

02. ECONOMIC SYSTEMS – DEFINITIONS AND CHARACTERISTICS - CAPITAL ECONOMY – SOCIALIST ECONOMY – MIXED ECONOMY

C. ECONOMIC SYSTEMS

i) Circular Flow of Goods and Money in an Economic System

Every economy is a system in which the production of many goods is organized to satisfy many wants of human beings. In an economic system, the two economic units namely households and enterprises are linked by a circular pattern of economic activities as illustrated in Figure 1.1. The choices and decisions of these two main units are the deriving forces of economic activity.

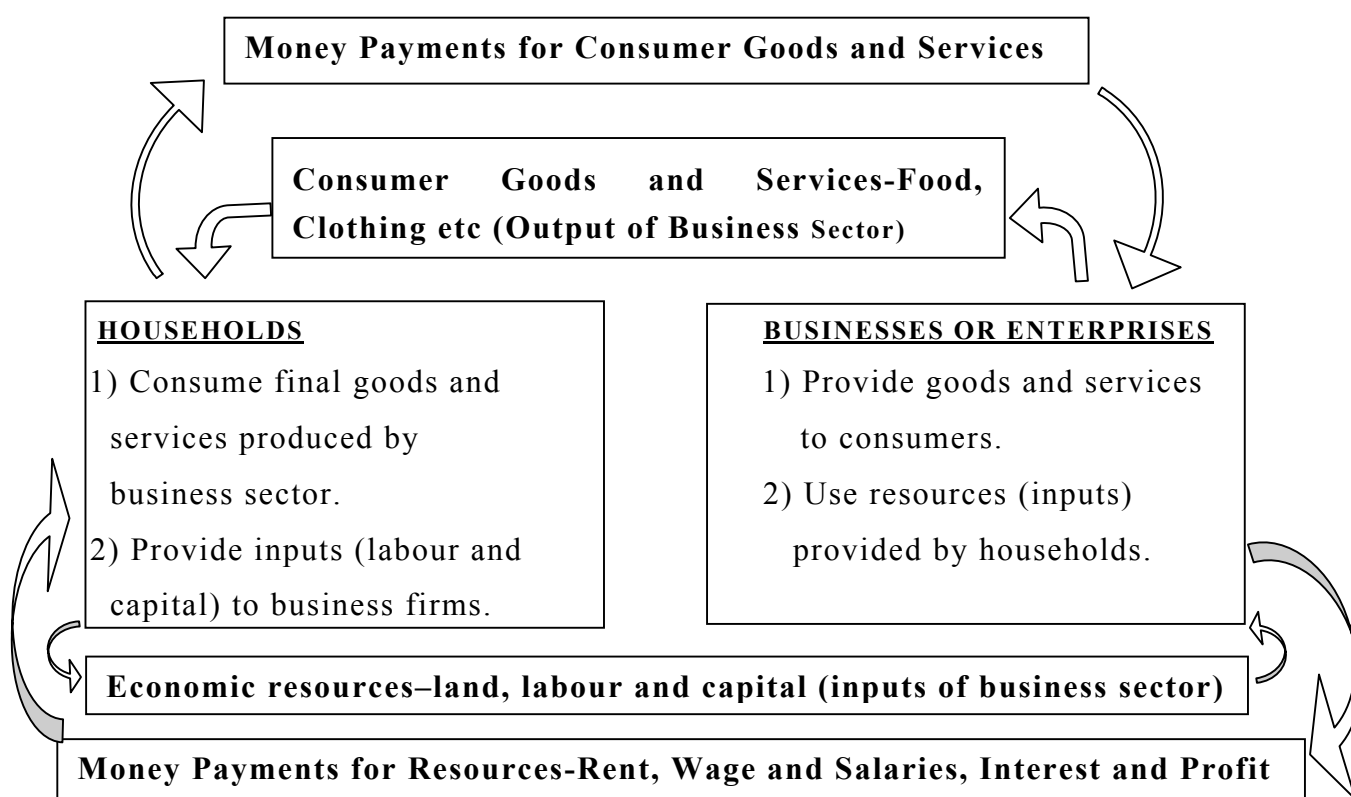


Fig. 1.1: The Flow of Goods, Services, Resources and Money Payments in a Simple Economy.

In their households, people make two sets of decisions: a) selling the inputs they own, primarily their labour and b) buying goods with their incomes. The enterprises or businesses engage in production, using the labour and other inputs bought from households. The goods produced by the firms are sold ultimately to the households.

The interactions of households and firms bring together the two sides of economics: demand and supply. The action occurs in two sets of markets; that

for inputs and that for outputs. In the input markets, households offer their labour, land and capital. Firms buy these inputs at prices set in the markets. In the output markets, the enterprises sell out the goods and services to the consumers or households.

ii) Types of Economy

An economy might be designed to depend exclusively either on the market or on government to make the three fundamental decisions of what, how and for whom. The economic system can be broadly categorized into a) capitalism and b) socialism.

a) Capitalism

Capitalism is a system of economic organization characterized by the private ownership and use of capital with profit motive. The most important feature of capitalism is the existence of private property. Every one has the freedom to form any firm anywhere he likes, provided he has the requisite capital and ability. It is based on the doctrine of *laissez faire* which would mean that the state interference in economic activity should be kept down to the minimum.

b) Socialism

Socialism is an economic system in which the means of production (capital equipment, buildings and land) are owned by the state. The main aim of socialism is to run the economy for social benefit rather than private profit. It emphasizes on work according to one's ability, and equal opportunities for all regardless of caste, class and inherited privileges.

Communism is a form of socialism. It was followed in the erstwhile Soviet Union. Communism means an idealistic system in which all means of production and other forms of properties are owned by the community as a whole, with all members of the community sharing in its work and income. People are supposed to work according to their capacities and get according to their needs. The aim is to create a classless society and the state machinery is utilized to crush all opposition to achieve this end. The main difference between communism and socialism is that the former believes and adopts violent revolutionary methods to capture the machinery of the government while the latter believes in peaceful and parliamentary methods.

c) Mixed Economy

It is neither pure capitalism nor pure socialism but a mixture of the two. In this system, we find the characteristics of both capitalism and socialism. Both private enterprises and public enterprises operate mixed economy. The government intervenes to regulate private enterprises in several ways. Generally, the basic and heavy industries like industries producing defense equipments, atomic power, heavy engineering goods etc. are put in the public sector. On the other hand, the consumer goods industries, small and cottage industries, agriculture etc. are assigned to the private sector. It is realized that in the under developed countries, like India, economic development cannot be achieved at the desired rate of growth without any active government help and guidance. Hence, the government in such countries actively participates in economic activities in order to minimize the evils of capitalism and to accelerate economic growth.

In capitalistic economy, the entrepreneurs utilize the available resources efficiently, as they have strong initiative to earn profit. But the free functioning of private enterprises results in extreme inequalities of income and wealth. In socialistic economy, the inequalities in income and wealth get reduced to the minimum and the national income is more equitably distributed. But the socialistic economy suffers from the problem of lack of private initiative that results in the lack of inventive ability and enterprising spirit and ultimately these lead to inefficient use of available resources. The mixed economy aims at achieving the goals of both capitalism and socialism (i.e., efficient use of resources and equitable distribution of income and wealth) and at the same time, it emphasizes on the reduction of evils of capitalism and socialism.

D. ECONOMICS AS RELATED TO AGRICULTURE

The principles of economics guide the farmers to balance the link between farm and household. As producers, farmers want to earn maximum profit from the scarce resources, which could have alternative uses, and at the same time, they want to provide maximum satisfaction to their families as consuming units. Thus, in an environment where a farmer desires to achieve profit maximization and improving the family standards of living with a limited stock of factors of production (land, labour, capital and organization) which can be put to alternative uses, economic principles, can be applied. Economic principles also form a guiding force in the formulation of policies influencing agricultural growth and development at the macro level.

CHAPTER 1: Questions for Review

1. Fill up the blanks:

- a) Lionel Robbins definition of economics is known as _____.
- b) Rice is a _____ good while medical service is a _____ good.
- c) Wealth definition was propounded by _____.
- d) Paul Samuelson gave _____ definition of economics.
- f) *Laissez faire* is being followed in _____ economy.

2. Write short notes:

- a) Central problems of an economy.
- b) Circular flow of an economy.
- c) Scarcity definition of economics.
- d) Economics as defined by Prof. Samuelson.
- e) Economics is both a science and an art.
- f) Economics as related to agriculture.

3. Differentiate the following:

- a) Deductive method and inductive method.
- b) Micro economics and macro economics.
- c) Positive economics and normative economics.

4. Answer the following:

- a) What are the defects in Adam Smith's definition of economics?
- b) What are the merits and demerits of scarcity definition of economics?
- c) Explain the traditional approach to the study of economics.
- d) Mixed economy is better than other types of economies-Substantiate.