of productive capacity.
3	Deals with	It deals with how consumers or the producers make decisions depending on their given budget and other variables.	It deals with how different economic sectors like households, industries and other government and foreign sectors make their decisions.
		The method of partial	The method of general

4	Method	equilibrium (i.e. equilibrium in one market) is used.	equilibrium (i.e. equilibrium in all the markets, simultaneously) is used.
5	Assumptions	It assumes that while studying micro economics, macro variables remains constant.	Study of macro economics assumes that micro variables remains constant.
6	Variables	The major variables involved are price, consumer's demand, wages, rent, profit, firm's revenue, cost, etc.	The major variables involved are aggregate demand, aggregate supply, inflation, unemployment, poverty, etc.
7	Significant role	In the context of micro economics 'market mechanism' plays an important role.	In the context of macro economics 'government' plays a significant role.
8	Theories	Various theories studied are: 1.Theory of Consumer's Behaviour and Demand 2. Theory of Producer's Behaviour and Supply 3. Theory of price Determination under different market conditions	Various theories studied are 1. Theory of National Income 2. Theory of Money 3. Theory of General Price level 4. Theory of Employment 5. Theory of International trade
9	Popularized by	Alfred Marshal	Keynes

2. What are the important features of a capitalist economy?

Ans: Capitalist economy is an economic system governed by capitalist i.e., where the means of production are privately owned. It is primarily run by price mechanism, without any interference of government. Its main motive is to earn profit. This economic structure is also known as free market economy or laissez faire.

Following are the features of a capitalist economy:

1. Role of the government: The government doesn't interfere in the day-to-day economic activities. This means producers are free to take decisions. The government provides the basic framework for the smooth functioning of an economy is responsible for maintenance of law and order, justice, growth and stability, Defence, etc.

2. Profit motive: The economic agents are driven by the prime motive of profit maximization.

3. Central problems: The central problems of an economy are solved by the market forces of demand and supply, i.e., the law of demand and supply operates here. The producers will supply only those goods and services that are demanded by the economy.

4. Role of private sector: The role of private individuals is more dominant. The main role of undertaking production and organizing factors of production are played by the private individuals and capitalists.

5. Laissez-faire: This economy is also called 'laissez faire'. It has minimum interference or restriction from the government.

3. Describe the four major sectors in an economy according to the macroeconomic point of view.

Ans: The four major sectors of an economy according to the macroeconomic point of view are:

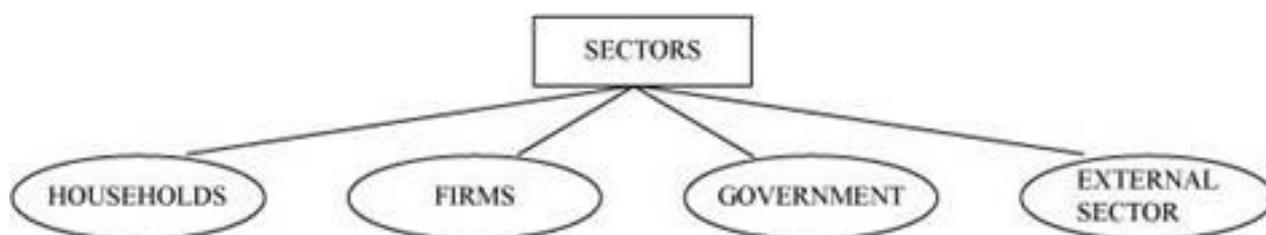
i. Households

ii. Firms

iii. Government

iv. External sector

These can be represented in the following flow chart:



i. Households: Household means a single individual or a group of individuals who independently take decisions regarding their economics activities (i.e., consumption and production). Household sector buy goods and services for consumption and also supply factors of production like land, labour, capital, and entrepreneur. Households provide the market for the output of the firms.

ii. Firms: Firms are economic units that carry out the production. They employ and organize factors of production and undertake production process for the motive of profit making.

iii. Government: A state/government provides law and order, maintains growth and stability and provides administrative services. The main motive of a government is to undertake developmental projects such as dams, roads, heavy industries that usually have long gestation periods by imposing taxes. The government invests in education, health sector and provides these services at nominal price. The motive of a government is to serve and not to make profits.

iv. External sector: This sector is engaged in export and import (external trade) of goods and services. If domestically produced goods and services are sold to the rest of the world, then it is called export. If the goods and services are purchased from the rest of the world, then it is called import. Apart from export and import of goods, there can be inflow of goods (i.e., a country inviting capital from foreign countries) and outflow of foreign capital (i.e., investing in foreign countries).

4. Describe the Great Depression of 1929.

Ans: The Great Depression was a severe economic crisis that started in the year 1929. It was the longest and deepest and most widespread depression of 20th century. In 21st century, the Great Depression is commonly used as an example of how far an economy can decline. It originated in the United States of America when the stock market crashed which results in

the beginning of a decade of high unemployment, poverty, low profit and deflation and it gradually spread to other countries of the world. The worldwide GDP fell by 15% as compared to less than 1% during the Great Recession in 2008-2009. The main cause behind this crisis was the fall in aggregate demand due to under consumption and over investment. Aggregate supply was greater than aggregate demand which resulted into depressing activities. Due to under consumption and over investment the stock of finished goods started piling up, which resulted in low price level and consequently the low profit level. The money in the economy was converted into unsold stock of finished goods that lead to an acute fall in employment and hence income level fell drastically. The demand for goods in the economy was so low that the production was lowered leading to the unemployment. In USA, the rate of unemployment increased from 3% to 25%.

The Great depression has its own implications and importance in economics, as it leads to the failure of the classical approach of economics. Those who believed in the market forces of demand and supply, paved the way for emergence of the Keynesian approach. It was this incident that provided the economists with sufficient evidence to recognize macroeconomics as a separate branch of economics.

The cause and effect relationship of the Great Depression can be summed up in this flow chart

Low demand → overinvestment → low level of employment → low level of output → low income → low demand.