FACULTY OF JURIDICAL SCIENCES

Lecture-2

DEVELOPMENT OF MACROECONOMICS

Macroeconomics is a branch of economics that studies how an overall economy—the market or other systems that operate on a large scale—behaves. Macroeconomics studies economy-wide phenomena such as inflation, price levels, rate of economic growth, national income, gross domestic product (GDP), and changes in unemployment.

Some of the key questions addressed by macroeconomics include: What causes unemployment? What causes inflation? What creates or stimulates economic growth? Macroeconomics attempts to measure how well an economy is performing, to understand what forces drive it, and to project how performance can improve.

Macroeconomics deals with the performance, structure, and behavior of the entire economy, in contrast to microeconomics, which is more focused on the choices made by individual actors in the economy (like people, households, industries, etc.).

- Macroeconomics is the branch of economics that deals with the structure, performance, behavior, and decision-making of the whole, or aggregate, economy.
- The two main areas of macroeconomic research are long-term economic growth and shorter-term business cycles.
- Macroeconomics in its modern form is often defined as starting with John Maynard Keynes and his theories about market behavior and governmental policies in the 1930s; several schools of thought have developed since.
- In contrast to macroeconomics, microeconomics is more focused on the influences on and choices made by individual actors in the economy (people, companies, industries, etc.).

History of Macroeconomics

While the term "macroeconomics" is not all that old (going back to the 1940s), many of the core concepts in macroeconomics have been the focus of study for much longer. Topics like unemployment, prices, growth, and trade have concerned economists almost from the very beginning of the discipline, though their study has become much more focused and specialized through the 20th and 21st centuries. Elements of earlier work from the likes of Adam Smith and John Stuart Mill clearly addressed issues that would now be recognized as the domain of macroeconomics.

Macroeconomics, as it is in its modern form, is often defined as starting with John Maynard Keynes and the publication of his book *The General Theory of Employment, Interest, and Money* in 1936. Keynes offered an explanation for the fallout from the Great Depression, when goods remained unsold and workers unemployed. Keynes's theory attempted to explain why markets may not clear.

Prior to the popularization of Keynes' theories, economists did not generally differentiate between micro- and macroeconomics. The same microeconomic laws of supply and demand that operate in individual goods markets were understood to interact between individuals markets to bring the economy into a general equilibrium, as described by Leon Walras. The link between goods markets and large-scale financial variables such as price levels and interest rates was explained through the unique role that money plays in the economy as a medium of exchange by economists such as Knut Wicksell, Irving Fisher, and Ludwig von Mises.

Throughout the 20th century, Keynesian economics, as Keynes' theories became known, diverged into several other schools of thought.

Macroeconomic Schools of Thought

Classical

Classical economists held that prices, wages, and rates are flexible and markets tend to clear unless prevented from doing so by government policy, building on Adam Smith's original theories. The term "classical economists" is not actually a school of macroeconomic thought, but a label applied first by Karl Marx and later by Keynes to denote previous economic thinkers with whom they respectively disagreed, but who themselves did not actually differentiate macroeconomics from microeconomics at all.

Keynesian

Keynesian economics was largely founded on the basis of the works of John Maynard Keynes, and was the beginning of macroeconomics as a separate area of study from microeconomics. Keynesians focus on aggregate demand as the principal factor in issues like unemployment and the business cycle. Keynesian economists believe that the business cycle can be managed by active government intervention through fiscal policy (spending more in recessions to stimulate demand) and monetary policy (stimulating demand with lower rates). Keynesian economists also believe that there are certain rigidities in the system, particularly sticky prices that prevent the proper clearing of supply and demand.