Economics Class 12

4th August, 2023 at 9:00 AM

HARROD DOMAR MODEL (09:00 AM)

- **Capital output ratio-**
- It is the amount of capital required to produce a single unit of output.
- Higher the COR, the lower the efficiency.
- Developing countries have higher COR in comparison to developed nations.
- **Harrod Domar Model**
- It is the model of economic growth in development economics.
- Developed by Harrod in 1939 and Domar in 1946.
- The model focused on understanding economic stability by analysing the dynamic nature of capital or investment.
- Major economic determinants like natural resources, population, and technological growth constantly influence two important factors-
- 1. Rate of investment
- 2. Capital output ratio.
- Economic growth= savings*(1/ COR).
- **Relevance of Harrod Domar model-**
- The model was devised for developed countries to protect themselves from chronic unemployment.
- The model focused on accurate COR and a high propensity to save.
- The model believed in a virtuous cycle of increased savings, transforming into increased investments which results in higher capital stocks leading to increased economic growth.
- **Limitations of the model:**
- Difficult to increase the savings ratio in low-income countries.
- A sound financial system is lacking in many emerging countries and therefore increased family savings will not be channelized through the banking system.
- Due to human capital deficiencies, assuming a constant capital-output ratio is difficult.
- R&D required to enhance COR is generally underfunded.
- A rise in capital spending is not always a precondition for economic growth and development.
- Borrowing from abroad to make up for the shortfall in funds leads to an increase in external debt.
- Unemployment problems in developing nations are quite different from developed countries i.e. investment alone can not solve the problem of unemployment in developing nations.

LEWIS MODEL (10:00 AM)

- In 1954, Sir Arthur Lewis published a paper entitled economic development with unlimited supplies of Labour.
- This model mainly postulates 2 sectors:
- a) Subsistence.
- b) Modern.
- This can also be termed as Agriculture and Industry although Lewis meant a broader class of subsistence which included agricultural labour, urban poor, domestic servants, etc.
- Generally, the rural subsistence sector is characterized by marginal labour productivity i.e. surplus labour can be withdrawn from the agricultural sector without any loss of output, and this surplus when shifted to the industrial sector will improve productivity.
- There is a continuous labour migration from the traditional to the modern sector and wages remained constant and low for longer periods of time.
- Economic growth occurs as a rising share of profits gets reinvested.

- In the Lewis model, eventually, the reservoir for cheap labour gets exhausted.
- Capital accumulation slows down and wages get determined by marginal productivity.
- **Limitations of the Lewis Model**:
- Capitalist profit may not be reinvested.
- The capitalist may replace labour with capital-intensive technology.
- Labour wages may not remain constant and low for longer periods.

MAHALANOBIS MODEL (10:35 AM)

- **Incremental capital-output ratio (ICOR)**
- It is defined as how much additional capital will be required to produce one additional unit of output.
- ICOR= Change in capital to GDP/ Change in output to GDP.
- ICOR represents how efficiently the new capital is being used in a country to produce output.
- **Mahalanobis Model**
- During the 2nd FYP (1956-61), Mahalanobis focussed on Industrialisation with a primary focus on heavy industries.
- Mahalanobis Model is an investment allocation model.
- Mahalanobis two sector theory focuses on consumer goods and capital goods
- If a country focuses on capital goods and basic industries, there will be exponential growth in the long term.

ECONOMIC PLANNING (11:30 AM)

- It refers to the allocation of resources in a comprehensive way to achieve the pre-determined objectives with optimal utilisation of resources.
- In India, economic planning was adopted in 1951.
- In an economic system, characterised by the co-existence of the public and private sectors.
- For four decades, the public sector was considered the main engine of growth.
- However, with the beginning of the liberalisation process, the govt started withdrawing from direct involvement in productive activities.
- And hence the private sector has now become the dominant sector and the public sector is merely an adjunct to the former.
- **Failure of market mechanism:**
- When India got independence, it was economically backward.
- India had to focus on economic growth along with ensuring inclusiveness.
- A market economy may increase economic growth but may fail to handle economic development.
- Ensuring inclusiveness was going to be difficult due to the experience of the failure of the trickle-down theory.
- Therefore, India decided to rely on market mechanisms along with centralised economic planning.
- In a free enterprise economy, the benefits of economic growth rarely trickle down, hence in an under-developed country like India state intervention is required for poverty alleviation along with ensuring social justice.
- Mobilisation and allocation of resources- As India lacks resources, it has to be careful about the optimum utilization of resources.
- Also, resources should be pushed into socially low-priority areas to make the growth egalitarian.
- **Long terms goals concerning Planning**
- Stagnation of the manufacturing sector.
- Capital-intensive rather than labour-intensive growth.
- Challenges of jobless growth.

- Stringent labour laws.
- No specific focus on skill development.
- Increase in the labour force.
- Over-tertiarization of the Indian economy.
- MSMEs turning out to become dwarfs.

TOPIC OF NEXT CLASS- ECONOMIC PLANNING (TO CONTINUE)