ASIC CONCEPTS IN

Macro-economics

Neil Fuller

BASIC CONCEPTS IN MACRO-ECONOMICS

Neil Fuller

B.Sc., M.Sc., M.Inst. P.S.

Checkmate/Arnold

Basic Concepts in Macro Economics

First published in Great Britain 1984 by
Checkmate Publications,
4 Ainsdale Close, Bromborough, Wirral L63 0EU.

Reprinted with revisions 1985

Edward Arnold (Publishers) Ltd.,
41 Bedford Square, London WC1B 3DQ

Edward Arnold (Australia) Pty Ltd.,
80 Waverley Road, Caulfield East,
Victoria 3145, Australia

Edward Arnold, 3 East Read Street,
Baltimore, Maryland 21202, USA.

ISBN 0 946973 30 X

Text set in 10/12pt Times by Birkenhead Press Ltd. and
Merseyside Graphics Ltd.

Printed and bound by Richard Clay (The Chaucer Press),
Bungay, Suffolk

INTRODUCTION

This book is intended to assist students in the early stages of an economics course to understand some of the basic concepts involved in the subject, although it may also prove useful as a revision aid. Experience has shown that students frequently have difficulty at the outset where the issues are clouded by an excess of data and empirical results, although this is essential at a later stage. The objective here is therefore to produce a concise text which explains in simple terms the concepts involved. Having understood these concepts they should utilise other texts which take a more empirical approach, or the text could be supplemented with information provided by the teacher/lecturer during class exercises and data response work. In order to derive the maximum benefit from this book students should first read the companion text Basic Concepts in Micro Economics. This book covers the requirements in Macro Economics for an A level course, but will also be useful to students studying for the foundation stages of professional examinations, first year degree courses, and graduate conversion courses.

Neil Fuller

CARTOONS BY GRAHAM DAVIES

CONTENTS

Chapter 1
NATIONAL INCOME

1. National income refers to the aggregate, or total, income of the nation which results from economic activity. Income however depends upon how much output is produced and as output is a continuous process rather than a stock, we have to measure this output over a specified time period, usually one year. Total output is referred to as **NATIONAL PRODUCT**, and includes all the **GOODS** and **SERVICES** produced each year.

2. National income was defined by Alfred Marshall as "the aggregate net product of and sole source of payment to, all the agents of production." If this definition is studied closely we can identify three components:

2.1 Aggregate net product of, i.e. total output.
2.2 Sole source of payment, i.e. incomes.
2.3 All the agents of production, i.e. how the national product is distributed, and therefore the source of all expenditure.

3. From this definition we can identify three possible methods of measurement:

3.1 **OUTPUT**
3.2 **INCOME**
3.3 **EXPENDITURE.**

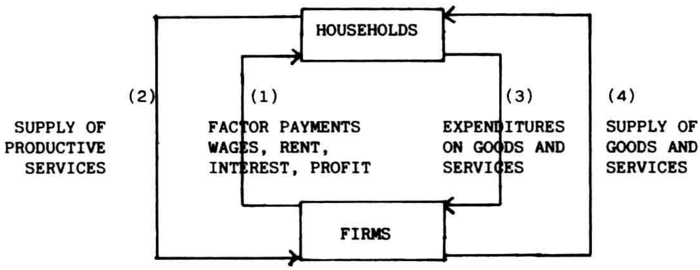
Measurement by either of these methods will produce identical results because theoretically:

NATIONAL INCOME = NATIONAL OUTPUT = NATIONAL EXPENDITURE

4. In order to understand the concept of income as a **FLOW** it is useful to study the **CIRCULAR FLOW OF INCOME** in the form of a **FLOW DIAGRAM.** If Diagram 1.1 is studied closely it can be seen that households provide the supply of productive services to firms and in return receive the factor rewards of wages, rent, interest and profit. These are the total of all incomes to households and will therefore form the basis of all expenditures. When expenditures are made with firms in the form of consumption then there must be an

equivalent flow of goods and services from firms to households. It is therefore possible to measure each of these flows and achieve the same result, hence the conclusion that National Income = National Output = National Expenditure. In reality the circular flow Diagram 1.1 needs to be highly qualified, for example much of national expenditure is in the form of investment expenditure between firms, however it does illustrate the concept of national income as a **FLOW**.

DIAGRAM 1.1



5. To summarise therefore national income can be regarded as:

5.1 **The total value of the goods and services produced by all the industries and public services during the year.**

5.2 The total expenditure on final goods and services for CONSUMPTION AND INVESTMENT purposes during the year.

5.3 The cost of national output in terms of all the earnings: in producing the national output.

6. National income is estimated in money terms as money is the most convenient 'measuring rod', however care must be taken in comparing national income over time as a rise in the monetary value of national income does not necessarily imply a rise in living standards. The only real measure of whether national income has grown is whether the **REAL** value of output has increased, and it is possible that any apparent increase is a result of rising prices. For this reason data must be 'deflated' by a suitable index before comparisons of national income between different time periods can be made. One method of deflating data is to use the Retail Price Index.