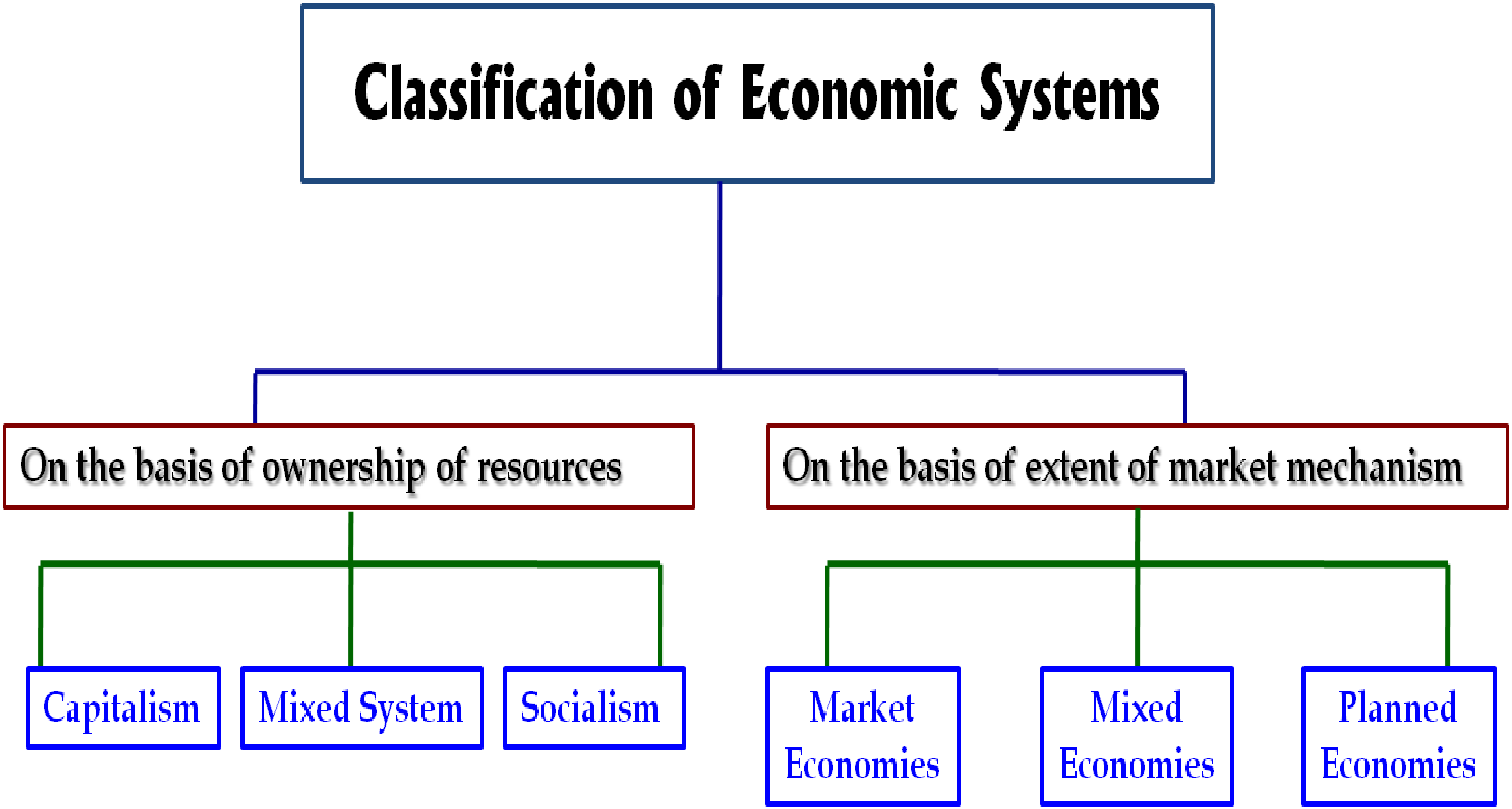

Classification of Economic Systems
On the basis of ownership of resources
On the basis of extent of market mechanism
Capitalism
Mixed System
Socialism
Market Economies
Mixed Economies
Planned Economies

Economic Systems

Capitalism: **Economic resources are owned by the private individuals and organizations.**

All economic decisions (*production*, *distribution*, *exchange*, etc.) are taken by those private parties without any interference by the government. *Market mechanism governs the entire economic system.*

Private ownership of the means of production and creation of goods or services for ***profits*** are fundamental characteristics of a capitalist economy.

Criticisms of Capitalism

- Uneven distribution of WEALTH
  - Poor people live in SQUALOR: slums, bad sanitation, etc.
  - Working conditions are miserable,

Socialism: **The State owns and operates most of the nation's major sectors such as banks, airlines, railroads, telephone, electricity and other factors of production and designs the means of distribution.**

Planning plays an important role and State plans for a given period of time *what to produce*, *how much to produce*, *how to produce* and at *what price to supply* resources and commodities to the producers and consumers.

***The basic objective of socialism is to ensure social justice and more equitable distribution of wealth*.**

Extreme form of socialism is communism; e.g., China in pre-1978 period.

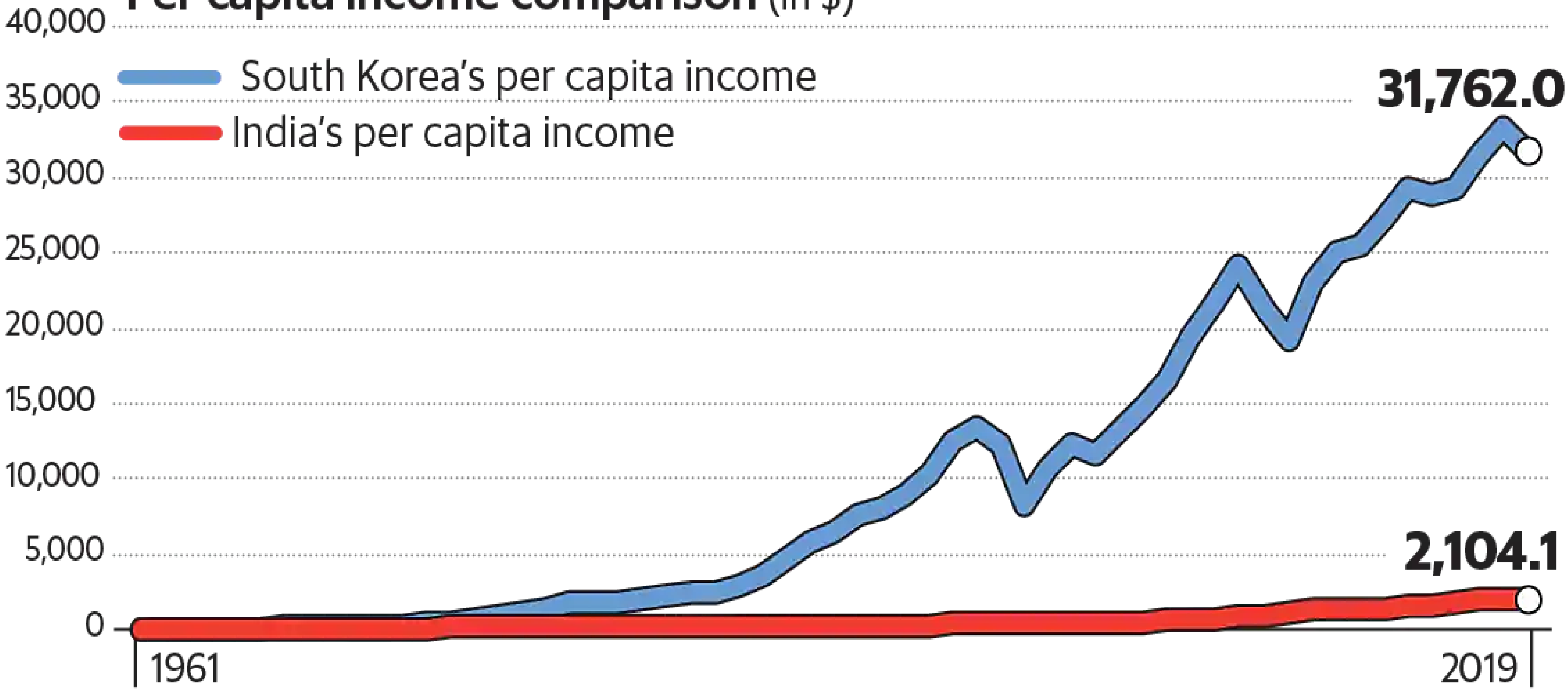
Public Investment

- concentrated in the area of *public infrastructure.*
- directed primarily towards *agriculture.*
- directed towards *industrial development.*

Trade miracle

In the early 1950s, South Korea and India had comparable per capita incomes. However, in the 1960s, South Korea switched to export-led policies, resulting in economic transformation and GDP growth of 8.97% per year from 1960 to 2000.

Per capita income comparison (in $)



Source: World Bank

Surajit Bhattacharyya@Econ.

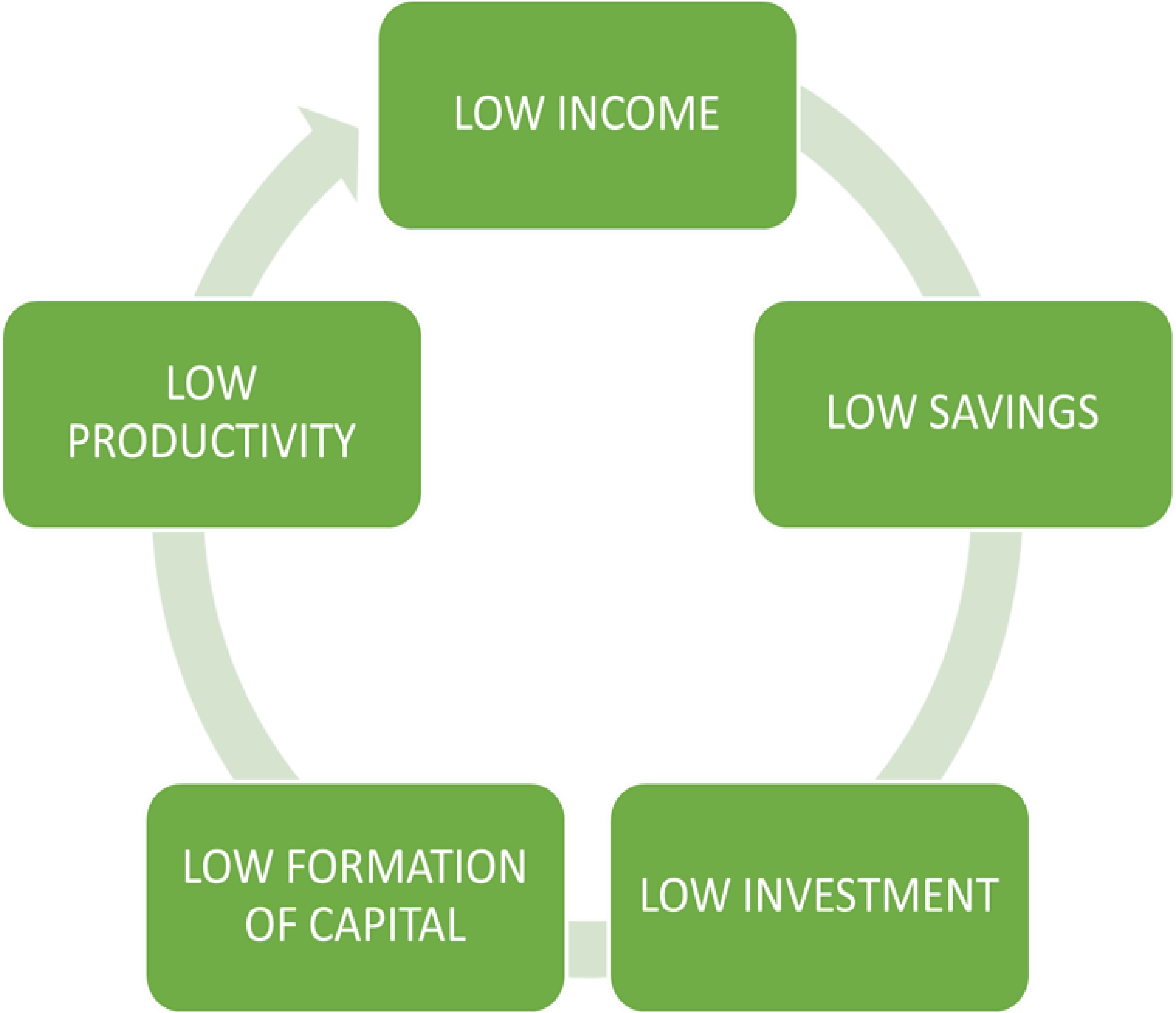
Why market economies perform better?

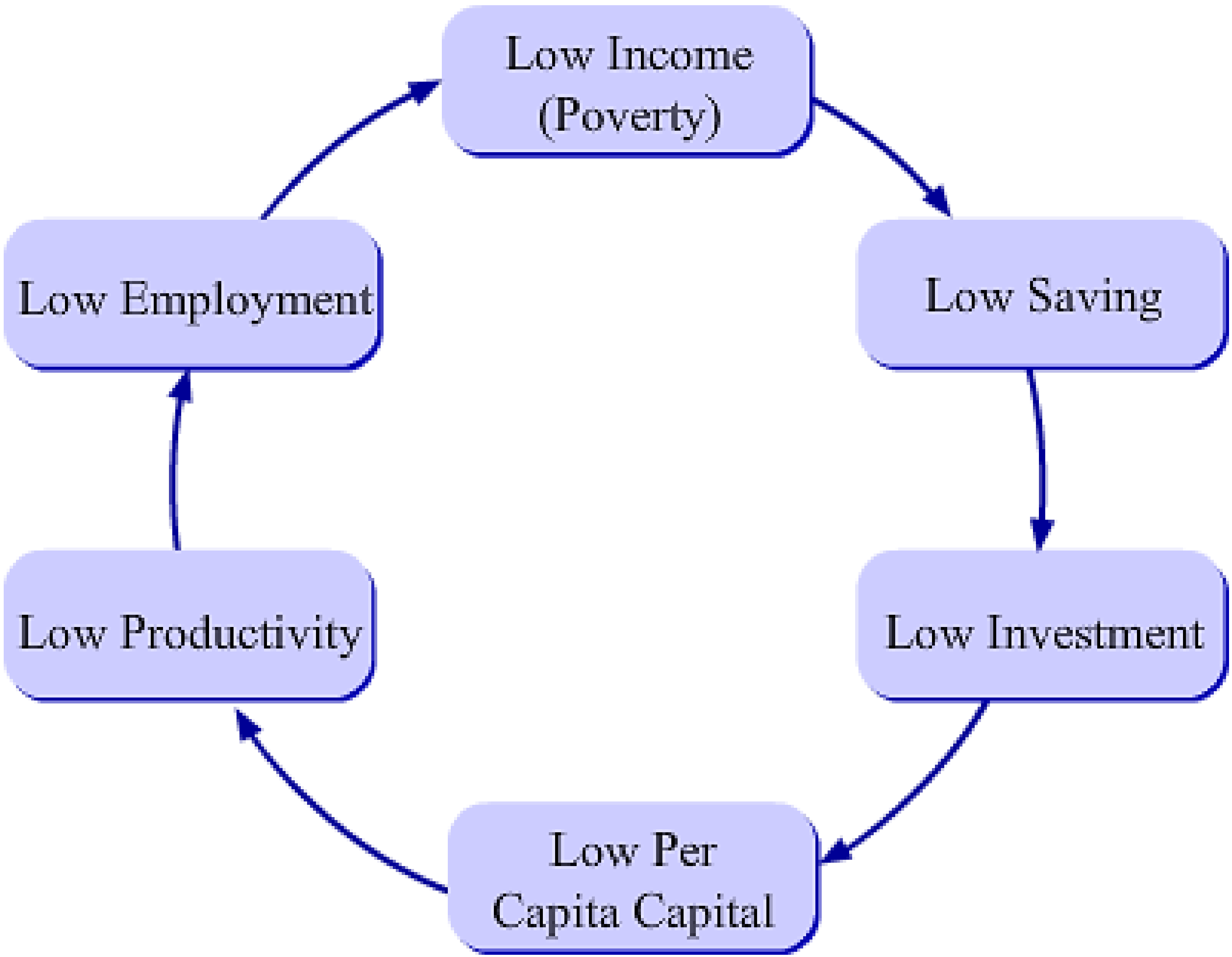
- Most of goods and services produced by private firms
- Role of government is ***limited***
- Existence of private property rights
- Right of freedom of enterprise and choice
- Competition and self interest would ensure that all the goods and services consumers wanted would be produced at the best quality and the lowest price

Common Characteristics of Developing Nations

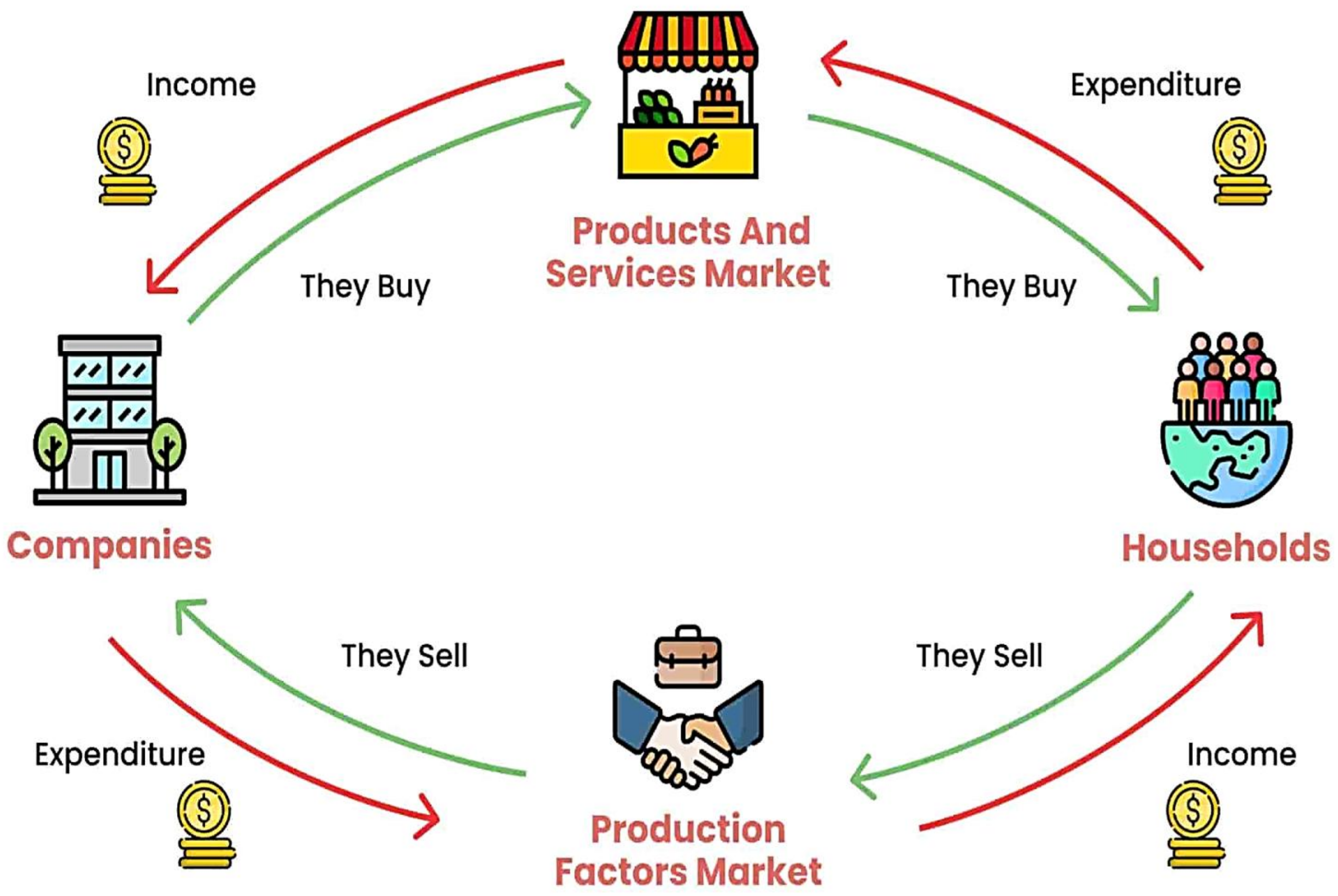
- **Low levels of living**
- **Low levels of productivity**
- **High rates of population growth and dependency burdens**
- **Dependence and vulnerability**
- **Substantial dependence on agricultural production and primary-product exports**
- **Prevalence of *imperfect* markets**

The *dependency burden*, which is the ratio of dependent young and old to the population of working age, varies as a country moves through demographic transition.

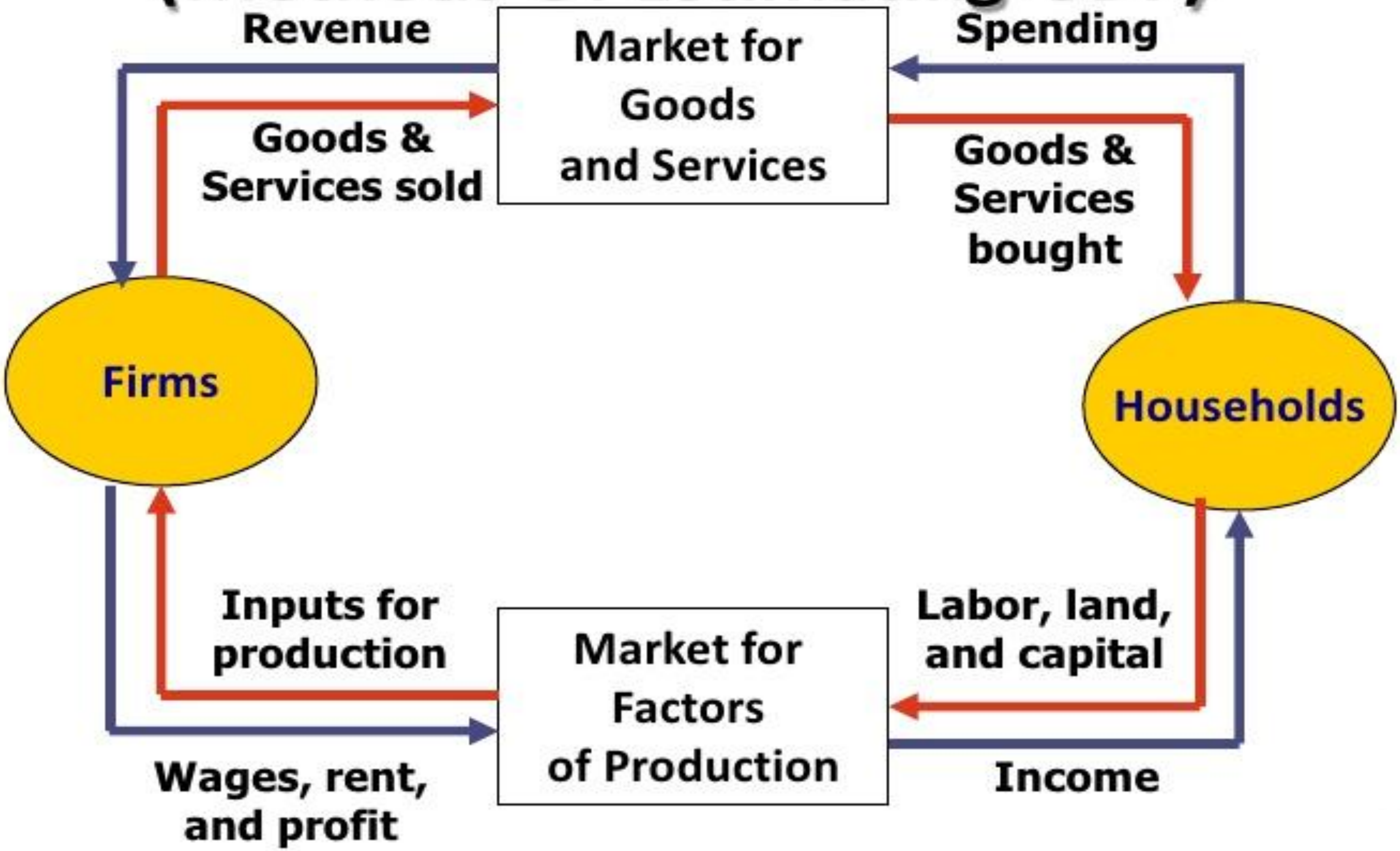

LOW INCOME
LOW SAVINGS
LOW INVESTMENT
LOW FORMATION OF CAPITAL
LOW PRODUCTIVITY


Low Income
(Poverty)
Low Saving
Low Investment
Low Per
Capita Capital
Low Productivity
Low Employment

CIRCULAR FLOW OF ECONOMY



Circular-Flow Diagram (Methods Of Estimating GDP)



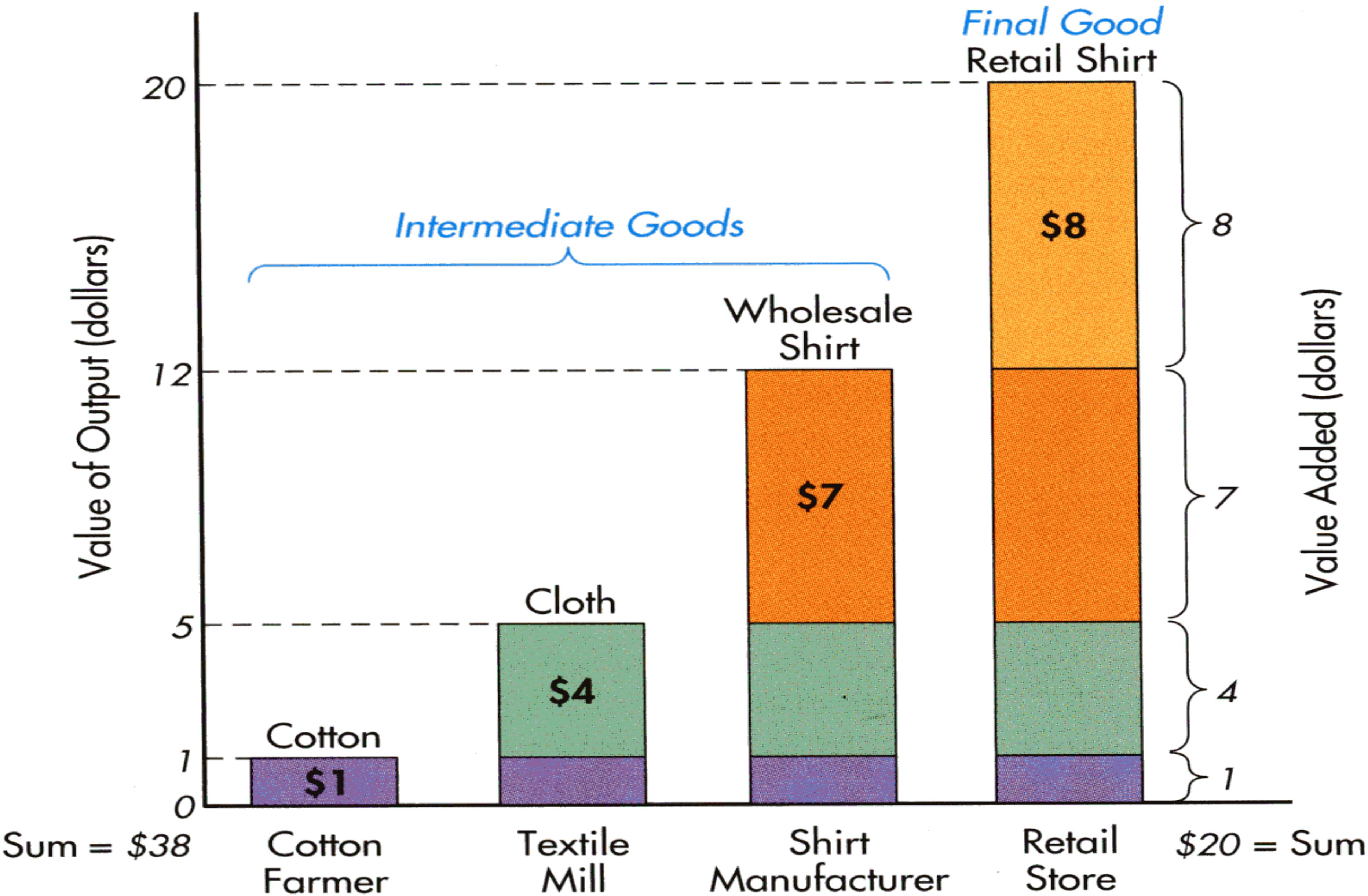
National Income Accounting

Three approaches:

- amount of output produced, excluding output used in the intermediate stages of production (Product approach);
- total income generated in the economy (Income approach);
- amount of spending by the ultimate purchasers of output (Expenditure approach).

All the three approaches give identical measurements of the amount of current economic activity.

The Concept of Value Added



The Product Approach (*Value Added Approach*)

***Value added*:** The *value added* of an producer is the value of its output *minus* the value of the (intermediate) inputs it purchases from other producers.

Methods of Measuring Sectoral Output in India

Method / Approach	Sectors
Product Approach (*Value Added* method)	Agriculture, forestry, mining, manufacturing
Income Approach	Banking and insurance, transport, communication, real estate, hotels, restaurants, etc.
Expenditure Approach	Construction

Some Important Definitions

GDP: It is a measure of all currently domestically produced final goods and services evaluated at market prices. Market transactions such as exchanges of *previously produced* houses, cars, factories, and exchanges of stocks and bonds and other assets are <u>not</u> included in GDP.

GDP includes tangible goods (like DVDs, mountain bikes, mineral water) and intangible services (dry cleaning, concerts, cell phone service).

GDP includes currently produced goods, <u>not</u> goods produced in the past.

Non-market productive activities and the underground economy are left out.

- **Gross National Product (GNP)**
  - The value of all final goods and services produced by a country's factors of production and sold on the market in a given time period.

GNP = GDP + Net Factor Income from Abroad (NFIA)

NFIA = Factor Income Received from Abroad *minus* Factor Income Paid Abroad

GDP and **GNP** — ***ownership*** and ***location***

- GDP ⇒ **economic output based on *location***. If output occurs in India, then it is included in the GDP of India.

- GNP ⇒ **economic output based on *ownership***. If the resources that produce the economic output are owned by an American entity, they are included in the GNP.

$$GNP = GDP + NFIA$$

$$\text{If, } NFIA > 0, \text{ then } GNP - GDP > 0 \;\Rightarrow\; GNP > GDP$$

$$\text{If, } NFIA < 0, \text{ then } GNP - GDP < 0 \;\Rightarrow\; GDP > GNP$$

$$\text{If, } NFIA \approx 0, \text{ then } GNP \approx GDP$$

NFIA is the net interest earnings, profits and dividends coming into India from our assets owned overseas matched against the flow of profits and other income from foreign owned assets located within India.

In recent years there has been an increasing flow of direct investment into and out of India. Many foreign firms have set up production plants here whilst Indian firms have expanded their operations overseas and become multinational organisations.

What is Factor Income Received from Abroad?

Employee
India

Job →

← *Salary in Dollar*

Software Company
USA

In this Case

Employee is Factor of Production

He Receives Salary from USA

This is **Factor income from Abroad**

IS GDP A GOOD MEASURE OF ECONOMIC WELL-BEING?

- GDP is the best single measure of the economic well-being of a society.
- GDP per person tells us the income and expenditure of the average person in the economy.
- Higher GDP per person indicates a higher standard of living.
- GDP is not a perfect measure of the happiness or quality of life.

GDP and Economic Well-Being

- Some things that contribute to well-being are not included in GDP.
  - The value of leisure.
  - The value of a clean environment.
  - The value of almost all activity that takes place outside of markets, such as the value of the time parents spend with their children and the value of volunteer work.

Growth without social justice is inhuman and social justice without growth is inconceivable.