Microeconomics vs. Macroeconomics

Axis STEM Academy

Jolly/Honors Econ.

Macroeconomics vs. Microeconomics

- Microeconomics examines the functioning of individual industries and the behavior of individual decision making units - business firms and households.

- Macroeconomics focuses on the *determinants of total national income*, deals with aggregates such as *total consumption and investment*, and looks at the *overall level of prices* instead of individual prices.

Gross Domestic Product (GDP)

Nominal GDP is the value of all nationally produced goods and services sold on the market during particular time interval.

Real GDP is the value of the total production of all the nation's farms, factories, shops, and offices linked back to the prices of a single year

Real GDP adjusts the value of total output to correct for changes in prices.

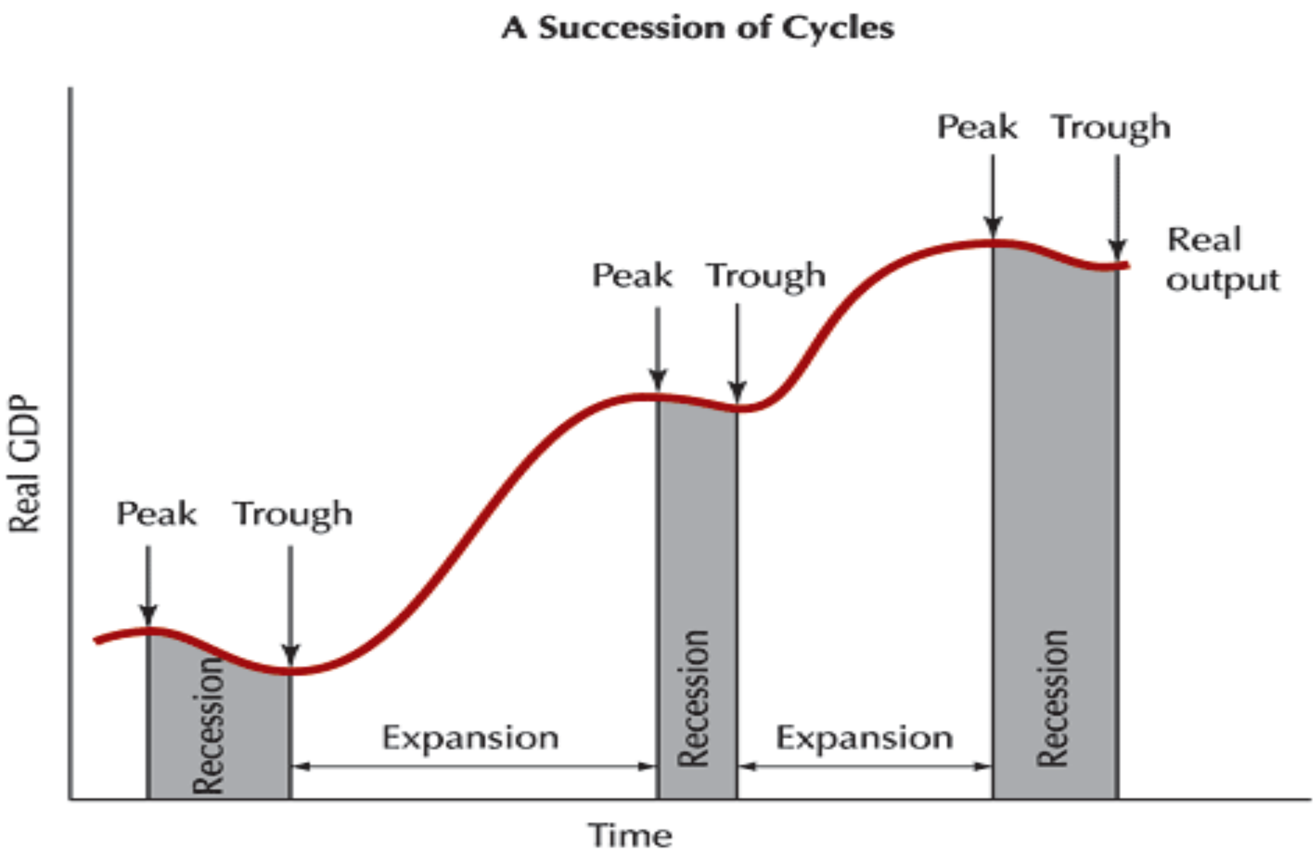
Timeframes: Short Run vs. Long Run

The **short run** lasts from 1-5 years and the main issue is the stability of the economy.

- The ups and downs (or economic fluctuations) of an economy are part of the **business cycle**. The business cycle has the following phases:
  - Expansion
  - Contraction

The **long run** ranges from one to several decades and is concerned with economic growth.

Figure 1-1
Basic Business-Cycle Concepts



Business-Cycle Concepts

- A **recession** is a period during which real GDP decreases for two successive quarters.
- An **expansion** is a period during which real GDP increases.
- When a business cycle expansion ends and a recession begins, the turning point is called a **peak**.
- When a business cycle recession ends and a recovery begins, the turning point is called a **trough**.

The Role of Stabilization Policy

A **Stabilization Policy** is any policy that seeks to influence the level of aggregate demand.

- **Monetary policy** tries to influence aggregate demand by changing the ***money supply*** and/or ***interest rates***.
- **Fiscal policy** tries to influence aggregate demand by changing ***government spending*** and/or ***tax rates***.

The "Internationalization" of Macroeconomics

- A **closed economy** has no trade in goods, services, or financial assets with any other nations.
- An **open economy** exports and imports goods and services to and from other nations, and has financial flows to and from foreign nations.

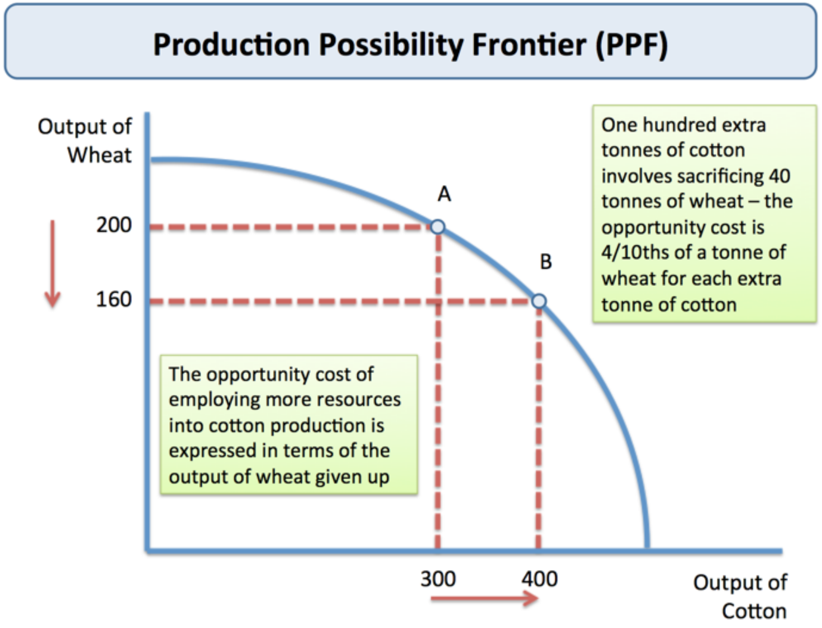
Issues of Macroeconomics

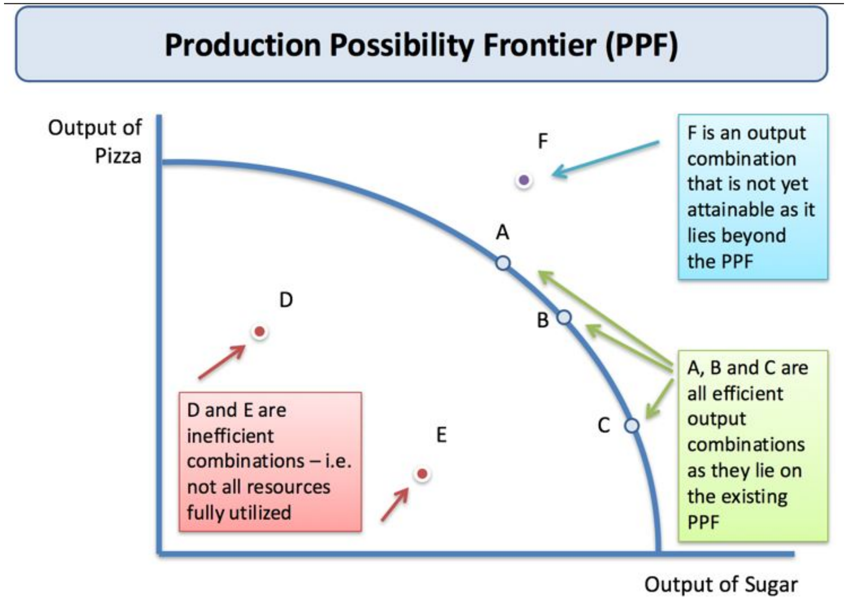
Macroeconomic Problems

1) Economic Growth
2) Unemployment
3) Inflation
4) Deficits

Economic Growth

- Economic growth is the expansion of the economy's production possibilities
- Measured by real GDP





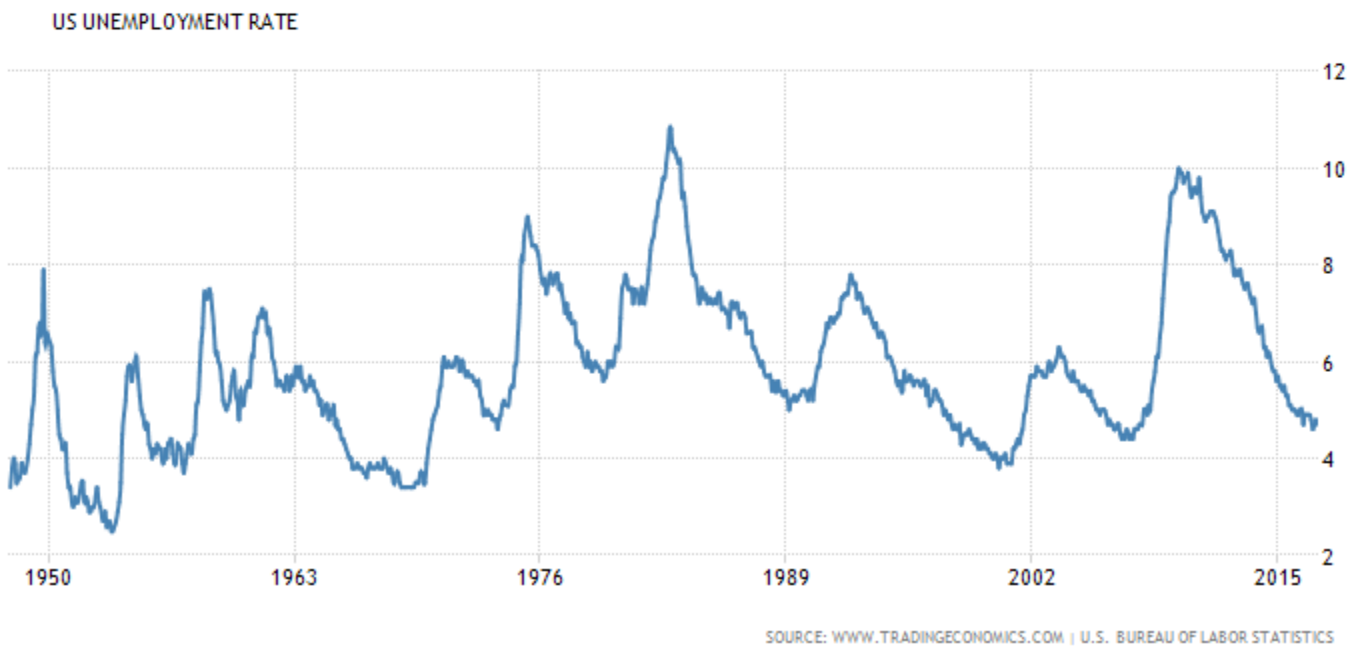
Unemployment

Unemployment is defined as a state in which a person does not have a job but:

- is available for work,
- is willing to work, and
- has made some effort to find work within the previous four weeks.

Unemployment

Unemployment



Types of unemployment

Unemployment can be classified into three types:

- Frictional
- Structural
- Cyclical

Types Of Unemployment

Frictional unemployment is unemployment that arises from normal labor market turnover.

- The creation and destruction of jobs requires that unemployed workers search for new jobs
- Increases in the number of young people entering the labor force raises frictional unemployment

Types Of Unemployment

- **Structural unemployment** is unemployment created by changes in technology and foreign competition that change the the skills necessary to perform jobs and the locations of jobs vs. the skills and location of the labor force
- **Cyclical unemployment** is the fluctuation in unemployment caused by the business cycle

Types Of Unemployment

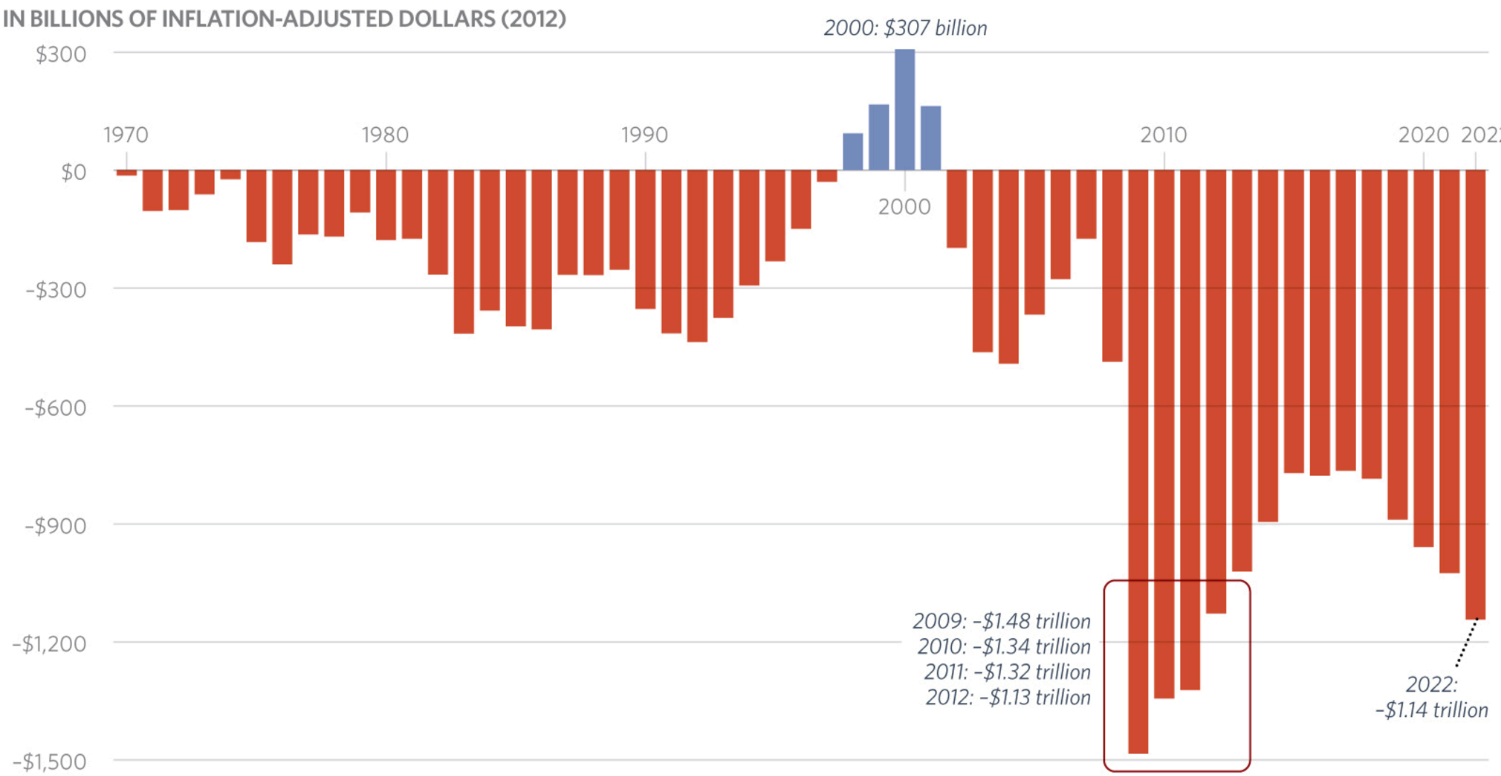
- **Full employment** occurs when there is no cyclical unemployment or, equivalently, when all unemployment is frictional or structural
- The unemployment rate at full employment is called the **natural rate of unemployment**
- This rate is roughly 4% - 5%

Inflation

- **Inflation**: an increase in the overall price level
- **Deflation:** a decrease in the overall price level
- **Stagflation:** Occurs when the overall price level rises rapidly (inflation) during periods of recession or high and persistent unemployment (stagnation)

Deficits

A government budget **deficit** exists if a government spends more than it collects in taxes.



Sources: Office of Management and Budget, *Budget of the U.S. Government, FY 2013: Historical Tables*, Table 1.1, February 2012, http://www.whitehouse.gov/omb/budget/Historicals (accessed August 8, 2012), and Congressional Budget Office, *An Update to the Budget and Economic Outlook: Fiscal Years 2012 to 2022*, Alternative Fiscal Scenario, August 22, 2012, http://cbo.gov/publication/43543 (accessed August 23, 2012).

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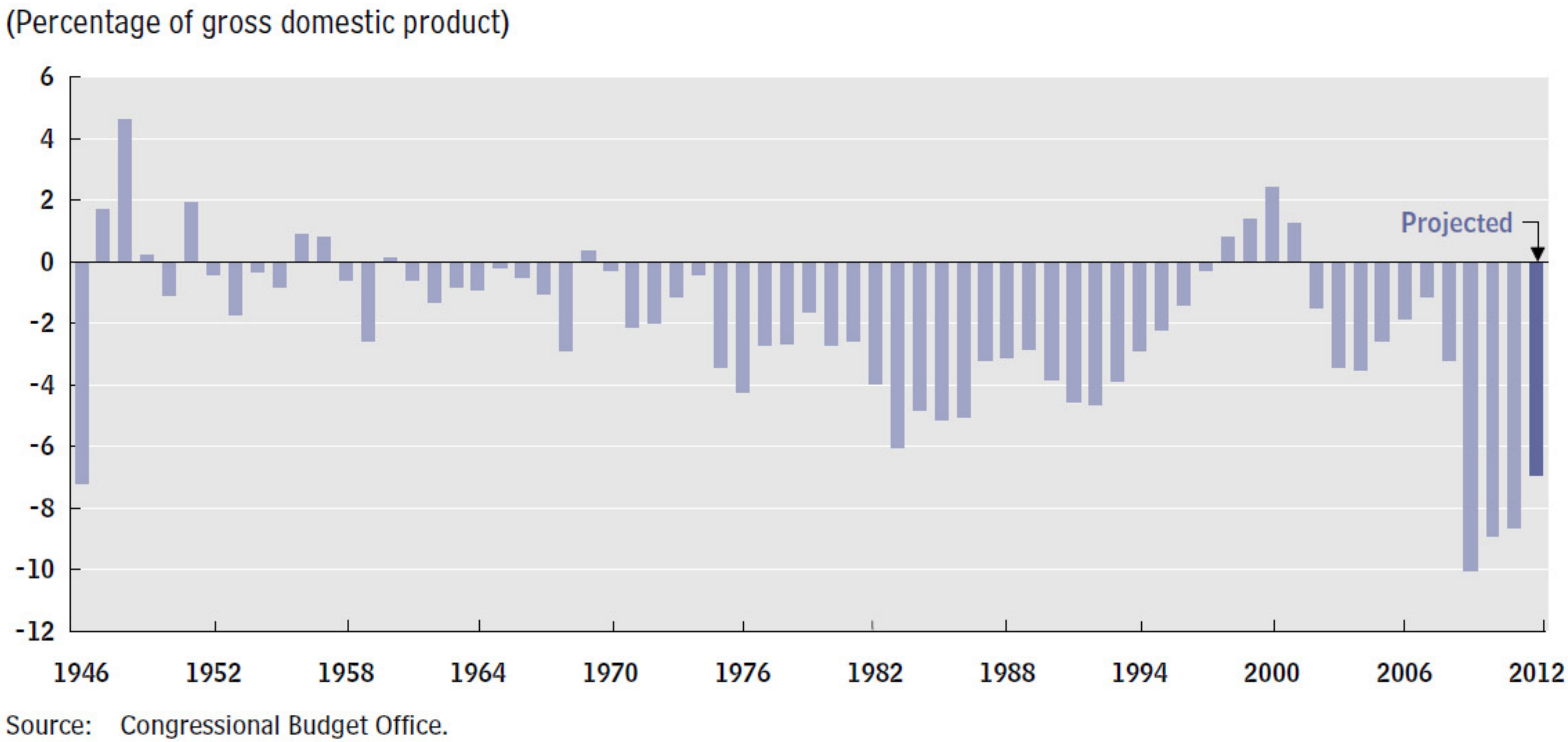
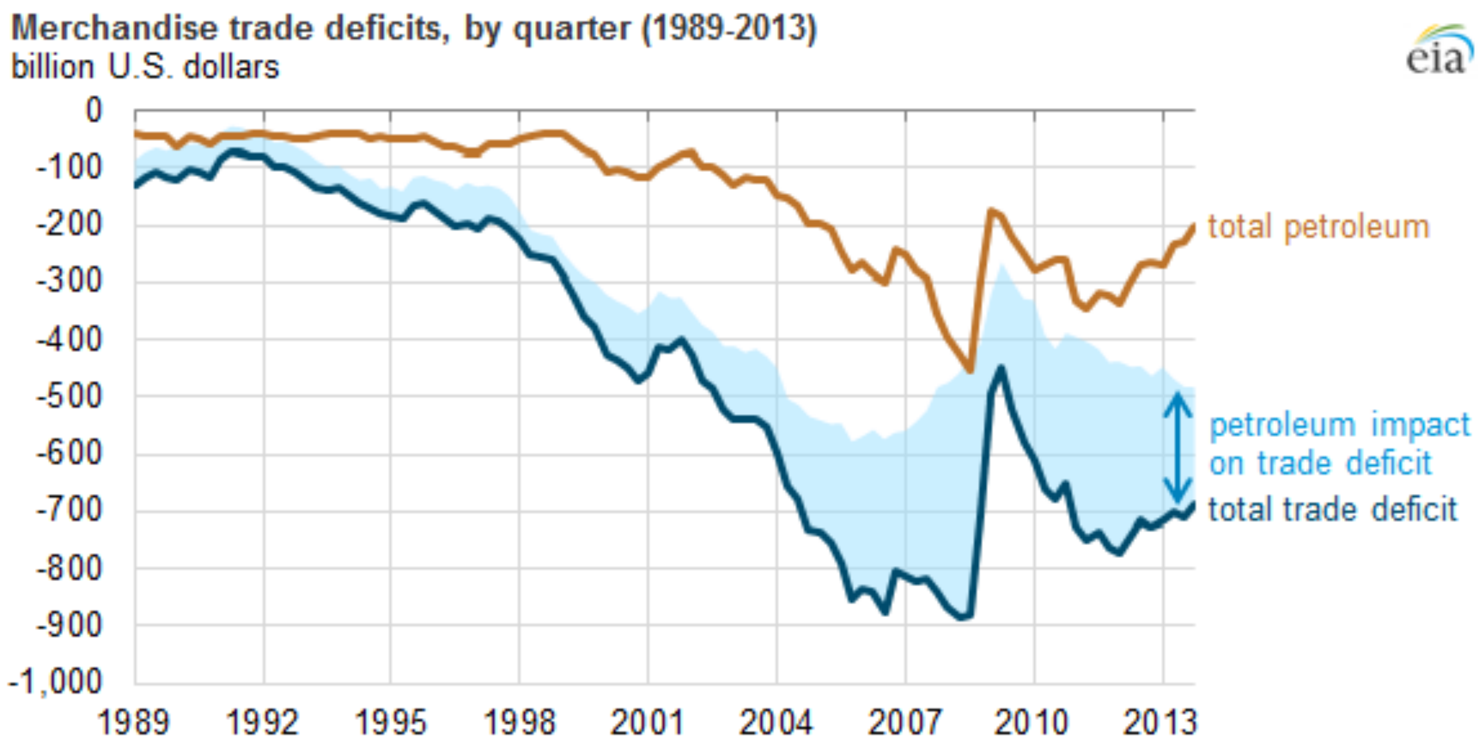


Deficits

An international deficit (or **trade deficit**) exists if imports exceed exports.



Debt

Debt is the total of all previous years' deficits *plus* interest owed on those deficits (which will be paid to bondholders – those who have 'loaned' money to the government by buying bonds).

(Go to usdebtclock.org)

The Components of The Macro Economy

Macroeconomics focuses on four groups:

- households
- firms which together compose the private sector
- the government (the public sector)
- international sector (the rest of the world)

Households

Households work for firms and the government & they receive wages for their work. Households also receive interest on corporate and government bonds and dividends from stocks. Many households receive other payments from the government such as Social security benefits. Economists call these payments from the govenment **transfer payments**. Households spend by buying goods services from firms and by paying taxes to the governments.

Firms

Firms sell goods and services to households and government. These sales earn revenue. Firms pay wages, interest and dividends to households and they pay taxes to the government.

Governments

The government collects taxes from households and firms. The government also makes payments. It buys goods and services from firms, pays wages and interest to households and makes transfer payments to households.

Rest Of The World

- Households spend some of their income on imports - goods and services produced in the rest of the world.
- Additionally, people in foreign countries purchase exports - goods and services produced by domestic firms and sold to other countries.

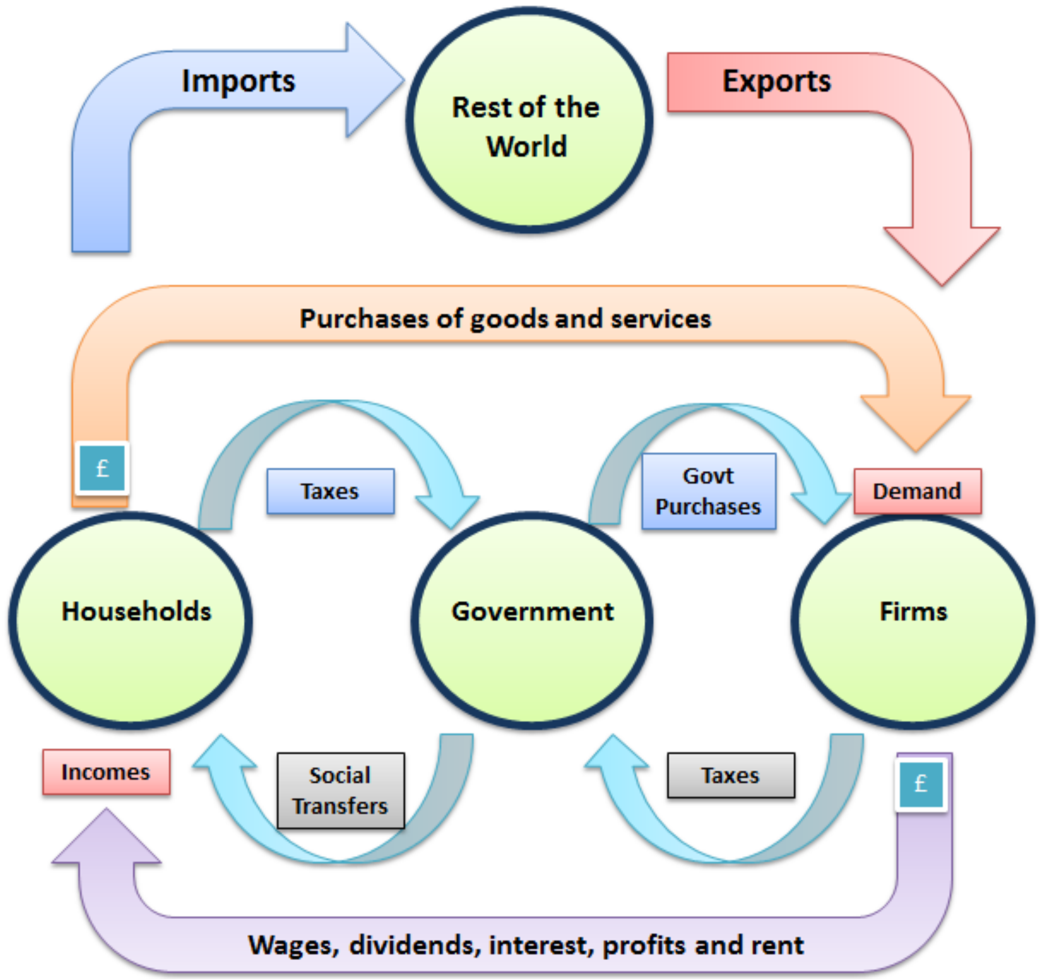
The Components of The Macro Economy

The External Trade Sector of the Economy

The Domestic Circular Flow of Income

Made up of

Households
Government
Firms



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