8/28/13

Macroeconomics Chapter 6

Macro vs Micro

Microeconomics focuses on how decisions are made by individuals and firms and the consequences of those decisions

This focuses on one actor in the economy, one person, one household, one firm and how they get their money and how much the y allocate money towards consumer spending etc.

For a firm it could be how much does the firm produce at what price and how much do they pay etc.

Individual decisions made by individual actors

The broadest part of micro is individual industries

Macroeconomics examine the aggregate behaviors of the economy ie how the actions of the individuals and firms in the economy interact to produce a particular level of economic performance

In macro the behavior of the whole macroeconomy is indeed different than the sum of individual actions and market outcomes

In the 30's it was believed if everyone pursued their own goals and acted responsibly then the economy would be fine, but this isn't true

Paradox of Thrift: when families are afraid of hard times and prepare by saving and cutting their spending

This reduction in spending depresses the economy as consumers spend less.

This causes firms to back off on production, so they lay off workers which then brings the household income down

As a result, families and businesses may end up worse off than if they hadn't tried to act responsibly by cutting their spending.

In the gulf war recession people began saving because they were afraid oil prices would go up and cause a rcession, which caused one

In fact incomes may fall enough to reduce what the private sector can save

Another example: the fallacy of composition: cutting wages may raise profits; but if all firms cut wages, this may lower demand for all products, thus lowering profits for all firms