CHAPTER-1

INTRODUCTION TO MICRO ECONOMICS

(All MCQ of Study Material Highlighted in Yellow colour with Question number Identification)

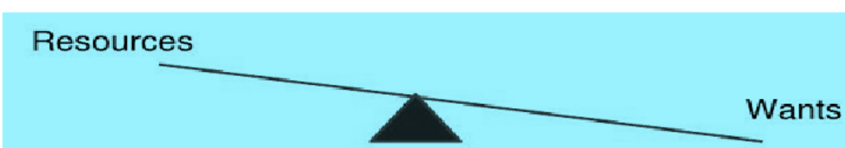
INTRODUCTION

- ✓ Economics is an important branch of social science, which deals with the behaviour of human beings in relation to economic activities.
- ✓ Economics is derived from two Greek words viz. [51&52]"Oikos" (means household) and "Nomia" (means management). Therefore, economics was understood as a "Science of Household Management" - managing a household with the limited resources available, in an economical manner.

- ✓ But later, the scope of economics has expanded from mere household management to the nation's management.
- ✓ Infact, Out of social sciences, it is economics which has more practical applicability, hence regarded as 'Queen of Social Sciences'.
- ✓ The science of economics was born with the publication of Adam Smith's classical work "An Inquiry into Nature and Causes of wealth of Nations" in the year 1770. Before Adam Smith, there were many people who expressed ideas on economics. In the 17th century, Adam smith was the first person who put all the economic ideas in a systematic way, Hence, he is considered to be the "father of economics ".

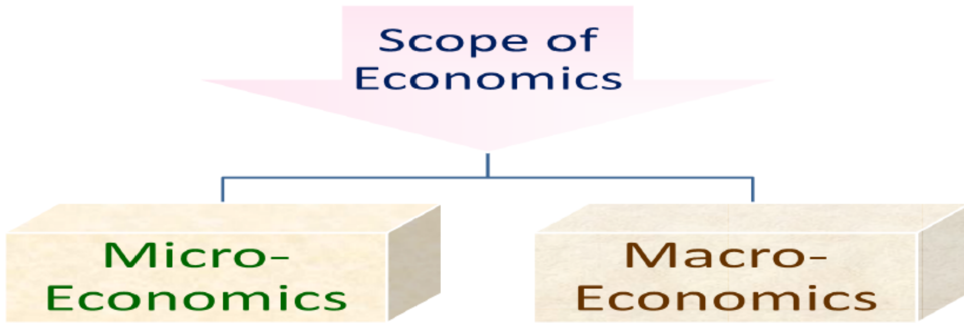
WHAT IS ECONOMICS

[4&64] Economics is mainly concerned with the way in which a society chooses to employ its scarce resources which have alternative uses, for the production of goods for present and future consumption.



[59]Balance between Unlimited Wants Limited Resources

MICRO ECONOMICS AND MACRO ECONOMICS



Micro = "Mikros" (Greek Word) meaning "small"

Particular Unit (we study the economic behavior of individual, household, firm, industry in the national economy)

- **According to Prof. Boulding**, *"Microeconomics is the study of particular firms, particular households, individual price, wages, income, individual industries and particular commodities"*
- [47]Micro Economic theory deals with the problem of allocation of resources.
- Under Micro Economics we study:
  - (i) product pricing;
  - (ii) consumer behaviour;
  - (iii) factor pricing;
  - (iv) economic conditions of a section of the people;
  - (v) study of firms; and
  - (vi) location of industry.

Macro = "Makros" (Greek Word) meaning "large"

[9]Aggregates (we study the [63]working and performance of the economy as a whole such as total production, total consumption, total saving and total Investment)

- **According to Mc Connel,** *"Macroeconomics examines the forest and not the trees. Thus it analyses and establishes the functional relationship between large aggregates".*
- Micro Economic theory deals with growth and development of resources.
- Under Macro Economics we study:
  - (i) [12]national income and output;
  - (ii) general price level;

(iii) balance of trade and payments;
(iv) external value of money;
(v) saving and investment; and
(vi) [43]employment and economic growth.

Example

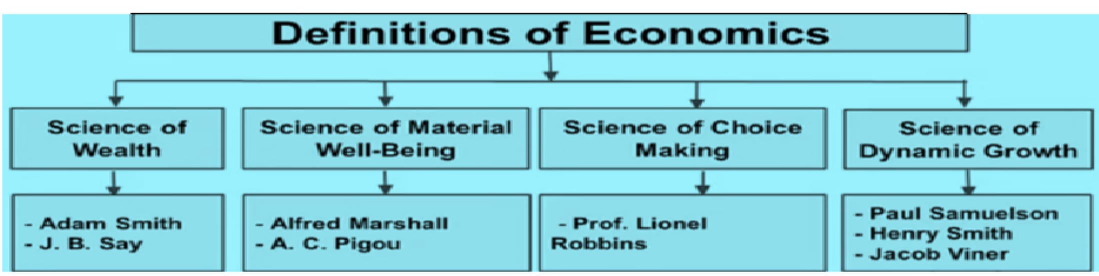
Case	Micro	Macro
Production	How many burgers docs McDonald's produce?	How many goods does the India produce each year?
Prices	Prices the price of an McDonald's Burger?	What Is the price of all consumer goods In the economy?
Income	What are the wages of the workers at McDonald's?	What are the total wages and salaries of workers in the economy?
Employment	How many workers are employed at McDonald's	What are the total number of workers In an economy?

Differences between Micro economics and Macro economics

Micro Economics	Macro Economics
Studies a particular part or a component of the economy.	Studies the economy as a whole
It is known as 'Price Theory'	It is known as 'Income Theory'
Makes assumptions while studying an economy	Doesn't make any assumptions
It is unrealistic study	It is more realistic study
It has limited scope	It has wider scope
It gives a worm's eye view of an economy	It gives a bird's eye view of an economy
It is known as Microscopic study	It is known as Telescopic study
Studies bit by bit	Studies whole economy at one stretch
Eg. [15]Lockout in TELCO, [13]Finding the Causes of Failure of X & Co.	E.g. Per capita Income, Corporate Income Tax, Economy Growth

Note:- [11]It should be noted that micro & macro Economics are interdependent .

DEFINITIION OF ECONOMICS



1. **Science of Wealth**
   Definitions
   - **Adam Smith**, "Economics is an inquiry into the nature and causes of wealth of nations."
   - [65]**J.B. Say**, "Economics is the science which deals with wealth"

Adam Smith

He is the author of the famous [53&54]book "Wealth of Nations" (1776). He is known as the Father of Political Economy because he was the first person who put all the economic ideas in a systematic way. It is only after Adam Smith, we study economics as a systematic science.

Features

- ✓ Economics is a science of study of wealth only;
- ✓ The main objective of human life is acquisition and attainment of wealth.
- ✓ Economics is a science which deals with the causes behind the creation of wealth of nation.
- ✓ It only considers material wealth.

Merits

- ✓ It highlighted an important problem faced by each and every nation of the world, namely creation of wealth.
- ✓ It focused on various important issues of economies by considering the problems of poverty, unemployment etc. can be solved to a greater extent when wealth is produced and is distributed equitably; it goes to the credit of Adam Smith and his followers to have addressed to the problems of economic growth and increase in the production of wealth.

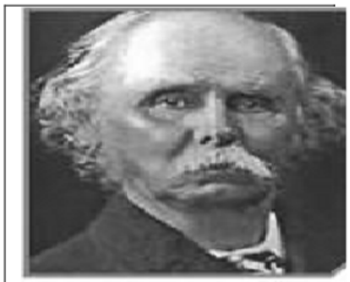
Demerits

- ✓ Adam Smith and other classical economists concentrated only on material wealth. They totally ignored creation of immaterial wealth like services of doctors, chartered accountants etc.
- ✓ The advocates of Economics as a 'science of wealth' concentrated too much on the production of wealth and ignored social welfare. This makes their definition incomplete and inadequate.

2. **Science of Material Well-being**

Definitions

- **Alfred Marshall**, "Economics is a study of mankind in the ordinary business of life. It examines that part of individual and social action which is most closely connected with the attainment and with the use of the material requisites of well-being. Thus, it is on the one side a study of wealth and on the other and more important side a part of the study of man."
- **A.C. Pigou**, "The range of our inquiry becomes restricted to that part of social welfare that can be brought directly or indirectly into relation with the measuring rod of money"



Alfred Marshall

He is the author of the famous book "Principles of Economics" (1890). From 1890 to1930, for almost four decades, welfare definition was considered the best definition.

Features

- ✓ Economics is the study of wealth, but more importantly it is the **study of man**.
- ✓ **Wealth is 'mean' and welfare is an 'end'**
- ✓ Economics has been indicated to be a study of mankind in the **ordinary business of life**. The study enquires how an individual gets his income and how he uses it.
  (HINT:- Extra-ordinary activity like war-economy, imperfect competition, monopoly are not cover here)
- ✓ Economics is a study of those activities that are concerned with **material welfare** of man.

Merits

- ✓ This definition **is more wide and comprehensive** as it covers not only wealth in the scope of economics, but also the welfare of human beings. According to this definition, economics is a **normative science**
- ✓ It lays emphasis on the material requisites of well-being. So material things such as **food, clothing and shelter are important economic objectives.**

Demerits

- ✓ **Neglect of Immaterial things** : Economics is concerned with not only material things but also with immaterial things like services of singes, teachers, actors etc. Marshall and Pigou chose to ignore them.
- ✓ **The concept of welfare is very vague** : Robbins criticised the welfare definition on the ground that it is very difficult to state which things would lead to welfare and which will not. He is of the view that we would study in Economics all those goods and services which carry a price, whether they promote welfare or not.

3. **Science of Choice Making**

Definitions

- [1]**Lionel Robbins**, "Economics is the science which studies human behaviour as a relationship between ends and scarce means which have alternative uses".

Prof. Lionel Robbins

Prof. Lionel Robbins of the London School of Economics gave a new definition to Economics in his famous book [55]"Nature and Significance of Economics" which he brought out in 1931.

Features

- ✓ **Economics is a science**: Economics studies human behavior scientifically. It studies how human beings use the scarce resources optimally under given constraints. ([7]positive Sicence)
- ✓ **Unlimited ends**: Ends refer to wants. It is a general human tendency that when one want is satisfied, another want crops up. Thus, a choice has to be made between more important and less important wants.
- ✓ **Scarce Means ([60]W>R)** : Means refer to resources. Resources may be **natural** (oil. mineral ore) **or man-made** (capital goods, consumer goods). [2]Wants are unlimited, but the resources (means) to satisfy these wants are limited i.e. [5&30]all wants cannot be satisfied. [14]Economic goods are considered scarce because they do not exist in adequate quantity to satisfy social requirement. To quote Prof. Oscar Lange's words here: "Economics is science of Administration of Scarce resources in human society",

  Example: A steel producing film wants to produce steel. iron and cement. It also wants to diversify geographically, but the amount of capital it has is limited. The labour force is also limited. Availability of steel and iron is also scarce. Hence, it has to restrict itself to the scarce means.
- ✓ **Alternative uses**: Resources are not only scarce, but they can also be put to many uses. Thus, a choice has to be made between the most urgent and the less urgent needs.

  Example! Arun, a student, has exams on the next day. However, he wants to watch cricket match. His friends want him to attend a birthday party. Given the many alternatives. Arun has to choose the best way of utilizing the scarce resource (time).

Merits

- ✓ This definition has **widened scope** of economics. In Economics we **study all sorts of economic ativities** relating to scarce means of man. These means may be **material goods or non-material services**. They **may or not promote well being**. Hence, Robbin's definition is that it does not distinguish between material and non-material, and between welfare and non-welfare.
- ✓ Anything which satisfies the wants of the people would be studied in Economics. Even if a good is harmful to a person, it would be the subject matter of Economics if it satisfies his wants.

- ✓ Robbin's definition of economics is regarded as **universal.** It is concerned with the problem of unlimited ends (wants) scarce means. This problem is [42]**found at any place and in any type of economy**, that is capitalism, socialism, etc.

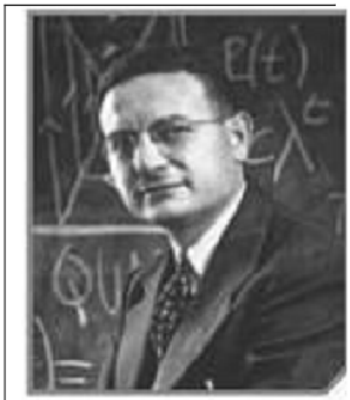
Demerits

- ✓ Concept of welfare not explicitly mentioned.
- ✓ It lacked human touch because, according to Robbins, it is only a positive science which fails to deal with what is good or bad for the society's welfare. (Definition makes economics a positive science instead of social science.)
- ✓ This is definition is narrow and restricted in scope. It does not talk about economic growth and development.
- ✓ Robbins' definition is totally silent about certain macro-economic aspects, such as determination of national income and employment
- ✓ An economic problem will arise only when there is scarcity, but it may arise during times of abundance as well. for example, For example, abundance of human resource (i.e. over population) is a major problem for many economies.
- ✓ [6]Rational decision-making requires that one's choice be consistent with one's goals.

4. Science of dynamic growth and development

Definitions

- **Paul A. Samuelson**, "Economics is the study of how men and society choose, with or without the use of money, to employ scarce productive resources which could have alternative uses, to produce various commodities over time and distribute them for consumption now and in the future amongst various people and groups of society".
- [56]**Prof Henry Smith**, "Economics, is the "the study of how in a civilized society one obtains the share of what other people have produced and of how the total product of society changes and is determined".
- [57]**Jacob Viner**, "Economics is what Economists do".


Prof. Samuelson

Features

- ✓ The above definition is very comprehensive because it does not restrict to material well-being or money measure as a limiting factor. But it considers economic growth over time.
- ✓ Samuelson's definition is combination of wealth, welfare and scarcity definitions
- ✓ Samuelson goes a step further and discusses how a society uses limited resources for producing, goods and services for present and future consumption of various people Or groups.

Conclusions

- ✓ Economic is a science that studies those activities, which are, concerned with the efficient production, consumption, exchange, and distribution of scare means which have alternative uses.
- ✓ The purpose of economics is to achieve maximum satisfaction of wants and increasing of welfare as well as economic growth.

NATURE OF ECONOMICS

Economics as a Science

A subject is considered as Science if	**Whether economics has features of science,**
It is systematised body of knowledge which studies the relationship between cause and effect.	Yes, E.g. Law of demand
It is capable of measurement.	Yes, the measurement is in terms of money.
It has its own methodological apparatus	Yes, Deductive and inductive method.
It has the ability to forecast.	Yes, future market condition can be predicted with the help of various statistical and non-statistical tools.

But it is to be noted that Economics is not a perfect science like physics or chemistry as:-

- Economists **do not have uniform opinion about** a particular event.
- The subject matter of Economics is the economic **behaviour of man which is highly unpredictable**.
- **Money**, which is measurement economy, **is itself a dependent variable**.
- It is not possible to make correct predictions about the behaviour of economic variables.

Economics as an Art

- ✓ Art is the practical application of knowledge and it guides us as how to achieve an objective.
- ✓ Whereas science teaches us to know, art teaches us to do. Unlike science which is theoretical, art is practical.
- ✓ Daily problems call be solved with help of general economic activities like production, distribution, etc. Many economic concepts, which are theoretical are also pragmatic. For example, elasticity of demand concept being used while imposing tax on a product or service. Law of diminishing marginal utility concept being used while deciding the price of a commodity,

Conclusion, Economic is both science and an art

Economic is both science and an art. It is science in its methodology and art in its application.

Economics as Positive Science and Economics as Normative Science

Positive science: Positive statement only expresses the situation. It does not pass value judgement (statements that are recommendative and suggestive). Positive science has following features:

• It deals with real situations
• It tells us what it is
• It is derived from the cause and effect relation of facts

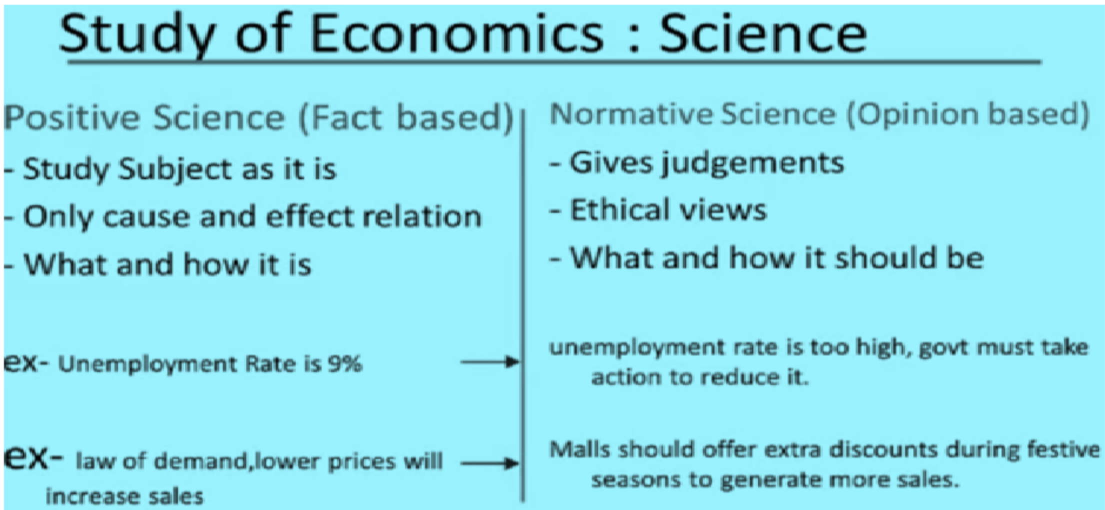
Economics is a body of systematized knowledge concerning what it is! Its objective is the establishment of uniformities. It only describes the problems and it doesn't give any solution. It is a tool maker, Prof Robbins, Senior, and Keys say economics should be positive in nature. Example for a positive statement is "[10]according to the law of demand, a lower price will lead to more goods sold and vice versa". [3]According to Robbins economics should be neutral between ends. An economist should not pass value judgements on decisions of human beings.

Normative science: Normative science not only studies the facts, but also makes value judgement. Normative science has following features:

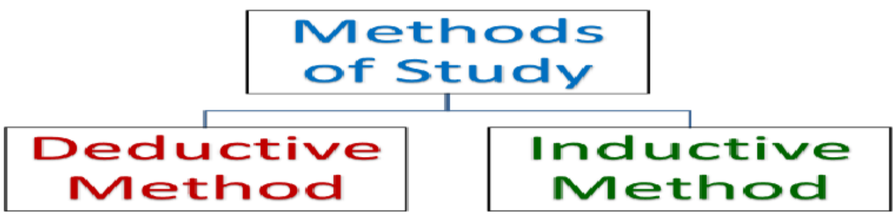
• It tells us what should be the situation
• It Involves value judgement
• It also takes ethics into consideration

Economics is a body of systematized knowledge concerning what ought to be. Its objective is the establishment of ideals. It is a prescriptive science as it describes the problems and also gives suggestions, It is the tool user. Prof. Marshall and Pigou say that economics should be normative in nature. For example. it gives judgement on various economic activities like what should be the level of national income. wage rate, [41]steps to be taken to solve various economic problems, [8]Reducing inequality should be a major priority of mixed economies etc.

Thus, we can conclude that economics is both. a positive and a normative science. While framing theories. it is a pure and positive science, but when practically applied it is normative in nature.



METHODS OF STUDY OF ECONOMICS:-



(1) **Deductive Method**:-

Deductive method is the process of reasoning from general to particular or universal to individual. This method is called abstract or a priori because it is based on a priori reasoning and conclusions are drawn from certain fundamental assumptions. and not on actual facts.

(2) **Inductive Method**:-

Inductive method is the process of reasoning from particular to general or from individual to Universal. The generalizations are based on observation of individual instances.

Difference Between Induction & deduction method

Basis	**Deduction Method**	**Induction Method**
Process of reasoning	From general to particular	[61]From particular to general
Advocated by	Classical economist	Modern economist
Based on	Certain assumptions	Concrete facts
Suitability	More suitable when facts & data are not available.	More suitable when facts & data are available.
Principal steps	- Perception of problem - Defining the technical terms and making appropriate assumptions - Deducing the hypothesis - Testing the hypotheses deduced	- Perception of problem - Collection, classification & analysis of data by using appropriate statistical techniques. - Finding out the reasons for the

		relationship established through statistical analysis and to set rules for the verification of the principles
Merits	- It is simple method - Is leads to definite and clear conclusion - It is free from bias - It is helpful in comprehending economic objectives	- Conclusions drawn from by this method are more real. - People attention is paid to the complexities of economies features. - Its approach is dynamic - Precise, exact & measurable conclusions.
Demerits	- Correct conclusions cannot be drawn for wants of real facts - It is not easy to prove the conclusion drawn by the method - Many of assumptions are unrealistic. - It is static approach	- Scope of its examination is limited - It is a complex & time consuming method as collection of facts becomes difficult. - There is possibility of bias under this method. - Due to unavailability of insufficient facts, Hurried conclusion can be drawn
Example	- Inverse relationship between price and demand - Direct realationship between price and supply	- Relationship between income and consumption - Factor determine Investment and savings.

Marshall rightly pointed out, “induction and deduction are both needed for scientific thought as the right and left foot are both needed for walking”.

CENTRAL ECONOMIC PROBLEMS

Human *wants are unlimited* and productive *resources are scarce*. An economy without scarcity is not found in the real world. All wants cannot be satisfied with the scarce productive resources for the satisfaction of wants, so [21]problem of use of scarce resources arise. This is generally called ‘the central economic problem’. The central economic problem may be four types-

WHAT to Produce

- Capital Goods or Consumer goods and in what quantities

HOW to Produce

- Labour Intensive Techniques or Capital Intensive Techniques

FOR Whom to Produce

- Share of different people in nation's population
  produce mass consumption goods at a large scale or goods for upper classes

What PROVISIONS for Economic Growth i.e., Future Growth

- Resources for current consumption, and future requirement by means of saving & investment.
- [31]Increase in current level of consumption provides slower economic growth in the future & [46]larger production of capital goods would lead to higher production in future.

Key Note: -[44]it is to be noted here that 'when are goods produced' is not central problem of economy.

PRODUCTION POSSIBILITY CURVE (PPC)

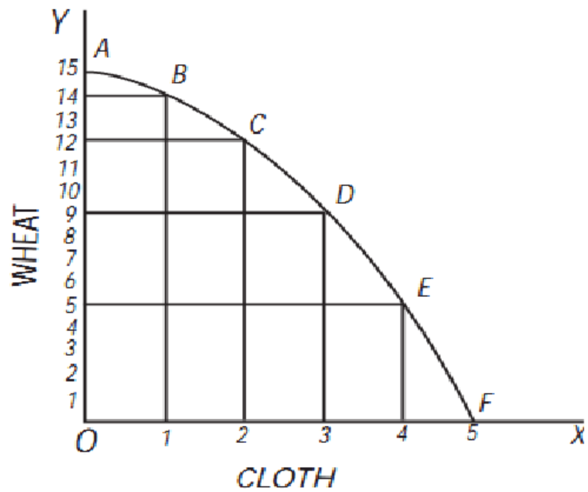
- Production-possibility curve (PPC) or "**Production possibility Frontier** (PPF)" or [66]"**transformation curve**"
- may be defined as a curve which shows the [49]**different rates of production** of **two goods** with limited productive resources and technology.

Assumption

1. **Two types of goods –cloth & wheat produced**
2. **Productive Resources remain Fixed.**
3. **Full Employment of Productive Resources- neither Unemployed nor Underemployed.**
4. **No change in technology.**

It is assumed that there are only types of goods-cloth & wheat. The resources of economy can be alternatively used in both the commodities. If the production of a commodity is increased then the production of the other commodity will be decreased. Following table shows the production possibilities of production.

Production possibilities	Cloth (in thousand metres)	Wheat (in thousand quintals)	Opportunity cost
A	0	15	
B	1	14	1
C	2	12	2
D	3	9	3
E	4	5	4
F	5	0	5



From the above table & figure it is clear that when production of of cloth increases then production of food decreases & [34&37] it will give concave shape or curvature or bowed out to PPC because opportunity cost are increasing.

PPC and Productivity Efficiency

All points on PPC curve like [24]A,B,C,D,E and f shows that [23]goods and services produced at least cost and no resources is wasted and the economy is 'Productivity Efficient'

Opportunity Cost & PPC

- Opportunity Cost or Marginal rate of substitution (MRS) or marginal rate of transformation or foregone cost and [32]trade off is rate at which the producer gives up the production of one good for another.is is expressed in terms of One unit of one good (say wheat in our case) foregone to produce one additional units of other good (say cloth in our case). Thus,

  [35]MRS = $\frac{\text{Change in No. of units in Wheat}}{\text{Change in no. of units of Cloth}}$

- [38]PPC is **downward sloping** because more production of one good is associated with less of other good.

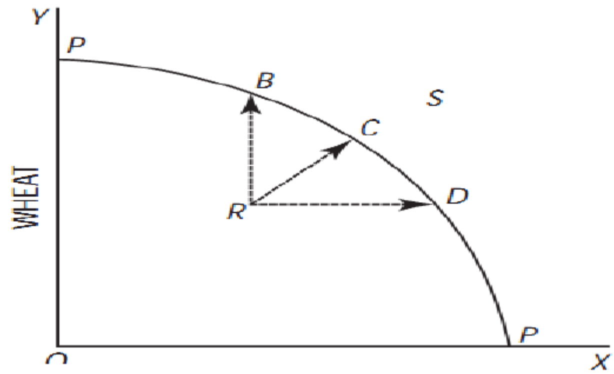
PPC- Concave to the origin-due to Increasing opportunity cost

It is this principle of increasing opportunity cost that makes the PPC concave to the origin. [27&45]If opportunity costs were constant, **PPC would be a straight line**.

Unemployment & PPC

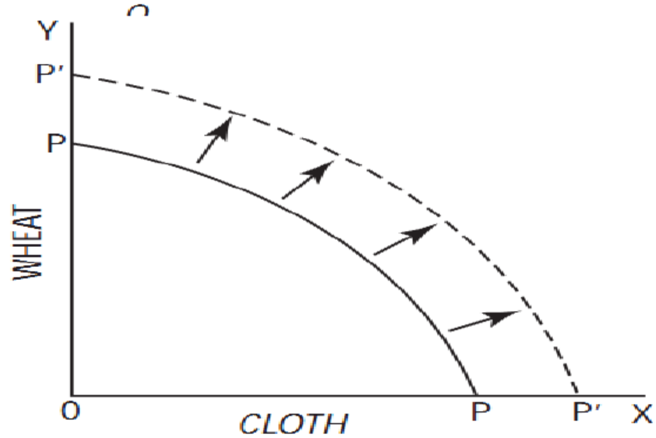
When an economy produces on PPC, it means that there is no unemployment and all the resources are being used efficiently. But [28]if an economy operates inside the PPC then there is unemployment or inefficient use of resources.

The the figure given below Point [36]'R' inside the PPC indicate underutilization of resources. In other words economy would not utilizising its resources fully. [22]Point 'S' indicate that an economy could not produce with the given resources and technology. Of economy moving from [25&26] "R" to 'B' or 'C' or 'D' points, its indicate resources which were lying unutilized are now being utilized fully.



Economic growth and shift in Production Possibility Curve

All points on the PPC show that goods and services are produced at least cost and no resource is wasted i.e. an economy is productively efficient. But that does not mean that there is no scope of progress. When the economy makes progress in technology, that is, when scientists and engineers discover new and better ways of doing things, the production possibilities curve can shift outward and to the right which indicates economic growth) in following circumstances-



1. [29&33]Improvement in overall technology
2. Greater capital formaton
3. Increase in population growth/labour force/employment

In the above figure PPC curve shift from 'PP' to 'P1P1' it indicates economic growth.

[48]Sometimes PPC may shift inward when earthquake destroy resources of the country.

ECONOMIC SYSTEMS

Capitalist economy :

- ✓ [58]Capitalism is an economic system in which all factors of production are privately owned and managed and in which production takes place on the initiative for private profits.
- ✓ The government is not supposed to interfere in the management of economic affairs under this system.
- ✓ It is called capitalist or a free market economy or laissez-faire economy.
- ✓ Eg. The United States of America, Brazil, Japan etc.

The salient **features** of market economy as follows:-

- ✓ **The right of private property** : The right of private property means that various factors of production such as land, factories, machinery, mines etc. are under private ownership. The owners of these factors are free to use them in the manner in which they like. However, The government may put some restrictions for the benefit of the society.
- ✓ **Freedom of enterprise** : This means that any individual is free to engage in any economy activity of his choice. He is also free to start a new enterprise.
- ✓ **Freedom to choice by the consumers** : This means people in a capitalist economy are free to spend their income as they like. This is known as [50]**consumer sovereignty**. Consumers are sovereigns in the sense that producers produce only those goods which consumers wish to buy.
- ✓ **Profit motive** : In a capitalist economy, Producer or entrepreneurs in their productive activities are guided by their profit motives.
- ✓ **Competition** : There always exists Competition among sellers to sell their goods and among buyers to obtain goods that satisfy their wants. Advertisement, price-cutting, discounts etc. are very common tools used to handle competition in a capitalist economy.
- ✓ **Inequalities of incomes** : Due to unequal distribution of weath, there exists a wide gap between rich and poor.

Solution of Central Problems in Capitalist Economy

In the absence of a central planning authority to solve the problems, a capitalist economy uses the forces Of demand and supply or price mechanism to solve its problems.

(1) Deciding what to produce

The main motive of an entrepreneur is to earn profit. Therefore, to earn more profit. an entrepreneur produces only those goods that are demanded by the consumers. In a free market economy, [16]allocation of resources is determined by *consumer preference.*

Example: [18]If consumers want more motorcycles, then there will be an increase in price due to an Increase in demand, which will lead to more profit. This will Induce the producer to produce more motorcycles. On other hand, if there Is less demand for cars, then there will be less production of cars in the economy.

(2) Deciding how to produce

To earn more and more profits, the entrepreneur will use the technique of production in such manner that the cost of production is minimal. There are two techniques or methods of production.

- [40]Labour intensive method: arc primarily used in labour rich countries
- [39]Capital intensive method: used primarily in capital rich countries

(3) Deciding for whom to produce :

In a capitalist economy Goods and services will be produced for those who have the buying capacity. The buying capacity of an individual depends upon his income.

Example: BMW cars are not manufactured for the middle class of the society. It is manufactured for the upper class of the society.

(4) Deciding about consumption, savings and investment

Entrepreneurs invest and consumers save and consumes. But, consumer's savings depends on interest rates. More savings is possible when the interest rates are high on saving. Decision of investment is based on rate of return. Consumers' savings depends on the rate of interest. Higher the rate of interest, higher will be the savings. Investment decisions depend upon the rate of return. Higher the rate of interest, greater will be the investment in a capitalist economy, Savings also depend on age group (generation) and disposable income. Generally, the younger generation saves less while the older generation spends less.

Merits of Capitalist economy:

- ✓ To attract the consumer, the producer will bring out **newer and finer varieties of goods**.
- ✓ [62]The existence of private property and the driving force of profit motive results in **high standard of living.**
- ✓ Capitalism works automatically through **price mechanism** since [17]a capitalist economy uses prices as principal means of allocating resources.
- ✓ The freedom of enterprise results in **maximum efficiency in production**.
- ✓ All activities under capitalism enjoy the **maximum amount of liberty and freedom**.
- ✓ Under capitalism, [68]**freedom of choice brings maximum satisfaction to consumers**
- ✓ Capitalism preserves fundamental rights such as right to freedom and **right to private property.**
- ✓ It rewards men of **initiative and enterprise**.
- ✓ The country as a whole benefits through **growth of business** talents, development of research, etc.

Demerits of Capitalist economy:

1. In capitalism, the enormous wealth produced is approtioned by a few. This causes [19]**rich to become richer and poor to become poorer.**
2. **Welfare is not protected** under capitalism, because, here, the aim is profit and not welfare of the people.

3. **Economic instability** in terms of over production, economic depression, unemployment, etc., is very common under capitalism.
4. The producer **spends huge** amounts of **money on advertisement** and sales promotion activities like fair, exhibitions etc.
5. **Class conflict arises between employer and employee**. Workers will be paid low wages and this leads to strikes and lock-outs.
6. Productive **resources** are misused under capitalism. They are **used for the production of luxuries** as they will bring high profits.
7. Capitalism leads to the **formation of monopolies**. (Mega corporate units will replace smaller units of production)
8. There is **no security of employment** under capitalism.

Socialist economy:

- ✓ In a socialist economy, the means of production are owned and operated by the Slate.
- ✓ All decisions regarding production and distribution are taken by the central planning authority, Hence, the [67]socialist economy is also called as a planned economy or command economy.
- ✓ The government plays an active role. Social welfare is given importance; hence, equal opportunity is given to alL.
- ✓ Example: Erstwhile USSR
  (Note :- In today's world there is no Country which has controlled economy)

The salient **features** of Socialist economy as follows:-

- ✓ **Collective Ownership** : In Socialist economic system, all the means of production are owned. Accordingly, the firms producing goods and services such as factories, banks, insurance, and transport etc, are owned and managed by state. Small farm, workshops, and trading firms may, however remain in the private hands.
- ✓ **Central Planning Authority** : Major economic decisions, such as what to produce, when and how much to produce, etc., are taken by the central authority. In India it is by the Planning Commission.
- ✓ **Absence of Consumer Choice**: Freedom from hunger is guaranteed, but consumers' sovereignty gets restricted by selective production of goods. The range of choice is limited by planned production. However, within that range an individual is free to choose what he likes most.The right to work is guaranteed, but the choice of occupation gets restricted because these are determined by some authority on the basis of certain socio-economic goals before the nation.
- ✓ **Relatively Equal Income Distribution** : A Socialist state strives to achieve economic equality, but it does not mean that everyone earns the same amount of income that there is no social differentiation. The society is devided intovarious functional strata. Since the requirements of the workers from different strata are unequal, their wages cannot be equal. Skilled and unskilled works from different streta of the society, and hence are paid different wages. **Socialism** only **guarantees equality of opportunity and equal pay for equal work.**
- ✓ **Minimum role of Price Mechanism or Market forces :** Price mechanism exists in a socialist economy but it has only a secondary role, e.g., to secure disposal of accumulated stocks. Since

allocation of productive resources is done according to a predetermined plan, the price mechanism as such does not influence these decisions. In the absence of the profit motive, price mechanism loses its predominant role in economic decisions.

Merits of Socialism

- ✓ **Equitable distribution** of wealth **and** income and provision of **equal opportunities** for all help to maintain social justice.
- ✓ Socialist economy is a planned economy. In a socialistic economy, there will be **better utilization of resources** and it ensures maximum production.
- ✓ **Wastes** of all kinds are **avoided through strict economic planning**.
- ✓ In a planned economy, **unemployment is minimised, business fluctuation are eliminated and stability is brought about and maintained.**
- ✓ The absence of profit motive helps the community to develop a **co-operative mentality and avoids classwar.**
- ✓ Socialism **ensures right to work and minimum standard of living to people**.
- ✓ Under socialism, the **labourers and consumers are protected from the exploitation by the employer and monopolies respectively**

Demerits of Socialism

1. Socialism involves the **predominance of bureaucracy**.(daftershahi) Moreover, there may also be **corruption, favouritism**, etc.
2. It **restricts the freedom of occupation by individuals** as there is state ownership of the material means of production and state direction and control of economic activity.
3. Socialism takes **away** such right as the **right of private property**.
4. It will **no**t provide necessary **incentive to hard work** in the form of profit.
5. There is **no proper** basis for cost calculation. In the absence of such practice, the most economic and scientific **allocation of resources** and the efficient functioning of the economic system are impossible.
6. **State monopolies** created by socialism will sometimes **become uncontrollable**. This will be more dangerous than the private monopolies under capitalism.
7. Under socialism, the consumers have **no freedom of choice**. Therefore, what state produces has to be accepted by the consumers
8. The extreme form (**pure**) of **socialism is not at all practicable**.

Mixed economy:

- ✓ In a mixed economy, both public and private institutions exercise economic control. The public sector functions as a socialistic economy and the private sector, as a free enterprise economy.
- ✓ All decisions regarding what, how and for whom to produce are taken by the state. The private sector produces and distributes goods and services.

- ✓ Cost-benefit analysis is used to answer the fundamental questions-what how and for whom to produce?
- ✓ Example: India

The salient **features** of Mixed economy as follows:-

(1) Co-existence of private and public sector : There are three sectors viz.,

(a) **Private sector** Production and distribution in this sector are managed and controlled by private individuals and groups. Industries in this sector are based on self-interest and profit motive. However, However, government may intervene, where it feels necessary. E.g Reliance & Infosys.

(b) **Public sector** Industries in this sector are not primarily profit-oriented, but are set up for the welfare of the community. E.g. SAIL, BHEL

(c) **Combined sector** A sector in which both the government and the private enterprises have equal access, and join hands to produce a commodity, leading to the establishment of joint sectors.

(2) Existence of Economic Planning : A mixed economy is a planned economy, i.e. an economy in which the government has a clear and definite economic plan. Public sector enterprises have to work according to a plan and to achieve the objectives laid down. The government has also to create necessary atmosphere for the private sector to develop on its own.

(3) **Positive role of the government** : In a mixed economy, balanced regional development is expected. Public sector enterprises may be located in the backward regions so as to ensure their development. Subsidies and other incentives may be offered to private sector lured to establish and develop industries in backward regions.

(4) Administered Price : In a mixed economy, a dual system of pricing exists. In the private sector, prices of goods and factors of production are determined through the free play of market forces of demand and supply. In the public sector, the state determines the prices of various products The state may fix the prices of certain essential commodities which are used by common man. For example, in India, the prices of essential commodities like diesel, LPG, etc. are fixed by the government.

Merits of Mixed Economy

- ✓ Mixed economy secures the [20]**merits of both capitalism and socialism while avoiding the evils of both.**
- ✓ Mixed economy **protects individual freedom.** Under the system, individuals have the freedom of consumption, choice of occupation, freedom of enterprise and freedom of expression.
- ✓ **Price mechanism is allowed to operate** under mixed economy.
- ✓ **Reducing the inequalities** of wealth **and class struggle** is one of the aims of mixed economy.
- ✓ Economic **fluctuations can be avoided due to** the presence of a **centrally planned economy**.

- ✓ Mixed economy **helps under-developed countrie**s to have rapid and balanced economic development.

Demerits of Mixed Economy

1. Mixed economy is **difficult to operate**. Balancing and adjusting the public and private sectors is often difficult.

2. **Excessive controls and heavy taxes** are likely to prevail under mixed economy. These will discourage production in the private sector.

3. **Problems of nepotism, favouritism, officialdom,** etc. are also found in this type of economic system.

4. Mixed **economy is described by Schumpeter as "Capitalism in the oxygen tent"**. According to him it is only a trick of the capitalists to cheat the working class by offering them some temporary advantages like social security, upliftment of the depressed classes, etc.