Economics Class 11
29th July, 2023 at 9:00 AM

INTRODUCTION (09:00 AM)
- A Brief Review Of The Previous Class.

INVESTMENT MODELS AND ECONOMIC PLANNING (09:05 AM)
- **Topics to be covered:**
- Concept of Investment.
- Concept of investment-led growth
- 5T dollar economy target.
- Shift from consumption to investment-led growth.
- Why China wanted to shift from investment to consumption-led growth.
- Harrod Domer.
- Lewis Model.
- Mahalnobis Model.
- Why eco-planning.
- Different types of plans.
- Five-year plans.
- NITI aayog VS Planning commission.
- Perspective planning.

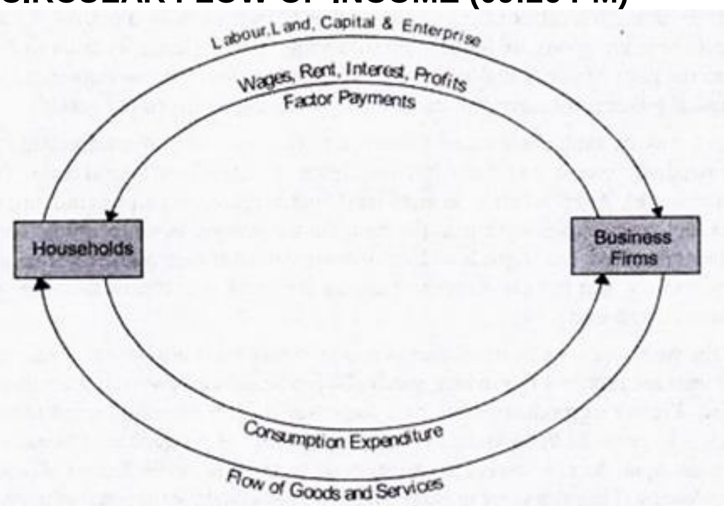
CIRCULAR FLOW OF INCOME (09:26 PM)


Fig. 6.1. *Circular Flow of Income in a Simple Two Sector Economy*

- **Assumptions: Closed economy.**
- One firm and households.
- Households provide factors of production, such as labour, land, and capital, to the firm.
- The firm pays factor payments (wages, rent, interest, etc.) to households for their contributions, shown by the arrow going up from the firm to households.
- Households, in turn, spend their income on goods and services produced by the firm, as indicated by the arrow going down from households to the firm.
- This spending is known as consumption expenditure.
- The firm uses the factors of production received from households to produce goods and services, as shown by the arrow going from households to the firm.
- The cycle continues, creating a circular flow of income between households and the firms in the closed economy.

- This basic circular flow model illustrates the fundamental economic interactions between the two sectors in a closed economy,
- Demonstrating how income earned by households is used to purchase goods and services produced by the firm, resulting in a continuous flow of economic activity.
- **Circular Flow in an open economy.**

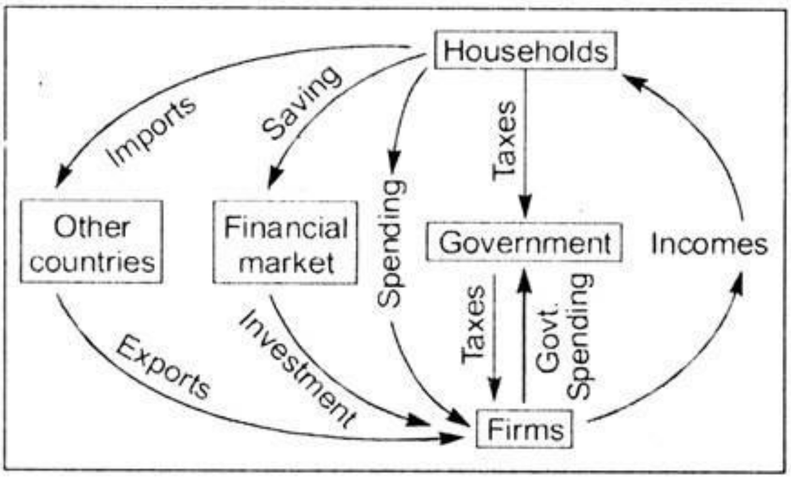


Fig. 2.3: Circular Flow of Income and Spending in an Open Economy

- **Banks:** In the circular flow, banks act as financial intermediaries.
- They receive savings from households and channel those funds to firms for private investment purposes.
- Banks play a crucial role in mobilizing savings and allocating funds to productive investment projects.
- **Private Investment:** Private investment refers to the spending by firms on capital goods (e.g., machinery, equipment) to expand their production capacity. When firms engage in private investment, they borrow funds from banks, leading to an inflow of funds into the firm's financial sector.
- **Households:** As before, households provide factor payments to the firm in exchange for their contributions of labour, land, and capital. With the income received, households spend on consumption expenditure, which represents their spending on goods and services produced by the firm.
- **Firm:** The firm uses the factors of production received from households to produce goods and services.
- Simultaneously, the firm receives private investment funds from banks, which are used to finance capital projects that enhance production capabilities.

INVESTMENT (09:55 AM)

- It is that part of the output that comprises physical capital goods.
- Investment is nothing but gross capital formation i.e. accumulation of capital stock of the nation.
- Example: If the total output of the country is RS1000 and proportion of consumption goods is RS800 and the proportion of Capital Goods is RS200.
- Gross investment is equal to 200/1000 = 20%.
- In the above case if the factory loses RS100 due to the consumption of fixed capital.
- The net Investment is equal to the Gross Investment - Depreciation. (Depreciation is the loss of value of the machine or capital good due to wear and tear.
- Depreciation does not consider calamities like Tsunamis or earthquakes.
- The term investment is different for economists and the rest of the world).
- Purchase of assets like stocks, mutual funds and insurance products are not investments for economists as they do not add to the net wealth of the nation

- Rather they reflect a credit relationship between 2 parties i.e. financial asset of one party in the economy could be offset by the financial liability of the other party.
- Thus when we aggregate the wealth of all the members of the economy, these assets and liabilities cancel and there is no creation of new assets.
- The 5 trillion dollar target was based on an investment-led growth model which is also called as Chinese or Shanghai model which mainly focuses on the increase in investment (Specifically Private investment as a main driving factor for capital formation and subsequently increase in economic growth,
- Note: The government's 5 trillion dollar target is the Nominal GDP target.
- **Question: 'Economic growth in the recent past has been led by an increase in labour productivity." Explain this statement. Suggest the growth pattern that will lead to the creation of more jobs without compromising labour productivity.**

INVESTMENT LED GROWTH (10:34 AM)

- **Investment-led growth model focuses on investment to create new capacity. (Capacity creation)**
- This leads to employment generation, thereby driving demand along with increasing production capacity.
- In investment-led growth, supply rises in tandem with demand leading to increased economic growth.

CHINESE EXPERIENCE OF INVESTMENT-LED GROWTH (10:45 AM)

- Chinese introduction of capitalist market principles led to mass privatisation and opening up of their market to private investment.
- Duer to the availability of cheap labour, overseas firms started building factories in China to take advantage of cheap labour.
- Chinese development strategy increased their focus on larger cities like Shanghai and Beijing.
- Investment-led growth model in China increased production but did not increase the consumption base proportionately i.e. lack of inclusiveness.
- China was successful in increasing the GDP growth but failed to increase HH income growth.
- India's Growth Model was different from the investment export-oriented strategy of China:
- India's growth is from internal sources i.e. India's net export to GDP ratio has been significantly lower than that of China
- India despite having a large trade deficit yet has managed to grow at reasonably high rates.
- Domestic savings to investment gap in India has been kept at a low level and
- India has managed to finance a predominant part of its capital formation from domestic savings.
- China has derived a predominant part of its growth from external sources both in terms of foreign investment and export market.

FACTORS THAT WILL DETERMINE THE TYPE OF GROWTH MODEL TO BE FOLLOWED (11:21 AM)

- Demographics of the country.
- Strength of the manufacturing sector.
- Openness of the economy.
- Trade balance and economic strength of the country.
- Consumer behaviour.
- **Reasons for China to shift from investment to consumption-led growth:**
- Protectionist policies and move towards deglobalisation.
- Subprime crisis (2008) and its impact on the external trade of the country.
- Lack of new markets for Chinese goods.
- Increase in labour cost.

- Change in consumer attitude and technology.
- **Reasons for India to shift to Investment led growth:**
- Huge demographic dividend.
- Aim of emerging as an industrialised nation to handle industrialization 4.
- To attract more foreign investment in the form of FDI, FII.
- **Challenges of investment-led growth model wrt India:**
- High inflation can erode savings.
- Dependent on Pvt investment. A prerequisite for private investment is that there should be public investment in the infrastructure.
- Logistic inefficies.
- Our savings to GDP ratio is dropping.
- Challenges of making export more competitive.
- Increasing saving investment gap due to issues of monetary policy transmission.
- Create jobs for only high-skilled labour.
- *COR (capital-output ratio): Amount of capital required to produce one unit of output.
- India has high COR.

(TOPIC FOR THE NEXT CLASS: CONTINUATION OF INVESTMENT MODELS)