Introduction

Chapter 1 Introduction Exercise Solutions

Exercise : Solutions of Questions on Page Number : **7**

Q1 :
What is the difference between microeconomics and macroeconomics?

Answer :

Points of Difference		**Microeconomics**	**Macroeconomics**
1.	Definition	It is a branch of economics that studies the economic variables at an individual level like the households, the firms, the consumers etc.	It is a branch of economics that studies the economic variables of an economy as a whole.
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.
4	Method	The method of partial equilibrium (i.e. equilibrium in one market) is used.	The method of general equilibrium (i.e. equilibrium in all the markets, simultaneously) is used.
4.	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.

5	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
6	Popularised by	Alfred Marshal	Keynes

Q2 :
What are the important features of a capitalist economy?

Answer :

Capitalist economy is an economic system where the means of production are privately owned. These means of production are driven by the motive of profit making. 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 provides the basic framework for the smooth functioning of an economy. It provides the basic framework and 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 organising 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.

Q3 :
Describe the four major sectors in an economy according to the macroeconomic point of view.

Answer :

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

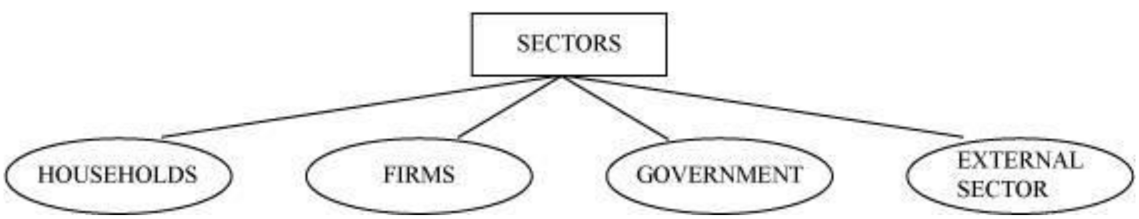
1. Households

2. Firms

3. Government

4. External sector

These can be represented in the following flow chart:



1. Households

Households 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.

2. Firms

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

3. 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. 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.

4. 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.

Q4 :
Describe the Great Depression of 1929.

Answer :

The Great Depression was a severe economic crisis that started in the year 1929. It originated in the United States of America with the crash of the stock market and gradually spread to other countries of the world. The main cause behind this crisis was the fall in aggregate demand due to under consumption and over investment. 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 recognise 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.