

Introduction to Economy

Economics: the discipline

- Scarce resources → Valuable commodities → Distribution
- Choice of organizations → impact society's use of resources
- “Science of Scarcity” – Lionel Robbins (1935)

Difference between Economics and Economy

- Economics comes out with theories
- Economy is the real picture after application of these theories

Focus of Economics

- Searching for possible alternatives for the betterment of human life.

Challenges of Economics

- Needs are never-ending
- Supply of one goods/service → Demand of another of higher order
- Solving one challenge and focusing on another.

Distribution network Models

1. State Model:

- State's responsibility of supplying goods and services
- No payment made by customer
- Distribution system of the former USSR and communist China

2. Market Model:

- Functions on basis of price mechanism
- Goods made available on basis of demand and supply
- Prices fixed in the open market, then distributed
- Distribution system of capitalist economies- the whole of Euro-America

3. State-Market mix:

- Most prevalent
- Came out of the experience of the former 2 systems
- Certain goods/services made available free/subsidized cost by the state
- Other goods supplied by the market

Capitalist Economy

- First proposed by Adam Smith → ‘Wealth of nations’ (1776)
- ‘invisible hand’ of ‘market forces’ → economic equilibrium
- Everything needs to be bought, nothing provided by state
- Market → private enterprises determines by way of demand, what to produce, how much to produce and at what price to sell
- State has no role (acts as regulator) in such an economy

State Economy

- Rooted in the ideas of Karl Marx (1818-1883)
- State acts as parents, selfless supply of products and services without any cost to the consumer
- First came up in USSR after Bolshevik revolution (1917)
- Got its ideal shape in People’s Republic of China (1949)
- Socialist economy (collective ownership) → erstwhile USSR
- Communist economy (absolute state ownership) → pre 1985 China

Mixed Economy

➤ Capitalist to mixed

- self-correcting’ & ‘invisible-hand’ → Great depression 1929
- Capitalist economy led to people having to buy everything, even basic necessities
- This led to shortage of purchasing power of people
- Which in turn led to a decline in demand
- Smithonian macro ideas failed to check the crisis

- “The General Theory of Employment, Interest and Money” → **John Maynard Keynes** 1936, brought new approach
- Governments started to supply basic goods and services
- This helped to increase demand

➤ State to mixed

- **Oscar Lange**, Polish philosopher suggested the same thing to State/Communist/Socialist economies
- He praised the Socialist economies, but wanted that it should include some of the features of capitalist economy
- He advised the state economies to adopt ‘market socialism’
- In 1985 China announced its ‘open door policy’

Role of State in an economy

- Acts as regulator in all types of economies
- As a producer/supplier of ‘private goods and services’ → State Economy
- As a producer/supplier of ‘public goods’ or ‘social goods’ → Mixed Economy (as well as State Economy)

Sectors of an Economy

1. Primary Sector: Economic activities where there is direct use of natural resources such as agriculture, fishing etc. (Mining activities are considered a part of secondary sector).
2. Secondary Sector: Manufacturing sector, which uses the produce of the primary sector as its raw materials, also called industrial sector
3. Tertiary Sector: Different services are produced in this sector, such as education, banking, insurance, transportation, tourism, IT. Also known as the services sector

Types of Economies

1. Agrarian Economy Share of primary sector is $> 50\%$ of total GDP of that economy
2. Industrial Economy Share of secondary sector is $> 50\%$ of total GDP of that economy
3. Service Economy Share of tertiary sector is $> 50\%$ of total GDP of that economy (India's economy is a service economy)