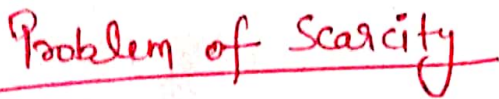


Topic - Introduction to Economy & The Preparation Strategy



* Central Problems of Economy

1. What to produce? — steel <

cycles
Tanks
2. How to produce? —

Capital intensive
Labour intensive
3. For whom to produce? —

Cheap
fancy
4. How to grow?

(2)

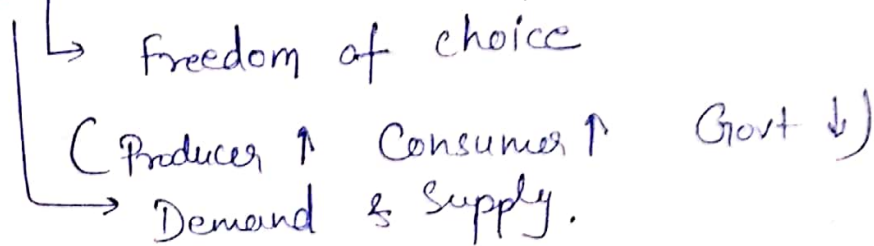
Solution to Central Problems

Economic Systems

Economic Systems refers to the scheme of ownership of resources and working of different economic units and broadly covers the following.

- 1- free market or capitalism system.
2. Centrally planned or socialistic system.
3. Mixed economy.

1. Free Market Economy



Certain Characteristics

- Freedom of Enterprise
- Profit Motive
- Laissez faire (limited role of Government)
- Consumer Sovereignty
- Right of Private Property
- Private ownership of resources.
- Incentive to hard work and creative

- Efficiency of Act & Production.
- Better economic growth
- ~~Wast~~ variety of goods & services.
- Neglect of Public welfare.
- Inequality of income and wealth.
- No job security.

How are Central Problem Solved in Free Market Economy?

1. What? → Demand
2. How? → Cost of factors
3. Whome? → who can afford

The central problems are solved on the basis of market forces of demand, supply, competition, price mechanism etc. which are collectively called as Invisible Hand by Adam Smith (1776).

$$\boxed{\text{Invisible Hand} = D + S + C + \text{others} \dots}$$

How are central Problem solved in Centrally planned Economy?

Centrally planned economies or command economies follow the concept of socialism and they are characterised by following features.

1. Public ownership of Resources
2. Govt. planning or economic planning
3. Social welfare (Public welfare)
4. Job security
5. Equality of Income or wealth.
6. Limited variety of goods and services.
7. Moderate economic growth rate
8. Limited freedom
9. Classless society.
10. Chances of corruption.
11. Chance of Redtapism.
12. Inefficiency of Acts and production.
13. Lack of competition.

Red Tap \Rightarrow Too much official rules & formalities

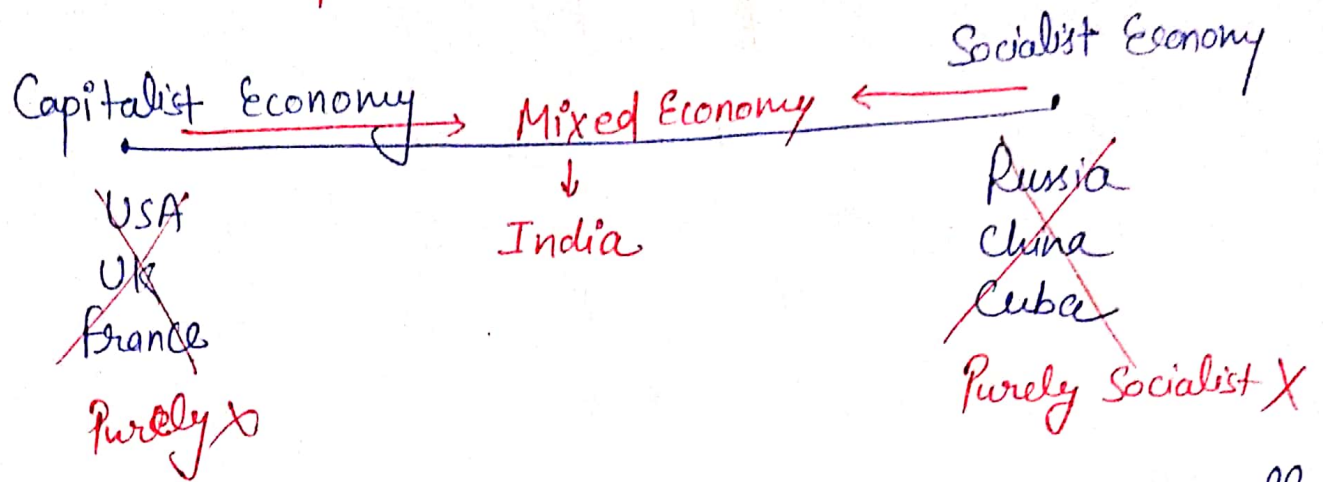
How are central problem solved in the planned economy?

All the central problem are solved through government policy based on the concepts of social welfare or public welfare.

FME
↓
Profit motive
(₹)

CPE
↓
Capital Welfare
(Stick figure)

Mixed Economy



The system is combination of market economy as well as planned economy. There is a coexistence of Govt. sector and private sector. Some sectors are reserved for the Govt. for eg in India we have Railways.

How are central problem solved in mixed economy?

The central planning is used for the sectors reserved for government and based on the principal of social welfare choices made. On the other hand the sectors where private firms are operating are left to market forces of demand, supply, competition etc. To conclude under mixed economy there is a mixture of solution as well. (Practically speaking most of the economy have become mixed and the concept of pure Capitalism and Socialism are matter of theories).

(6)

Q. 2013 Mains

Capitalism has guided world's economy to unprecedented prosperity. However it often encourages shortsightedness and contribute to wide disparity between rich and poor. In this light would it be correct to believe and adopt capitalism for bringing inclusive growth in India.

Some Important Terms

1. Crony Capitalism

It is an economic system in which business is prosper not by entrepreneur and hard work but through ~~access~~ ^{nexus} between business class and political class. Government policy are manipulated through improper means to get undue advantage for the capitalist. Some influential businessman management to get intensive from the govt in the form of loans, subsidies, tax concession and other methods. The Competition fails to work enhanced capitalism became distorted

2. Fabian Socialism

A type of democratic Socialism propagated by Fabian Society of England which promotes reformatory or practices instead of revolutionary socialism. practices like Nationalisation which means change of ownership from private hand to Govt. is the key strategy in promoting Fabian Socialism.

3. Market Socialism

In 1950s Professor Oscar Lange suggested an economic system involving public or social ownership of the factors of production within the framework of market economy. He praised the socialism for many good things including social welfare but also suggested some of the good things of capitalism. Hence he coined the term market socialism understanding the power of market sources of demand, supply and others.

4. Invisible Hand - A term coined by the father of Economics Adam Smith in 1776 to signify the collection of market forces of demand, supply, competition, price mechanism etc.

8

5. Opportunity Cost

The benefit forgone by taking decision which has two close alternative or options. If motorcycle are manufactured in place of scooters by an automobile company then expected profit from the scooter because the opportunity cost for the manufacture of motorcycle.

$$\begin{array}{rcl}
 \text{Scooter} & = & \text{Benefit forgone} \quad (100 \text{ Cr}) \\
 \text{Motor/Cycle} & = & \text{Expected Profit} \quad (150 \text{ Cr}) \\
 \hline
 \text{Net Benefit} & = & 50 \text{ Cr} \\
 & & (150 \text{ Cr} - \text{opp. Cost } 100 \text{ Cr}) \\
 & & \text{Loss}
 \end{array}$$

6. Trade off

Increasing any one factor or phenomenon at the cost of other that is to say decreasing the quantity of other than there is a trade off (for eg.) An Automobile company can manufacture more quantity of motorcycle by reducing the quantity of scooter they are manufacture. In short it is increasing one by decreasing other.

7. Factor Income

Factor of Production	Factor Income
Land	→ Rent 400
Labour	→ Wages 100
Capital	→ Interest 100
Enterprise	→ Profit (200)
	500

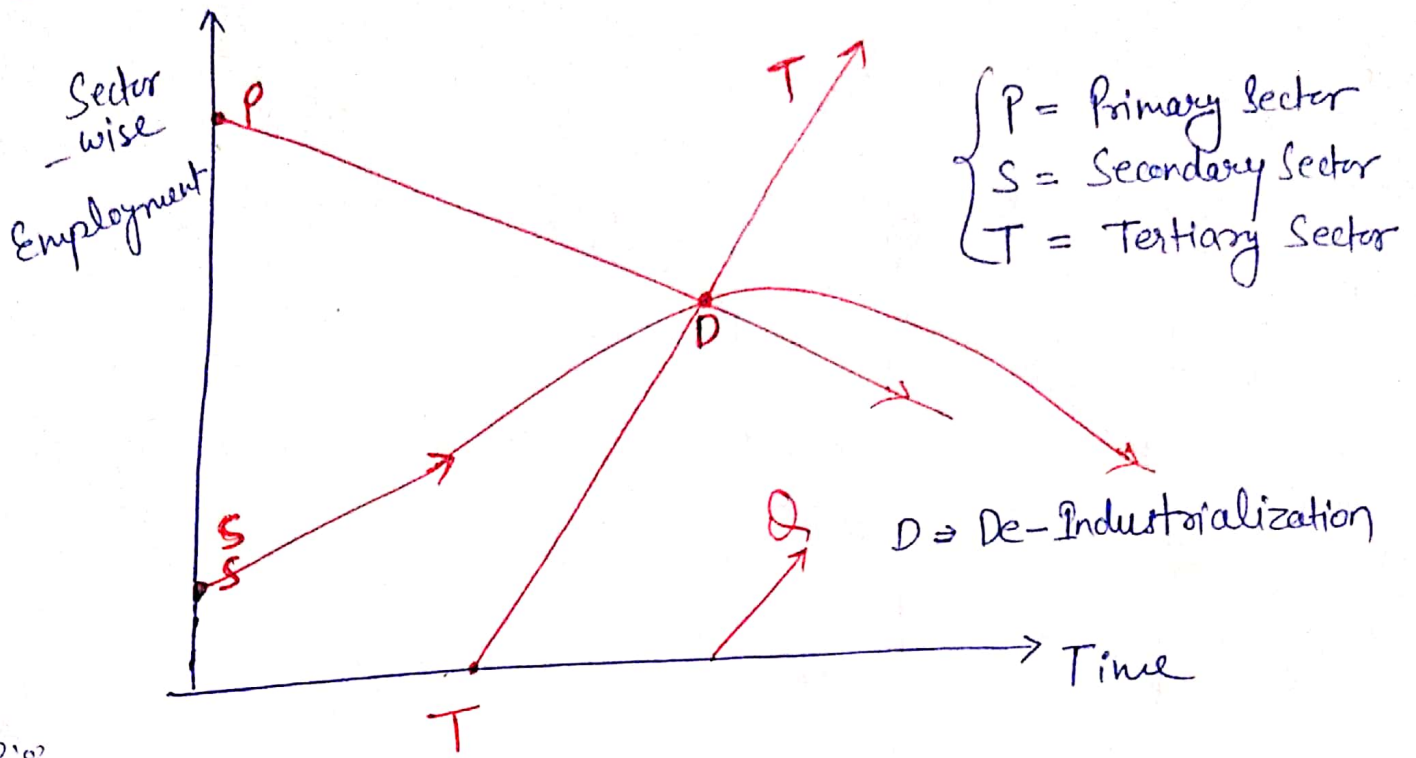
The factor ~~receives~~ or income or payment are the money received by different factors of production in the form of rent, wages, interest and profit.

Sectors of Economy Vs Economic Growth

3 Sector Theory Given by Alan Fisher & Colin Clark tries to explain the relationship between the growth of economy and the sectorwise employment. It is also called as Fisher Clark model or Clark model.

Ans.

(10)



2:02

According to Clark's Model when economic grows when the percentage employe in different sector ^{of economy} changes significantly. In the begining primary sector is the highest employed while later stages find that tertiary sector becomes the highest employed after De-industrialization and the employment in primary and secondary sector fall after this point.

Jean Fourastie Model

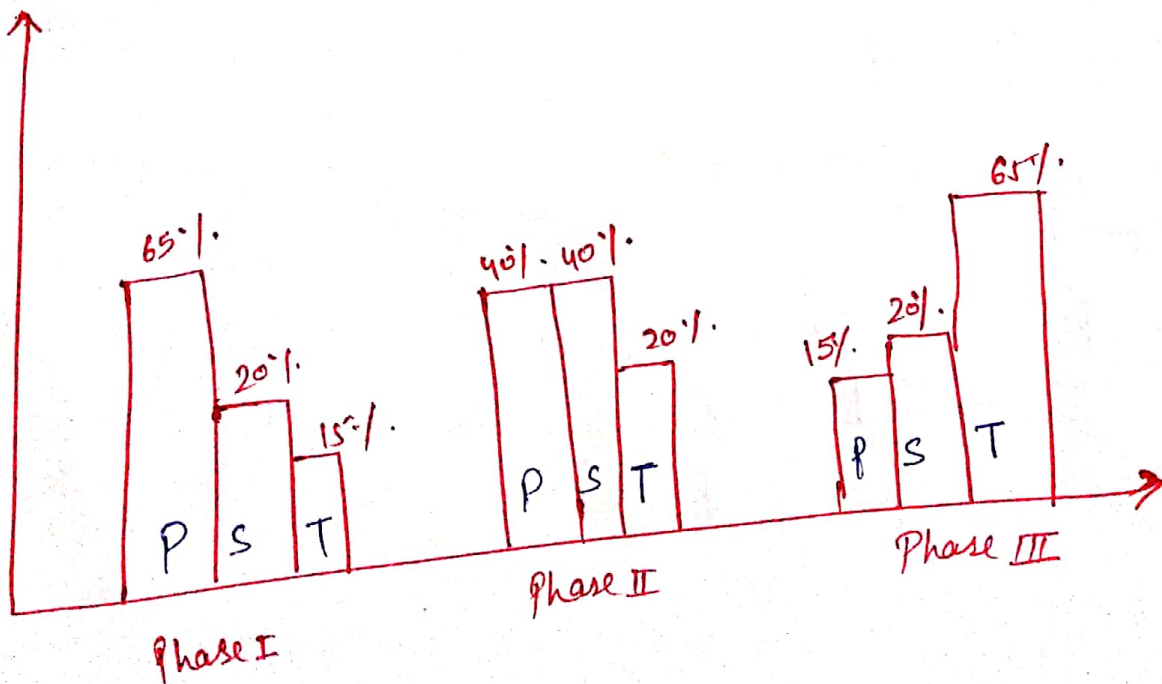
According to structural transformation model the economic growth passes through three stages as follows.

- 1: During the first phase called traditional civilization the employment is maximum in the primary sector and minimum in the tertiary sector.

for eg. 65% in Primary
20% in Secondary.
15% in tertiary

Phase II is transitional phase in which the employment in primary sector reduces while in other two sector increases. for eg. 40% in primary, nearly 40% in Secondary and 20% in Tertiary sector.

Phase III is called the tertiary Civilisation. where in maximum employment is found in the tertiary sector and minimum in the primary sector. 15%, 20%, 65% respectively.



(12)

Theory of Demand and Supply (Market Mechanism)

Market \Rightarrow A place where goods are sold.

Market is a system which connects buyers and sellers of goods, services, or any other items. The term market include physical market as well as electronic market eg: wholesale market, cloth market, share market e-National Agriculture market, Govt e-market Place (GeM) etc.

Demand \Rightarrow The quantity of a goods or service which a consumer is willing and able to buy at given price during a time period is called demand. It should not be just a desire which is not backed by ability to pay.

Factors affecting Demand \Rightarrow

- a. Price of Goods and Services
- b. Price of Related Goods & Services
- c. Income of Consumer / buyer

Law of Demand

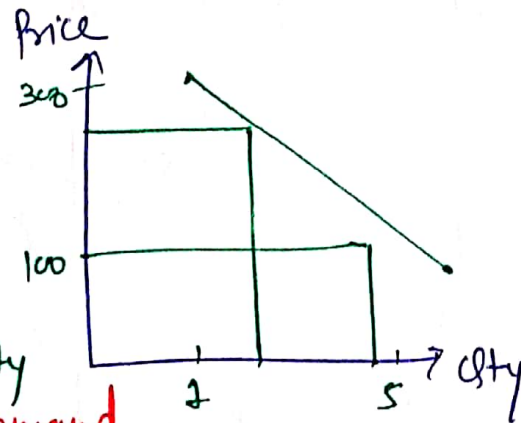
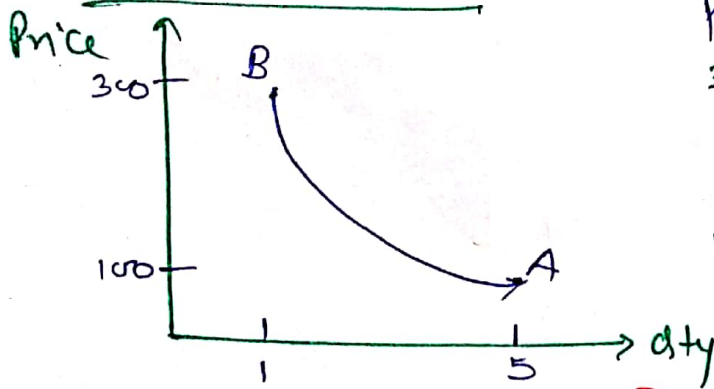
$$D \propto \frac{1}{P}$$

$$\begin{cases} \uparrow P = \downarrow D \\ \downarrow P = \uparrow D \end{cases}$$

$P = ₹ 100/\text{kg}$	300
$Q = 2 \text{ kg}$ (Demand)	0

Symbolically it can be represented by a demand curve which slopes downward towards the right.

Demand Curve



Exceptions to Law of Demand

$\uparrow P \quad \downarrow D$ — usual

$$\begin{cases} \uparrow P \quad \uparrow D \\ \downarrow P \quad \downarrow D \end{cases} ?$$

1 → Veblen (Ostentations) — Goods that are used as status symbols do not follow law of demand because the price tag is the main driver. Hence their demand can not be increased by just decreasing the price or vice-versa.

(14)

2. Giffin Goods

Law of demand is violated by inferior products which are the cheaper substitute of some superior item. for eg. Bread is a cheaper substitute of meat hence the price would increase the demand for bread would go up while the demand for meat will go down.

	old		New		
	P_1	Q_1	P_2	Q_2	
Meat	80	1	160	$\frac{1}{4}$	Law ✓
Bread	20	1	40	$1\frac{1}{2}$	Law X
	<u>₹ 100</u>		<u>₹ 100</u>		