



*Introductory*  
*Macroeconomics*

**Textbook in Economics for Class XII**



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NCERT

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# Foreword

The National Curriculum Framework (NCF) 2005, recommends that children's life at school must be linked to their life outside the school. This principle marks a departure from the legacy of bookish learning which continues to shape our system and causes a gap between the school, home and community. The syllabi and textbooks developed on the basis of NCF signify an attempt to implement this basic idea. They also attempt to discourage rote learning and the maintenance of sharp boundaries between different subject areas. We hope these measures will take us significantly further in the direction of a child-centred system of education outlined in the National Policy on Education (1986).

The success of this effort depends on the steps that school principals and teachers will take to encourage children to reflect on their own learning and to pursue imaginative activities and questions. We must recognise that, given space, time and freedom, children generate new knowledge by engaging with the information passed on to them by adults. Treating the prescribed textbook as the sole basis of examination is one of the key reasons why other resources and sites of learning are ignored. Inculcating creativity and initiative is possible if we perceive and treat children as participants in learning, not as receivers of a fixed body of knowledge.

These aims imply considerable change in school routines and mode of functioning. Flexibility in the daily time-tables is as necessary as rigour in implementing the annual calendar so that the required number of teaching days are actually devoted to teaching. The methods used for teaching and evaluation will also determine how effective this textbook proves for making children's life at school a happy experience, rather than a source of stress or problem. Syllabus designers have tried to address the problem of curricular burden by restructuring and reorienting knowledge at different stages with greater consideration for child psychology and the time available for teaching. The textbook attempts to enhance this endeavour by giving higher priority and space to opportunities for contemplation and wondering, discussion in small groups, and activities requiring hands-on experience.

The National Council of Educational Research and Training (NCERT) appreciates the hardwork done by the textbook development committee responsible for this textbook. We wish to thank the Chairperson of the advisory group in Social Sciences, Professor Hari Vasudevan, and the *Chief Advisor* for this textbook, Professor Tapas Majumdar, for guiding the work of this committee. Several teachers

contributed to the development of this textbook; we are grateful to their principals for making this possible. We are indebted to the institutions and organisations which have generously permitted us to draw upon their resources, material and personnel. We are especially grateful to the members of the National Monitoring Committee, appointed by the Department of Secondary and Higher Education, Ministry of Human Resource Development under the Chairpersonship of Professor Mrinal Miri and Professor G.P. Deshpande, for their valuable time and contribution. As an organisation committed to systemic reform and continuous improvement in the quality of its products, NCERT welcomes comments and suggestions which will enable us to undertake further revision and refinement.

New Delhi  
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*Director*  
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# Chapter 1

## *Introduction*



You must have already been introduced to a study of basic microeconomics. This chapter begins by giving you a simplified account of how macroeconomics differs from the microeconomics that you have known.

Those of you who will choose later to specialise in economics, for your higher studies, will know about the more complex analyses that are used by economists to study macroeconomics today. But the basic questions of the study of macroeconomics would remain the same and you will find that these are actually the broad economic questions that concern all citizens – Will the prices as a whole rise or come down? Is the employment condition of the country as a whole, or of some sectors of the economy, getting better or is it worsening? What would be reasonable indicators to show that the economy is better or worse? What steps, if any, can the State take, or the people ask for, in order to improve the state of the economy? These are the kind of questions that make us think about the health of the country's economy as a whole. These questions are dealt within macroeconomics at different levels of complexity.

In this book you will be introduced to some of the basic principles of macroeconomic analysis. The principles will be stated, as far as possible, in simple language. Sometimes elementary algebra will be used in the treatment for introducing the reader to some rigour.

If we observe the economy of a country as a whole it will appear that the output levels of all the goods and services in the economy have a tendency to move together. For example, if output of food grain is experiencing a growth, it is generally accompanied by a rise in the output level of industrial goods. Within the category of industrial goods also output of different kinds of goods tend to rise or fall simultaneously. Similarly, prices of different goods and services generally have a tendency to rise or fall simultaneously. We can also observe that the employment level in different production units also goes up or down together.

If aggregate output level, price level, or employment level, in the different production units of an economy,

bear close relationship to each other then the task of analysing the entire economy becomes relatively easy. Instead of dealing with the above mentioned variables at individual (disaggregated) levels, we can think of a single good as the representative of all the goods and services produced within the economy. This representative good will have a level of production which will correspond to the average production level of all the goods and services. Similarly, the price or employment level of this representative good will reflect the general price and employment level of the economy.

In macroeconomics we usually simplify the analysis of how the country's total production and the level of employment are related to attributes (called 'variables') like prices, rate of interest, wage rates, profits and so on, by focusing on a single imaginary commodity and what happens to it. We are able to afford this simplification and thus usefully abstain from studying what happens to the many real commodities that actually are bought and sold in the market because we generally see that what happens to the prices, interests, wages and profits etc. for one commodity more or less also happens for the others. Particularly, when these attributes start changing fast, like when prices are going up (in what is called an inflation), or employment and production levels are going down (heading for a depression), the general directions of the movements of these variables for all the individual commodities are usually of the same kind as are seen for the aggregates for the economy as a whole.

We will see below why, sometimes, we also depart from this useful simplification when we realise that the country's economy as a whole may best be seen as composed of distinct sectors. For certain purposes the interdependence of (or even rivalry between) two sectors of the economy (agriculture and industry, for example) or the relationships between sectors (like the household sector, the business sector and government in a democratic set-up) help us understand some things happening to the country's economy much better, than by only looking at the economy as a whole.

While moving away from different goods and focusing on a representative good may be convenient, in the process, we may be overlooking some vital distinctive characteristics of individual goods. For example, production conditions of agricultural and industrial commodities are of a different nature. Or, if we treat a single category of labour as a representative of all kinds of labours, we may be unable to distinguish the labour of the manager of a firm from the labour of the accountant of the firm. So, in many cases, instead of a single representative category of good (or labour, or production technology), we may take a handful of different kinds of goods. For example, three general kinds of commodities may be taken as a representative of all commodities being produced within the economy: agricultural goods, industrial goods and services. These goods may have different production technology and different prices. Macroeconomics also tries to analyse how the individual output levels, prices, and employment levels of these different goods gets determined.

From this discussion here, and your earlier reading of microeconomics, you may have already begun to understand in what