STUDY MATERIAL

ON

ECONOMICS-I

B.A;LL.B. 1ST SEMESTER

Contents:

(Paper Code : BL – 1004)

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BOOKS RECOMMENDED

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Introduction of Economics

Economics is a social science. Its basic function is to study how people – Individuals, household, firms, and nations –maximize their gains from their limited recourses and opportunities. In economic terminology, this is called maximizing behavior or, more appropriately, optimizing behavior. Economics is thus a social science, which studies human behavior in relation to optimizing allocation of available recourses to achieve the given ends.

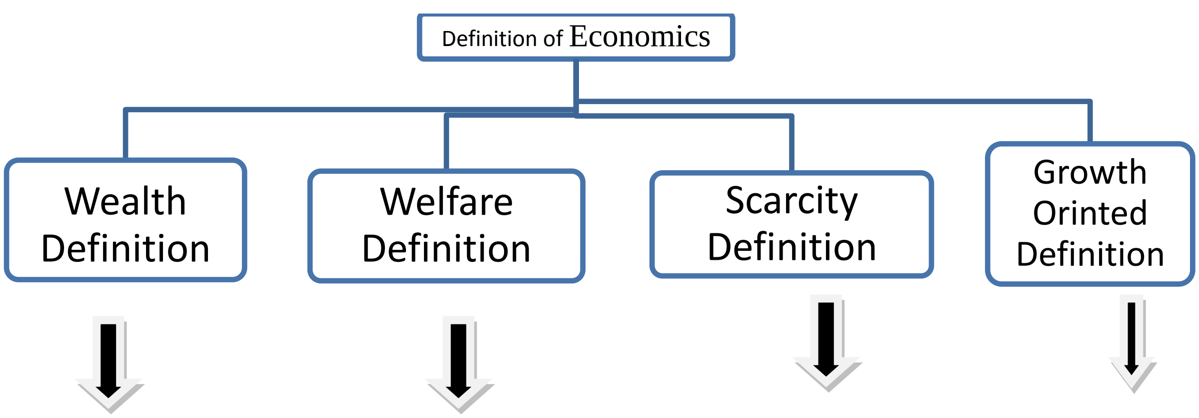
Economics studies how household allocate their limited resources (income) between centralize various goods and services they consume so that they are able to maximize their total satisfaction. It analyses how household with limited income decide **'What to Consume'** and **'how much to Consume'** with the aim of maximizing total utility.

Economics is the study of how individuals & group of make decision with limited resources as the best satisfy their wants, need, and desires.

Meaning of Economics:

The term 'Economics' in English language has its origin in two Greek words- Oikos (Household) and Nemein (Manage). Thus, they mean 'Manage of Household'. Wants of each household are unlimited but most of the means to satisfy them like food, cloth, etc., are limited or scarce. Thus, faced with scarcity, people while managing the household must make choice.

Definition of Economics:



1. Adam Smith	1. Marshall	1.LordRobbins	1.
Bentham			
2. J.S.Say	2. Cannan	2.Scitovosky	2.J.k
Mehta			
3. J.S.Mil	3. Penson	3. Stonier&Hogue	
4. Senior	4. Beverages	4. Harvey	

Wealth Definition:

- **According to Adam Smith: "**An enquiry into nature & cause of wealth of nations."
- Adam Smith defines Economics as the "Science of wealth". Economics was regarded as the science which studied the production & Consumption of wealth

Welfare Definition :

- **According to Alfred Marshall's: "**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 the use of the material requisites of well being."

Scarcity Definition:

- **According to Robbin's:** "Economics is the science which studies human behavior as a relationship between scarce means which have alternative uses."
- **'Scarcity** (also called paucity) is the fundamental **economic** problem of having seemingly unlimited human wants in a world of limited resources. It states that society has insufficient productive resources to fulfill all human wants and needs.'

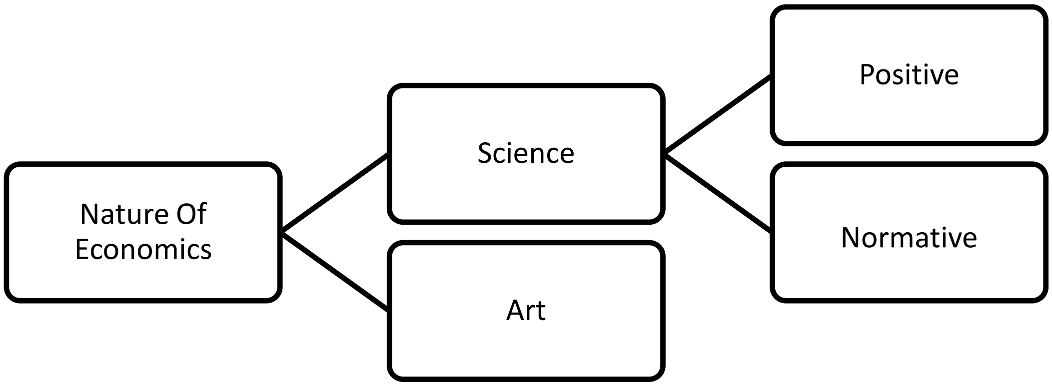
Growth Oriented Definition:

- **According to Him "**Economics is the study of how people and society end-up choosing, with or without, the use of money, to employ scarce productive resources that could have alternative uses to produce various commodities and distribute them for consumption, now or in the future among the costs and benefits of improving patterns of resource allocation ".

Nature of Economics:

The objective of the study of nature of economics is to know whether economics is a Science or an Art or it is both sciences as well art.

According to Samuelson, "Economics is the oldest of the Arts, the Newest of Science – Indeed the queen of all the Social Science".



<u>Economics as a Science:</u> The term Science has its origin in term 'Scientia' of Latin Language. It means "to know". By knowing a subject we mean understanding it and begin able to describe its causes and effects. Science has been defined in these terms-"**Science is a systematic body of knowledge concerning the relationship between causes and effects of a particular phenomenon".**

According to Poincare, "Science is built-up of facts as a house is built of stones but an accumulation of facts is no more a science than a heap of stones is a house". In other words, to build science, we must collect, classify and analyse the facts systematically. In economics also one collect classifies, and analyses economics facts systematically. \

<u>Economics is Positive science.</u>

- It is defined as a body of systematized knowledge concerning what **<u>is.</u>**
- The objective of a positive science is the establishment of uniformities
- It deals with things as they are.
- It explains their causes & effects.

<u>Economics is Normative science.</u>

- It is defined as a body of systematized knowledge relating to the criteria of what ought to be.
- It deals with things as they ought to be
- The objective of a normative science is the determination of ideals.

Economics as an Art:

Weather economics is an art or not, is yet another controversial subject among the economists.

The art is lays down a specific solution for specific problems.

According to J.N. Keynes: **“**An art is a system of rules for the attainment

Of given ends”.

Science teaches us to know or an Art teaches us to do.

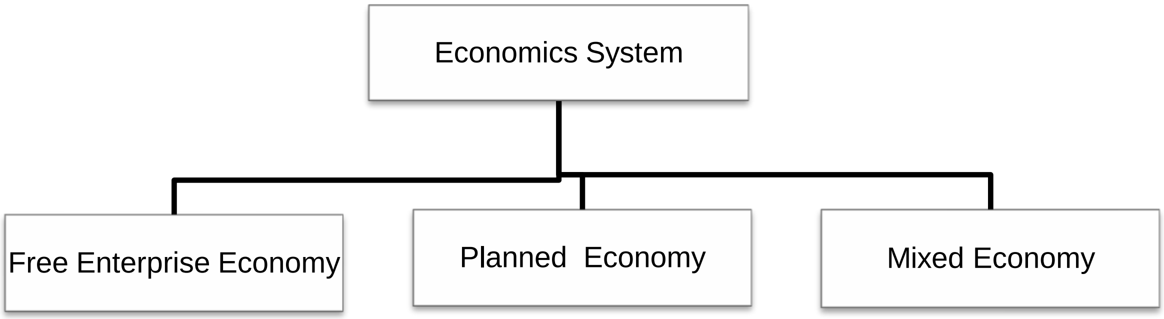
Economics as a Social Welfare :

- **Welfare economics** is a branch of **economics** that uses microeconomic techniques to evaluate well-being (**welfare**) at the aggregate (economy-wide) level. ... The field of **welfare economics** is associated with two fundamental theorems.
-
- **Social welfare** is not the same as standard of living but is more concerned with the quality of life that includes factors such as the quality of the environment (air, soil, and water), level of crime, extent of drug abuse, availability of essential **social** services, as well as religious and spiritual aspects of life.

Economics as a Social Justice:

- **Economic justice** is a component of social **justice**. It's a set of moral principles for building **economic** institutions, the ultimate goal of which is to create an opportunity for each person to create a sufficient material foundation upon which to have a dignified, productive, and creative life beyond economics.

Economics System is the means by which countries and governments distribute resources and trade goods and services. They are used to control the five factors of production, including: labor, capital, entrepreneurs, physical resources and information resources.



<u>Free Enterprises Economy</u>: Capitalism is an economic system in which the means of production are privately owned and operated for profit usually in competitive market.

In other word “An economics System in which investment in and ownership of the means of production, distribution, and exchange of wealth is made and maintained chiefly by private individuals or corporation.

<u>Merits of Free Enterprises Economy</u>:

1. The resources are utilized efficiently and economically.
2. Producers, consumers and the workers all enjoy economic freedom and are free to work, as they like. Goods are produced according to the taste, preference and circumstances of the economy.
3. Capitalist System can make change according to the needs and circumstances of the economy. It has inbuilt flexibility.
4. An automatic equilibrium is brought about by the operation of price mechanism and market forces. No central direction is required for the operation of the economy.
5. There is no interference in economic matters. Every individual is free to take decisions as to his economic activities keeping in mind his own – interest.

<u>DEMERITS OF FREE ENTERPRISES ECONOMY</u> :

In a Capitalist economy, wealth enjoys the prestige in the society, which results in erosion of human values.
There is a large –scale wastage of resources due to unnecessary competition.
In capitalist system, owners of the means of production can earn more as compared to those who do not possess much means of production. This brings wide inequalities in the distribution of income and wealth.
In modern capitalist market group rivalries and price wars, price-agreements etc. are commonly found.

In capitalist countries, society possesses two classes such as haves and have- notes. Such division result in conflict in the form of strikes, lockouts and industrial disputes in the economy. Under capitalism, Capitalists generally exploit the poor laborers.

Planned Economy: A socialist economic system is characterized by social ownership and democratic control of the means of production, which may mean autonomous cooperatives or direct public ownership; wherein production is carried out directly for use.

The term socialism refers to any system in which the production and distribution of goods and services is a shared responsibility of a group of people. Socialism is based upon economic and political theories that advocate for collectivism. In a state of socialism, there is no privately owned property.

PLANNED ECONOMY IS CHARACTERIZED IN THE FOLLOWING WAYS:

- The means of production are owned by public enterprises or cooperatives (the state), and individuals are compensated based on the principle of individual contribution.
- There is equal opportunity for all.

MERITS OF PLANNED ECONOMY:

- **NO LABOUR EXPLOITATION**:

There is only one class in a socialistic economy hence there is no question of exploitation.

- **PROPER UTILISATION OF RECOURSES**:

Under this economy, all types of natural resources are utilized in a most organized manner. Its main objective is to exploit these resources for the welfare of society.

Proper Planning:

In order to solve various problems, which arise from time to time, there is proper economic plan in this type of economy. Thus, with the help of economic plans socialist economy will adopt the balanced development strategy.

- **SOCIAL WELFARE:**

The aim of socialist economy is to maximize social welfare of the society. It provides equal opportunities of employment to all individual according to their abilities

Demerits of Planned Economy:

Economists like Robbins, Maurice Dobb, and Georg Helm etc., have criticized the socialist economy on the following:

- **Evils of Bureaucracy:**

In socialist economy, all economic activities are controlled by the government. Thus, they develop all evils of bureaucracy like favoritism, delay; corruption and other evils,

- **Burden on Government :**

All the economic activities are performed by the Central Authority on behalf of the government. Hence, it is overburdened with daily activities and, therefore, it gets very less time to think and plan for the economic prosperity of the economy.

- **Expenditure on Planning** :

  In fact, planning is a long process in a socialist economy. This expenditure is unnecessarily wasteful and a burden on the national economy.

Mixed Economy :

It is a golden mixture of capitalism and socialism. Under this system there is freedom of economic activities and government interferences for the social welfare. Hence it is a blend of both the economies. The concept of mixed economy is of recent origin.

According to "Murad":

"**Mixed economy is that economy in which both government and private individuals exercise economic control.**

According to Prof. Samuelson,

"**Mixed economy is that economy in which both public and private sectors cooperate."**

Merits of Mixed Economy :

- **Best Allocation of Recourses:** mixed economy incorporates the good features of both capitalism and socialism, the resources of the economy are utilised in the best possible manner. The price mechanism, the profit motive, and the freedoms of consumption, production, and occupation lead to the efficient allocation of resources within the economy.
- **General Balance**: A mixed economy maintains a general balance between the public sector and the private sector. There is competition as well as cooperation between the two sectors which are conducive for achieving a high rate of capital accumulation and economic growth.

- **Welfare State**: A mixed economy contains all the features of a welfare state. There is no exploitation either by the capitalists as under a free enterprise economy or by the state as under a socialist economy. The workers are not forced to work, Workers are provided monetary incentives in the form of bonus and cash rewards for inventions.

Difference Between Free Enterprise &Planned Economy

Free Enterprises	Planned Economy
1. Individual Freedom.	1. No Individual Problem.
2. Consumer is Sovereign.	2. Loss of Consumer's Sovereignty.
3. Unearned income in the form of profits.	3. No Unearned Income.
4. Existence of Competition.	4. Absence of Competition
5. Right to acquire private property.	5. State ownership of all factors of production. No right to acquire private property.
6. Wastage of resources.(advertisements).	6. No wastage of resources.
7. Price fixed by Demand and Supply.	7. No rationale in Price system. State fixes prices.
8. No equal opportunities, wealthy people get all the opportunities.	8. Equal opportunities to all.

UNIT -2

Introduction of Demand

One of the market forces which determine price is demand. Demand is related to consumption. It represents the process through which a consumer obtains goods and services he wants to consume The Demand in economics is something more than desire to purchase through desire is one element of it. **For Example** A beggar may desire food but due to lack of means to purchase it, his demand is not effective. It economics, demands refer to effective demand, which implies three things

1. Desire,
2. Means to purchase
3. On willingness to use those means for that Purchase

Definition ,of Demand

According to G.L Thiekttle : The demand for any commodity or service is amount that will be bought at any given price per unit time.

According to Benham : The demand for anything at a given price is amount of it , which will be bought per unit of time , at that price.

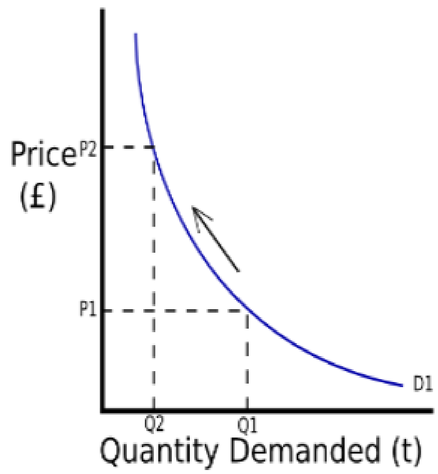
According to Bobber: By demand we mean the various quantities of a given commodity or service which consumers would buy in one market in a given period of time at various prices.

Features of Demand :

1. When the person, who is in need and desiring, is willing and able to pay for what he desires, the desire changes into demand.
2. The demand is always at a price.
3. The demand is always per unit of unit of time.
4. The demand indicates the quantity or the amount of the commodity the consumer are prepared to buy at the particular price.

Type of demand

Price demand : Price demand ,other things remaining unchanged ,refers to the various quantities of a commodity or service that a consumer would of a commodity or service that a consumer would purchase at a given time in a market at various prices.



Income demand : The Income demand ,other things remaining unchanged, refer to the various quantities of goods and service which would be purchased by the consumer at Various Income

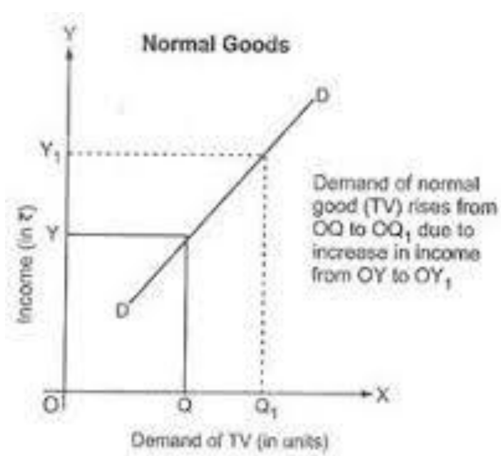


Fig. 3.16

Type of Income Demand:

- **Superior Demand: Superior goods** make up a larger proportion consumption as income rises, and therefore are a type normal **goods** in consumer theory. Such a **good** must possess tv economic characteristics: it must be scarce, and, along with that, it musı have a high price.
- **Inferior Goods:** an **inferior good** is a **good** that decreases in demand when consumer income rises (or rises in demand when consumer income decreases), unlike normal **goods**, for which the o te is ob . Normal **goods** are those for which consumers' demand increase when their income increases.

Cross Demand : The cross demand, other things remaining constant, refers o the quantities of a good or service which will be purchased with reference to change in price not of this good but of other inter-related goods. These goods are either substitutes, or complementary good.

Substitution Goods : **Substitute goods** are two **goods** that could be used for the same purpose. If the price of one **good** increases, then demand for the **substitute** is likely to rise. Therefore, **substitutes** have a positive cross elasticity of demand. A decrease in the price of A will result in a rightward movement along the demand curve of A and cause the demand curve for B to shift in. **Examples** of **substitute goods** include margarine and butter, tea and coffee

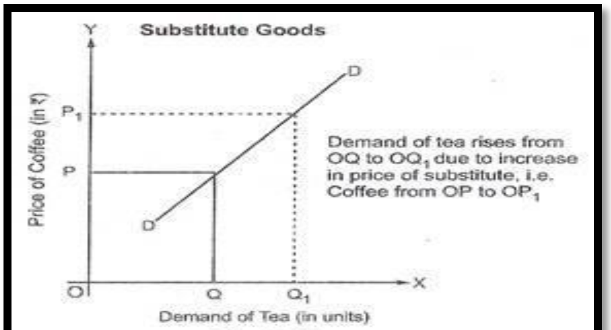
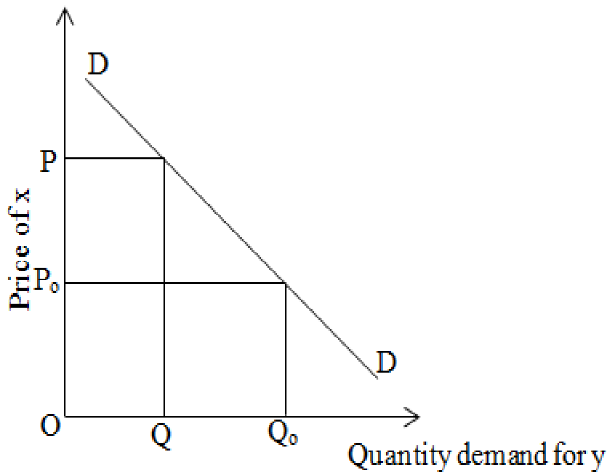


Fig. 3.10

<u>Complementary Goods:</u> A **complementary good** or **complement** is a **good** with a negative cross elasticity of demand, in contrast to a substitute **good**. This means a **good's** demand is increased when the price of another good is decreased. Conversely, the demand for a **good** is decreased when the price of another **good** is increased.



<u>Factors affecting demand or causes of changes in demand :</u>

- **<u>Price of the commodity:</u>** Demand is decisively affected by the change in the price of the commodity concerned. There is inverse relation between price and the quantity demanded.

- **Income of the Consumer:** The demand for a normal commodity goes up when income rises and falls down when income falls and thus the demand has direct relation with the Income.
- **Prices of related goods:** In the cases of substitutes example Tea and Coffee, an increase in the consumption of one will lead to a decrease in the demand for the other. Thus the demand for a commodity does not depend only on this own price but the prices of other goods.
- **Tastes, preferences and other fashion of the consumer:** The amount demanded also depends on consumer tastes which include fashion habit custom etc….
- **Wealth:** The amount demanded of a commodity is also affected by the amount of wealth. The wealthier are the people , higher is the demand for normal commodities.
- **Money supply:** The additional money supply will add to the purchasing power of the community, and the prices will rise, demand for certain goods will be reduced and for others stimulated.
- **Saving:** Larger the saving, lesser the demand for the commodities.
- **Conditions of trade:** The level of demand for different commodities also depends upon the business conditions in the country. In boom conditions, there will be a marked increase in demand and demand goes down during depression.
- **Expectations regarding the future:** If consumers expect their income to rise in the near future they may increase the demand for a commodity just now. If prices are expected to rise in future the demanded for goods will increase now in the present.
- **Climate and Weather:** The climate of an area and the weather of an area and the weather prevailing there has a decisive effect on consumer demand. In cold areas, woolen cloth is highly demanded. During hot summer days, ice is very much in demand.

Demand Schedule:

Demand schedule is a table or a chart which shows the relationship between price and demand of a commodity or service unit of time. If we list the different quantities of a commodity demanded at different prices in the form of raw and column the resulting format is demand schedule. In other words, demand schedule establishes a functional relationship between independent variable price and dependent variable demand.

Type of Demand Schedule

Demand schedule are of two types:

1. Individual Demand Schedule
2. Market Demand Schedule.

- **Individual Demand Schedule** : This is a tabular statement showing the different quantities of a commodity demanded by a consumer or a household within a given period of at different prices. **For Example** Let us suppose that a household purchase 350 gm of apples per days at a price of Rs. 10 per kilogram. When the price fall to Rs. 9 per kilogram It increases its demand to 600 grams. As the price goes on decreasing. The household continues to increase its demand. When the price falls to Rs. 1 per kilogram ,its demand shoots upto 8 kilogram

Price per kg	Apple demanded (in kg)
10	.35
9	.60
8	1.00
7	1.40
6	1.90
5	2.50
4	3.40

Market demand Schedule for obtaining the market demand schedule quantities demanded by different buyers at each price are added up. Every individual buyer will purchase different quantities of apple at different prices. The slope of this demand curve will be negative. It will slope downward from left to right. If there are only two buyers in the market and their demand schedule are identical then the demand for the commodity in the market will be exactly double the quantity demanded by a single buyer. Therefore, we have added up the quantities demanded by various buyers at different prices. This gives us the market demand schedule.

Price per kg	**Qty demanded 1**	**Qty demanded 2**	**Market demanded**
10	.35	1.25	1.60
9	.60	1.40	2.00
8	1.00	1.45	2.45
7	1.40	1.60	3.00
6	1.90	1.75	3.65
5	2.50	1.95	4.45
4	3.40	2.10	5.50
3	4.60	2.15	6.75
2	5.90	2.50	8.40
1	8.00	3.35	11.35

Reason for the law of demand or the sloping downwards of the demand curve

The downward slope of the demand curve implies inverse relationship between demand and price of a commodity. Following are the reasons for the downward or negative slope of the demand curve:

1. **Substitution Effect :** when the price of a commodity falls, it becomes relatively cheaper than other commodities. It induces consume to substitute the commodity whose price has fallen for other commodities. When have

now become relatively expensive. The result is that total demand for the commodity whose price has fallen increases.

2. **Income Effect :** when the price of a commodity falls the consumer can buy the same quantity of the commodity with lesser money or he can buy more of the same commodity with the same money. In other words as a result of fall in the price of the commodity, consumer real income or purchasing power increases. This increase in the real income induces him to buy more of that commodity. Thus demand for that commodity increases.
3. **Diminishing Marginal Utility :** when a consumer buys more units of a commodity , the marginal utility of that commodity continues to decline. Therefore the consumer will buy more unit of that commodity only when its price falls. When fewer units are available, utility will be high and the consumer will be prepared to pay more for the commodity. This proves that the demand will be more at a lower price and it will be less at a higher price. That is why the demand curve is downward sloping.
4. **Different Uses :** There are different uses of certain commodities and service that are responsible for the negative slope of the demand curve. With the increase in the price of such products. They will be used only for more important uses and their demand will fall. On the contrary, with the fall in price, they will be put to various uses and their demand will rise.
5. **Price Effect :** every commodity has certain consumers but when its price falls, new consumers start consuming it, as a result demand increase. On the contrary, with the increase in the price of the product, many consumers will either reduce or stop its consumption and the demand will be reduced. Thus ,due to the price effect when consumers consume more or less of the commodity ,the demand curve slope downward.

The law of demand

Meaning and definition of Law of Demand

Law of demand explains the relationship between change in quantity demanded and change in price. It states that higher the price. The lower would be the quantity demanded in the market. And the lower the price. The higher would be the quantity demanded in the market. "The law of demand says that and the price and the quantity demanded are inversely related, all other things being equal".

According to Marshall "(The amount demanded increases with a fall in price and diminishing with a rise in price)."

According to Bilas " (The law of demand states that other things being equal the quantity demanded per unit at time will be greater , lower the price and smaller, higher the price")

According to Prof. Samuelson "(law of demand states that people will buy more at lower prices and buy less at higher prices other things remaining the same)"

According to Ferguson's "(the law of demand the quantity demanded varies inversely with price)"

<u>Assumptions of the Law of demand</u>

According to Prof.Stigler and Boulding, the main assumptions of the law are:

1. No change in tastes and preferences, fashions of the consumers;
2. Consumer's income ,both money and real income must remain the same;
3. The price of the other commodities related to the commodity in demand should not change;
4. There should be no change in the wealth of the consumers;
5. Substitutes are not discovered ;
6. No anticipatory changes in prices.

<u>Different types changes in demand for a commodity</u>

There are four types of changes in demand. Two types of changes take place due to change in price and they are extension of demand and contraction of demand. Two types of changes take place due to change of other things and they are increase in demand and decrease in demand

1. **Extension of Demand:** when other things remain the same with a fall in the price, the amount demanded goes up or extends. There will be downwards movement along the same demand curve.

PRICE	QTY
5	5
4	10
3	15
2	20
1	25

In Table when price of commodity is Rs. 5, its quantity demanded is 5 unit. As the price of the commodity falls Rs. 4 quantity demanded increase to 10 unit, again when price falls to Rs 1 ,its quantity demanded further increases to 25 unit

2. **Contraction of Demand** it means other things remaining the same ,an increase in price leads to a fall in demand .

When price of commodity is Rs. 1, its quantity demanded is 30 unit. As the price of the commodity falls Rs. 3 quantity demanded increase to 20 unit, again when price falls to Rs 5, its quantity demanded further increases to 10 unit

Price	Qty
1	30
2	25
3	20
4	15
5	10

Increase in demand : as a result of changes in factor other than price, the demand shifts to another demand curve which is on the right side and above. The demand curve itself moves to the right side and moves above.

Decrease in demand : As a result of changes in factors other that price the demand shifts to another demand curve which than price the demand shifts to another demand curve which is on the left side below. The demand curve itself moves to the left side and moves below.

Thus we can find clear difference between extension and increase in demand and contraction and decrease in demand.

SUPPLY

Meaning and definition of Supply

Price is determined by the forces of demand and supply. They are called market forces. Supply indicates the amount of the goods offered for sale at a given price. Supply changes with the change in price. Supply is a flow of goods in the market.

According to Mayers "supply means the amount offered for sale at given price. We may define supply as a schedule of the amount of a good that would be offered for sale at all possible prices at any one instant of time, or during any one period of time,"

For a large number of goods, there is an intermediate step in supply. Individuals supply factors of production of firms. Firms are organizations of individuals that transform factors of production into consumable goods. For produced goods, supply depends not only on individuals decision to supply factors of production it also depends firm ability to produce to transform these factors of production into consumable goods.

The supply of non produced goods is more direct. Individuals supply their labour in the form of service directly to the good market.

Example; an independent contractor may repair washing machine. The contractor supplies his labour directly.

supply function

Supply of a goods or service refers to the quantities that the seller is willing to and able to offer for sale at various prices within a given time period, other factors held constant.

The quantity supplied of a commodity is not dependent upon its price alone but on a number of factors such as the prices of other commodities, the price of factors used in its production the goals of producers and the state of technology. These factors can be written in the form of equation known as supply Function thus:

Sn =f (pn, p1 ……. (n-1), T, Fp, MT,)

Sn = QUANTITY OF SUPPLY OF THE GOODS N,

F= REPRESENTS THE FUNCTIONAL RELATIONSHIP

PN = PRICE OF THE GOODS N

P1 …… (n-1) = price of the other goods

T = technology

Fp = price of factors of production which are include in cost

MT = TIME PERIOD

In a simple form we can say, the supply function other things remaining constant is Sn=f (Pn). This means that the quantity supplied of a good varies directly with price.

Causes of change in supply

1. **Prices of the commodity:** The supply of the commodity depends on the price of that commodity. Higher the price greater is the supply
2. **Prices of other commodities:** The supply of the commodity also depends on the prices of other commodities. If the prices of other goods are more

attractive then, they are demanded more and the demand of this commodity goes down.

3. **Cost of production:** Supply is influenced by the cost of production. Cost of production of a commodity may rise due to increase in the cost of the various factors of production. This will result in a decrease in supply
4. **State of Technology:** Supply depends on the state of technology. Improvement in technology lowers cost of production and increase supply
5. **Means of communication:** Improvement in the means of communication and transport may increase the supply of a particular commodity by expanding the market.
6. **Nature:** Favorable natural condition like better rainfall would increase the supply of food grain and larger supply of agriculture product provide lower costs for the production of industrial goods and increase in their supply.
7. **Producer's goals:** The supply of goods in determined by the goals set by the producing firms for themselves. They can decide to produce more or less on the basis of their ideology.
8. **Number of seller:** Entry of more sellers will increase the supply and the exit of sellers will decrease the supply.

SAVING

Meaning and Definition of Saving

Saving is important to the economic progress of a country because of its relation to investment. If there is to be an increase in productive wealth, some individuals must be willing to abstain from consuming their entire income. Progress is not dependent on saving alone; there must also be individuals willing to invest and thereby increase productive capacity. **Saving,** process of setting aside a portion of current income for future use, or the flow of resources accumulated in this way over a given period of time.

According to Keynesian "**Saving** is income not spent, or deferred consumption. Methods of **saving** include putting money aside in, for example, a deposit account, a pension account, an investment fund, or as cash. **Saving** also involves reducing expenditures, such as recurring costs.

Saving Function

Saving is defined as the part of income which is not consumed because disposable income is either consumed or saved.

Thus,

$$Y=C+S$$

$$S=Y-C$$

Where Y=Disposable income, C=Consumption , S= Saving

The saving function can be written as

$$S = f(Y)$$

Saving function is a counterpart of a consumption function, Therefore, given a particular consumption, function, we can derive the corresponding saving function. Let us take the Keynesian consumption, namely, C = a+bY, We can derive saving function corresponding to it.

Since $$Y = C+S$$

$$S = Y-C$$

(i)

Now. Substituting the above Keynesian function for C in (i) we have

$$S = Y-(a+bY)$$

$$= Y- a - b Y$$

$$= -a+Y-bY$$

$$= -a+(1-b)Y$$

(ii) That (1-b) in the above saving function in (ii) is the value of marginal propensity to save where b is the value of marginal propensity to consume.

Consumption

Meaning and Definition of Consumption

The process in which the substance of a thing is completely destroyed, used up, or incorporated or transformed into something else. **Consumption** of goods and services is the amount of them used in a particular time period.

Consumption is the value of goods and services bought by people. Individual buying acts are aggregated over time and space.

Consumption is normally the largest GDP component. Many persons judge the economic performance of their country mainly in terms of consumption level and dynamics.

According to Mainstream, "The final purchase of goods and services by individuals constitutes **consumption**, while other **types** of expenditure in particular, fixed investment, intermediate **consumption**, and government spending — are placed in separate categories"

Consumption Function

As the demand for a good depends upon its price, similarly consumption of a community depends upon the level of income. In other words, "consumption is a function of income".

The consumption function relates the amount of consumption to the level of income. When the income of a community rises , consumption also rises. How much consumption rises in response to a given increase in income depends upon the marginal propensity to consume. It should be borne in mind that the consumption function is the whole schedule which describes the amounts of consumption at various levels of income.

Income (Rs. In Crores) Y	Consumption (Rs. In Crores) C	Average Propensity to **Consume** $\mathbf{\Delta C = \frac{C}{Y}}$	Marginal Propensity to Consume $\frac{\Delta C}{\Delta Y}$
1000	750	$\frac{750}{1000}$=0.75	
1100	825	$\frac{825}{1100}$= 0.75	$\frac{75}{100}$=0.75
1200	900	$\frac{900}{1200}$= 0.75	$\frac{75}{100}$= 0.75
1300	975	$\frac{975}{1300}$= 0.75	$\frac{75}{100}$= 0.75
1400	1050	$\frac{1050}{1400}$= 0.75	$\frac{75}{100}$= 0.75
1500	1125	$\frac{1125}{1500}$= 0.75	$\frac{75}{100}$= 0.75
1600	1200	$\frac{1200}{1600}$= 0.75	$\frac{75}{100}$= 0.75

Consumption function should be carefully distinguished from the amount of consumption. By consumption function is meant the whole schedule which shows consumption at various levels of income, whereas amount of consumption means the amount consumed at a specific level of income. The schedule described above reflects the consumption function of a community i.e., it indicates how the consumption changes in response to the change in income. In the above schedule it will be seen that at the level of income equal to Rs. 1200 crores, the amount of consumption is Rs. 900 crores. As the national income increases to Rs. 1500 crores, the consumption rises to Rs. 1125 crores. Thus, with a given consumption function, amount of consumption is different at different levels of income.

The above schedule of consumption function reveals an important fact that when income rises, consumption also rises but not as much as the income. This fact about consumption function was emphasised by Keynes, who first of all evolved the concept of consumption function. The reason why consumption rises less than income is that a part of the increment in income is saved.

Therefore, we see that when income increases from Rs. 1000 crores to Rs. 1100 crores, the amount of consumption rises from Rs. 750 crores to 825 crores. Thus, with the increase in income by Rs. 100 crores, consumption rises by Rs. 75 crores; the remaining Rs. 25 crores are saved. Similarly, when income rises from Rs. 1100 crores to Rs. 1200 crores, the amount of consumption increases from Rs. 825 crores to Rs. 900 crores.

Here also, as a result of increase in income by Rs. 100, the amount of consumption has risen by Rs. 75 crores and the remaining Rs. 25 crores has been saved. The same applies to further increases in income and consumption. We shall see later that Keynes based his theory of multiplier on the proposition that consumption increases less than income and this theory of multiplier occupies an important place in macroeconomics

Consumption demand depends on income and propensity to consume. Propensity to consume depends on various factors such as price level, interest rate, stock of wealth and several subjective factors. Since Keynes was concerned with short-run consumption function he assumed price level, interest rate, stock of wealth etc. constant in his theory of consumption. Thus with these factors being assumed constant in the short run, Keynesian consumption function considers consumption as a function of income. Thus

$$C = f(Y)$$

In a specific form Keynesian function can be written as:

$$C = a + bY$$

Where **“a”** and “**b”** are constant. While “a” is intercept term of the consumption function, “b” stands for the slope of the consumption function and therefore represents marginal propensity to consume.

Investment

Meaning and definition of investment :

Investment is the purchase of goods that are not consumed today but are used in the future to create wealth. In finance, an investment is a monetary asset purchased with the idea that the asset will provide income in the future or will be sold at a higher price for a profit. An investment is an asset or item that is purchased with the hope that it will generate income or will appreciate in the future. In an economic sense, an investment is the purchase of goods that are not consumed today but are used in the future to create wealth. In finance, an investment is a monetary asset purchased with the idea that the asset will provide income in the future or will be sold at a higher price for a profit.

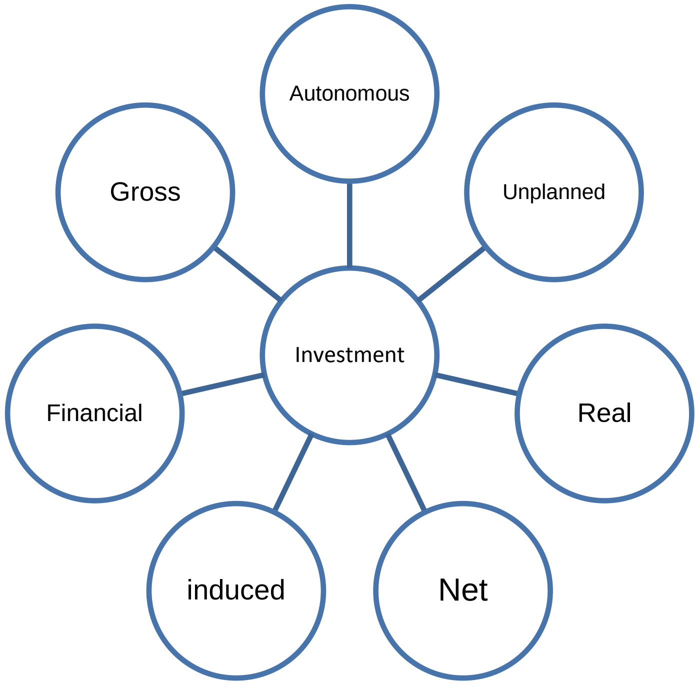
According to economic theories, “ **investment** is defined as the per-unit production of goods, which have not been consumed, but will however, be used for the purpose of future production”.

Examples of this type of investment are tangible goods like construction of a factory or bridge and intangible goods like 6 months of on-the-job training.

In terms of national production and income, Gross Domestic Product (GDP) has an essential constituent, known as **gross investment**.

Type of Investment

Different Types of Investment



1. **<u>Gross Investment:</u>** Gross Investment means the total amount of money spent for a creation of new capital assets like Plant, House, Factories, Machinery, etc.

   It is the total expenditure made on new capital assets in period.

   Gross Investment = Net Investment +Capital consumption

2. **<u>Net Investment :</u>** Net Investment refers to that amount of expenditure which is obtained after deducting the capital consumption from the Gross Investment .

   Net Investment = Gross Investment – Capital Consumption

3. **Financial Investment** : Investment made in buying financial Instruments such as a new shares, Bonds, securities etc. is considered as a financial Investment.

   However, the Money used for Purchasing existing financial instruments such as old bond, old shares, etc., cannot be considered as financial investment. It is a transfer of financial assets from one individual to another. In financial investment, money invested for buying of new shares and bonds as well as debentures have a positive impact on employment level.

4. **Real Investment** : Investment made a new Plant and Equipment, Construction of Public utilities like schools. Roads, and Railway, etc.., is considered as Real Investment.

   Real Investment in new machine tools, Plants and equipments purchased, factory building etc.., Increases employment, production and economic growth of the nation. Thus real investment has a direct impact on employment generation, economic growth, etc..,

5. **Planned Investment** : Investment made with a plan in several sectors of the economy with specify objectives is called as Planned Investment.

   Planned Investment can also be called Intended Investment Because an Investor while making investment makes a concrete plan of his investment.

6. **Unplanned Investment** : Investment t done without any planning is called as an Unplanned Investment.

   In Unplanned Investment Investors make investment randomly without making any concrete plans. Hence it can also be called Unintended Investment. Under this type of investment, the investor may not consider the specific objectives while making an Investment decision.

7. **Induced Investment** : Investment which change with the changes in the income level, is called as Induced Investment Induced Investment is positively related to the income level. That is, at high levels of income entrepreneurs are induced to invest more and vice-versa. At a high level of

income, consumption expenditure increases this leads to an increase in investment of capital goods, in order to produce more consumer goods.

8. **Autonomous investment** : Autonomous investment is that kinds of investment which is not affected by the changes in the level of income or output and is not induced solely by profit motive. Autonomous investment is not a function of output or income. It is related to the technological developments, discovery of the new resources growth of population, etc.

Difference between Saving and Investment

The basic differences between savings and investment are explained in the following points:

1. Savings means to set aside a part of your income for future use. Investment is defined as the act of putting funds into productive uses, i.e. investing in such investment vehicles which can reap money over time.
2. People save money, to fulfill their unexpected expenses or urgent money requirements. Conversely, investments are made to generate returns over the period that can help in capital formation.
3. With an investment, there is always a risk of losing money. Unlike savings, where the no or comparatively fewer chances of losing the hard-earned money.
4. Undoubtedly, the investment provides higher returns than savings, as there is a nominal rate of interest on savings. However, the investments can earn money more than the invested amount, if invested wisely.
5. You can have access to your savings, anytime because they are highly liquid, but in the case of investment you cannot have easy access to money because the process of selling the investments takes some time

Theories of Economic Growth

Economists have been indulging in building growth models to explain the process economic development. However these models are built in the light of economic development in western countries especially England. For a long time, economists were concerned with problems other than growth foreign trade, natural resources full employment etc.

Prof. Samuelson: Many writers have tried to read into economic history a linear progression through inevitable stages, such as primitive economy, feudalism capitalism and some from communism. Actual facts have not agreeably stuck to such timetables, in particular the mixed economics dominate the western world and came into being without the permission of social prophets... The single most surprising development of our age was that unpredicted growth in production and living standards has taken place in second level countries – Japan , Germany , Italy , France, Scandinavia, And Western Europe , generally , rather than in the most advanced countries like the US and Asia whose smaller rates of growth imply a widening relative group.

Growth Models

Economic growth is the increase in the goods and services produced by an **economy**, typically a nation, over a long period of time. It is measured as percentage increase in real gross domestic product (GDP) which is gross domestic product (GDP) adjusted for inflation. Economics as a science is, on the one hand, a body of knowledge and on the other hand, an engine of analysis.

As a result of knowledge, it contains generalizations about the working of economic system. Prof. Ricardo added little to the economic knowledge gathered by Smith.

As an analytical engine, economics provides an apparatus through which actual economic problems are analyzed.

RICARDIAN ’S THEORY

Ricardo’s greatest contribution to economics is the provision of engine of analysis. By using the technique of deductive or abstract reasoning, he constructed a rigorous model in which some selected economic variables were systematically placed to form logic. Such a theoretical model helps to understand how a system works and how the change in variables affects the working of the system.

Ricardo propounded no theory of development. He simply discussed the theory of distribution. This theory is based on the marginal and surplus principles. The marginal principle explains the share of rent in national output and surplus principle explains the division of the remaining share between wages and profits.

Assumptions:

The Ricardian theory is based on certain assumptions which are as under:

1. Supply of land is fixed.

2. Land is used for production of corn and the working force in agriculture helps in determining the distribution in industry.

3. Law of diminishing returns operates on land.

4. Demand for corn is perfectly inelastic.

5. Labour and capital are variable inputs.

6. Capital consists of circulating capital.

7. There is capital homogeneity.

8. All workers are paid subsistence wages.

9. The state of technological knowledge is given.

10. There is perfect competition.

11. Demand for labour depends upon accumulation of capital.

12. Demand and supply price are independent of the marginal productivity of labour.

13. The supply price of labour is given and constant.

14. Capital accumulation results from profits.

Ricardian system considers agriculture as the most important sector of the economy. The difficulty of providing food to expanding population is the main problem. According to Ricardo, there are three major groups in the economy. They are landlords, capitalists and labourers among whom the entire productive land is distributed. It is the capitalists who initiate the process of economic development in the society by reinvesting profits and, thus, increasing capital formation

MARXIAN MODEL

In Marxism, **Marxian** class **theory** asserts that an individual's position within a class hierarchy is determined by his or her role in the production process, and argues that political and ideological consciousness is determined by class position.

Karl Marx, the father of scientific socialism, is considered a great thinker of history.

He is held in high esteem and is respected as a real prophet by the millions of people.

Prof. Schumpeter wrote,

“Marxism is a religion. To an orthodox Marxist, an opponent is not merely in error but in sin”.

He is regarded as the father of history who prophesied the decline of capitalism and the advent of socialism.

The Marxian analysis is the greatest and the most penetrating examination of the process of economic development. He expected capitalistic change to break down because of sociological reasons and not due to economic stagnation and only after a very high degree of development is attained. His famous book ‘Das Kapital’ is known as the Bible of socialism (1867). He presented the process of growth and collapse of the capital economy.

Assumptions of the Theory:

Marxian economic theory of growth is based on certain assumptions:

1. There are two principal classes in the society. (1) Bourgeoisie and (2) Proletariat.

2. Wages of the workers are determined at subsistence level of living.

3. Labour theory of value holds good. Thus labour is the main source of value generation.

4. Factors of production are owned by the capitalists.

5. Capital is of two types: constant capital and variable capital.

6. Capitalists exploit the workers.

7. Labour is homogenous and perfectly mobile.

8. Perfect competition in the economy.

9. National income is distributed in terms of wages an**d** profits.

Mahalanobis Model

Mahalanobis strategy of development emphasizing basic heavy industries which was adopted first of all in the Second Plan also continued to hold the stage in Indian planning right up to the Fifth Plan which was terminated by the Janata Government in March 1978, a year before its full term of five years.

It will be useful to explain first Mahalanobis model of growth which provided a rationale for the heavy industry biased development strategy. An important point to note is that Mahalanobis identifies the rate of growth of investment in the economy not with rate of growth of savings as is usually considered by the economists but with rate of growth of output in the capital goods sector within the economy.

The growth of capital goods sector in turn depends upon the proportions of total investment allocated to the capital goods sector and output-capital ratio in the capital goods sector. Given the output-capital ratio in capital goods sector (i.e. heavy industries), he proves that if the proportion of total investment allocated to the capital goods is relatively greater, the rate of growth of output of capital goods will be greater and hence, given the Mahalanobis assumption, the future rate of growth of investment in the economy will be greater.

Rostow's Theory of Economics Growth

Rostow's theory of the stages of Economics Growth is the most widely circulated and highly commented piece of economics literature in recent years. **Rostow's Stages of Economic Growth** model is one of the major historical models of **economic growth**. It was published by American economist Walt Whitman**Rostow** in 1960. The model postulates that **economic growth** occurs in five basic **stages**, of varying length: ... Preconditions for take-off

Rostow took an historical approach in suggesting that **developed countries** have tended to pass through 5 stages to reach their current degree of economic development.

These are:

1. **Traditional Society Not Necessary for Development** :

   This is an agricultural economy of mainly **subsistence farming**, little of which is traded. The **size of the capital stock is limited** and of low quality resulting in very low labour productivity and little surplus output left to sell in domestic and overseas market.

   According to critics, it is not true that every country essentially passes though the first stage of traditional Society. There are countries in the world like USA, New Zealand, Australia, Canada, which were born free traditional society and they attained the preconditions from the U.K.-an advanced country.

2. **Preconditions May Not Precede the Take –Off** : the stage of precondition for take-off Rostow views agriculture as performing three roles, first, agriculture must produce sufficient food-grains to meet the demand of growing population and of the workers who get employment in agriculture.

3. Secondly, increase in agricultural incomes would lead to the demand for industrial products and stimulate industrial investment.

4. **Take off** : Manufacturing industry assumes greater importance, although the number of industries remains small. Political and social institutions start to develop - external finance may still be required. Savings and investment grow, perhaps to 15% of GDP. Agriculture assumes lesser importance in relative terms although the majority of people may remain employed in the farming sector. There is often a **dual economy** apparent with rising productivity and wealth in manufacturing and other industries contrasted with stubbornly low productivity and real incomes in rural agriculture.
5. **Drive to maturity** : Industry becomes more diverse. Growth should spread to different parts of the country as the state of technology improves - the economy moves from being dependent on factor inputs for growth towards making better use of innovation to bring about increases in real per capita incomes
6. **Age of mass consumptions:** Output levels grow, enabling increased consumer expenditure. There is a shift towards tertiary sector activity and the growth is sustained by the expansion of a middle class of consumers.

Problems of Economics Growth :

Major obstacles to economic development and growth of underdeveloped countries are as follows:

Vicious Circles of Poverty: According to Prof. Nurkse, "The main reason of vicious circle of poverty is the lack of capital formation."

Similarly, Kindleberger opined that vicious circle of poverty takes place due to the small size of the market.

Vicious Circles of Poverty can be classified into three groups

1. Supply side of vicious circles

2. Demand side of vicious circles

3. Capital Shortage

Traditional obsolete and outdated technology : Another obsolete as to development of

An underdeveloped country is existence of traditional, obsolete and outdated Technology. The progress which we witness in developed countries in only due to the adoption of modern and latest technology.

The underdeveloped countries are not in a position to use this modern and latest technology on account of several bottlenecks, such as abundant supply of Labour lack of skilled labour, sacristy of capital , poverty etc..,

Population Explosion : Rapid growth of population is another important obstacle in the way of economic development of underdeveloped countries. According to Jacob Viner "Population increase hovers like a menacing dark cloud over all poor countries". Population growth in a backward country does not induce capital widening investment or innovation.

Population may be considered positive hindrance in the way of economic development of a country.

In a ‘capital poor’ and technologically backward country, growth of population reduces output by lowering the per capita availability of capital.

Too much population is not good for economic development

The rate of growth of population is very high. So far as the size of population is concerned, India ranks second next only to China (1312 million in 2006). India’s population is now 1110 million in 2006- 07. During the decade of 1991, the growth rate of population in India was 1.61 p.c. per annum, as compared to 0.7 p.c. growth rate of population of developed countries.

High birth rate (23.5 per 1000) coupled with low death rate (7.5. per 1000 in 2005-06) is the genuine cause for population explosion in India. In the 20th century, India’s population went up by 5 p.c. as against 3 p.c. increase in the world’s population as a whole.

Agriculture Constraints: Another major obstacle to the economic development of underdeveloped countries relates to agriculture sector. The majority of underdeveloped countries are predominantly agricultural.

Less developed countries live mainly upon agriculture and extractive industries, like mining, fisheries and forests. Predominance of agriculture is explained from the viewpoint of sectoral composition of national income and occupational pattern.

In India, in 1950- 51, more than 55 p.c. of our GDP came from the agricultural sector or the so- called primary sector. In 2007-08, however, the contribution of this sector toward GDP came down to 19.4 p.c.

Banking

According to Prof. Sayers “ Ordinary banking business consists of changing cash for bank deposits and bank deposits for cash; transferring bank deposit from one person or corporation to another, given bank deposits in exchange for bill of exchange , Government Bonds and so Forth.”

A commercial bank is a financial institution that provides various financial service, such as accepting deposits and issuing loans. Commercial bank customers can take advantage of a range of investment products that commercial banks offer like savings accounts and certificates of deposit. The loans a commercial bank issues can vary from business loans and auto loans to mortgages.

Functions of a Commercial Bank

1. Acceptance of deposits
2. Advancing of loans
3. Creation of money or credit
4. Clearing of cheques
5. Financing foreign trade
6. Financing industries

It is seen from the above that commercial bank play a vital role in the economy. Therefore a central Agency i.e. Central Bank is necessary to supervise and direct the operations of the Commercial Bank and that they should not misuse their powers. A Central Bank has been established in every country for this purpose. As an apex of the monetary and banking structure of the country, it performs the following functions. In India, the Reserve Bank Of India:

1. Issue Currency of the Country
2. The performance of general banking and agency service for the State Bank.
3. Protection of depositor's interests.
4. Controlling Fluctuations in the Economy.

Monetary Policy: Monetary policy is the macroeconomic policy laid down by the central bank. It involves management of money supply and interest rate and is the demand side economic policy used by the government of a country to achieve macroeconomic objectives like inflation, consumption, growth and liquidity.

"Monetary policy is the process by which the monetary authority of a country, like the central bank or currency board, controls the supply of money, often targeting an inflation rate or interest rate to ensure price stability and general trust in the currency."

According to Prof. Crowther "Monetary policy is referred to as either being expansionary or contractionary, where an expansionary policy increases the total supply of money in the economy more rapidly usual, and contractionary **policy** expands the money supply more slowly than usual or even shrinks it."

According to Dr.D.C. Rowan, "The monetary policy is defined as discretionary action undertaken by the authorities designed to influence:

- The Supply of Money
- Cost of Money or Rate of Interest
- The Availability of Money

Objective of Monetary Policy

The monetary policy in developed economies has to serve the function of stabilization and maintaining proper equilibrium in the economic system. But in case of underdeveloped countries, the monetary policy has to be more dynamic so as to meet the requirements of an expanding economy by creating suitable conditions for economic progress. It is now widely recognized that monetary policy can be a powerful tool of economic transformation.

- Neutrality of money
- Stability of exchange rates
- Price stability
- Full Employment
- Economic Growth
- Equilibrium in the Balance of Payments

LIMITATION OF MONETARY POLICY

1. Higher Proportion of Non –Banking Credit:
2. Limitations of Monetary Instruments
3. Limitations of Monetary Aggregates
4. High Currency Deposit Ratio
5. Selective Application of Credit Constraints
6. Rigidity In the Policy
7. Interest Rate
8. Growing Fiscal

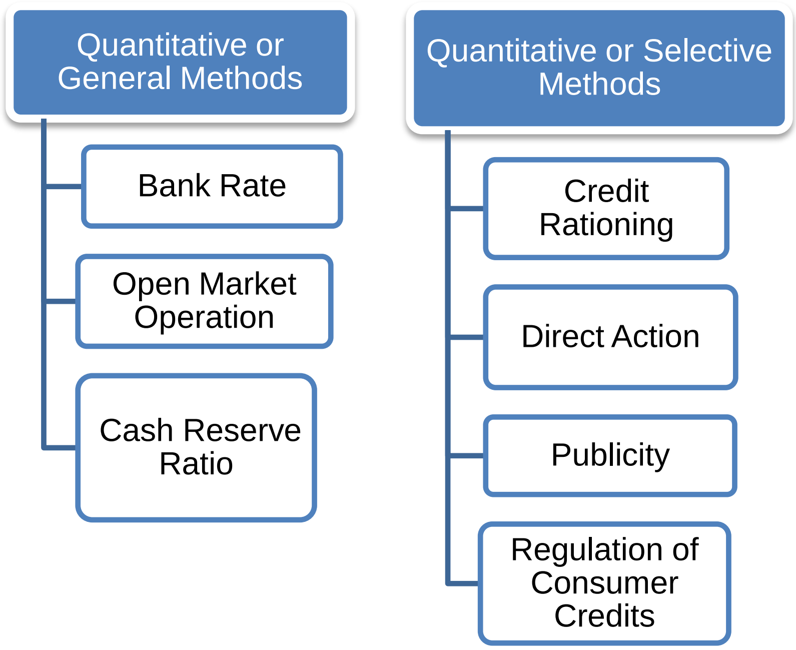
CONTROL OF CREDIT

Credit control is an important tool used by Reserve Bank of India, a major weapon of the monetary policy used to control the demand and supply of money (liquidity) in the economy. Central Bank administers control over the credit that the commercial banks grant.

The instruments of Monetary Policy may be classified according to the area of their greatest initial impact- whether they operate principally on the supply of money through changing either the stock of reserve money or the multiplier, or on the demand for credit through cost and other influences.

Broadly, the methods of credit control by the Reserve Bank of India are quantitative as can be seen in the following chart:

METHODS OF CREDIT CONTROL



1. **Bank Rate:** The bank rate is the rate at which the Central Bank of a country is prepared to re-discount the first class securities.

It means the bank is prepared to advance loans on approved securities to its member banks.

2. **Open Market Operation:** **In Narrow Senses** The Central Bank starts the purchase and sale of Government securities in the money market. **But in the Broad Sense**—the Central Bank purchases and sale not only Government securities but also of other proper and eligible securities like bills and securities of private concerns. When the banks and the private individuals purchase these securities they have to make payments for these securities to the Central Bank. This gives result in the fall in the cash reserves of the Commercial Banks, which in turn reduces the ability of

create credit. Through this way of working the Central Bank is able to exercise a check on the expansion of credit.

3. **Cash Reserve Ratio:** Under this system the Central Bank controls credit by changing the Cash Reserves Ratio. For example—If the Commercial Banks have excessive cash reserves on the basis of which they are creating too much of credit which is harmful for the larger interest of the economy. So it will raise the cash reserve ratio which the Commercial Banks are required to maintain with the Central Bank. This activity of the Central Bank will force the Commercial Banks to curtail the creation of credit in the economy. In this way by raising the cash reserve ratio of the Commercial Banks the Central Bank will be able to put an effective check on the inflationary expansion of credit in the economy. With this, the Commercial Banks will now be in a position to create more credit than what they were doing before. Thus, by varying the cash reserve ratio, the Central Bank can influence the creation of credit.

4. **Rationing Credit:** Under this method the credit is rationed by limiting the amount available to each applicant. The Central Bank puts restrictions on demands for accommodations made upon it during times of monetary stringency. In this the Central Bank discourages the granting of loans to stock exchanges by refusing to re-discount the papers of the bank which have extended liberal loans to the speculators. This is an important method of credit control and this policy has been adopted by a number of countries like Russia and Germany.

5. **Direct Action**: Under this method if the Commercial Banks do not follow the policy of the Central Bank, then the Central Bank has the only recourse to direct action. This method can be used to enforce both quantitatively and qualitatively credit controls by the Central Banks. This method is not used in isolation; it is used as a supplement to other methods of credit control. Direct action may take the form either of a refusal on the part of the Central

Bank to re-discount for banks whose credit policy is regarded as being inconsistent with the maintenance of sound credit conditions. Even then the Commercial Banks do not fall in line; the Central Bank has the constitutional power to order for their closure.

6. **Publicity:** In modern times, Central Bank in order to make their policies successful, take the course of the medium of publicity. A policy can be effectively successful only when an effective public opinion is created in its favor. Its officials through news-papers, journals, conferences and seminar's present a correct picture of the economic conditions of the country before the public and give a prospective economic policies. In developed countries Commercial Banks automatically change their credit creation policy. But in developing countries Commercial Banks being lured by regional gains. Even the Reserve Bank of India follows this policy.

7. **Regulation of Consumer Credit:** Under this method consumers are given credit in a little quantity and this period is fixed for 18 months; consequently credit creation expanded within the limit. This method was originally adopted by the U.S.A. as a protective and defensive measure, there after it has been used and adopted by various other countries.

Fiscal policy

Fiscal policy means the use of taxation and public expenditure by the government for stabilisation or growth.

According to Culbarston, "By fiscal policy we refer to government actions affecting its receipts and expenditures which we ordinarily taken as measured by the government's receipts, its surplus or deficit."

The government may offset undesirable variations in private consumption and investment by compensatory variations of public expenditures and taxes.

Fiscal Policy is fundamentally concerned with the aggregate effects of Public Expenditure and taxation on Income, output and employment

Components of Fiscal Policy

The Main Components of Fiscal Policy are as follows:

Budgetary Policy: According to Prof. J.M Keynes "The old classical economists advocated a policy of balanced and small budgets. However, this policy will not help to tide over depression and unemployment. The need at such a time is to increase the flow of income stream into the economy and could be made possible, only through deficit budgeting.

Taxation Policy: Taxation is a powerful instrument of fiscal policy in the hands of public authorities which greatly affect the changes in disposable income, consumption and investment. An anti- depression tax policy increases disposable income of the individual, promotes consumption and investment. Obviously, there will be more funds with the people for consumption and investment purposes at the time of tax reduction.

Public Expenditure: An increase in Public Expenditure can also be employed by the government as an instrument to fight against depression and unemployment. Increase in Public Expenditure at such a time may take the following to forms:

Pump Priming: Pump Priming refers to that public Expenditure which helps initiate and revive economic activity in an economy where stagnation reigns supreme consequent upon depression.

Compensatory Spending: Compensatory Spending refers to the government expenditure which is undertaken with a view to compensating the decline in Private Investment

Objectives of Fiscal Policy

The main objectives of Fiscal Policy are as follow:

Economic Stabilisation: The first and the foremost objective of fiscal policy are to eliminate cyelical fluctuations in economic activity and to maintain it at a stable level. The up –and –down swings in business are checked by compensatory fiscal action to counteract fluctuations.

Economics Growth: The second important objective of Fiscal Policy is to maintain a continuous upward trend in economic activity. Stability continues to be an important aim of fiscal Policy.

Full Employment: Fiscal policy is considered as an effective instrument for reducing unemployment and securing full employment. Full employment occurs where there is job available for everyone who is fit to work and wants a job at the prevailing wage rates.

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INTRODUCTION OF INDIAN ECONOMY

Indian economy is developing economy in which agriculture is the back bone of Indian economy. About 30 % of India's population is on the below poverty line. Mineral resources are not fully utilized. Majority of the people of India are poor. Indian economy is affected by it. Countries which are on the part of progress and which have their potential for development are called developing economies. So, India is termed as developing economy by modern schools. India is of mixed economy, both public and private sectors coexist. Industries in India are broadly divided into two categories: those that are run by the public sector and those that are licensed to be established and run by the private sector.

Economy before British Rule

To understand the present level of the Indian economy, it is important to understand the economic system of India during the British rule and post-independence economic development policies.

- Before the advent of British rule, India had an independent economy. It was largely primary sector economy and the major occupations were agriculture, handicrafts, and many other primary sector works.
- The economy was full of resources and a prosperous one. Therefore, high quality agricultural products and handicrafts made by the Indians were traded across the world.

Economy during British Rule

- During the British rule, India's economy became a net raw material supplier and a net importer of finished products.
- No British economist attempted to measure the per capita income and national income of India.
- Some of the Indian economists Dadabhai Naoroji, V.K.R.V. Rao, R.C. Desai and British Findlay Shirras and William Digby attempted to measure India's national income. Among all, V.K.R.V. Rao was the most successful.
- Before independence, India's economy was solely dependent upon agriculture.
- 85 percent of the Indian populations were rural and their main source of subsistence was agriculture.

- During the British colonial period, agriculture (in spite of being the main occupation) was suffering from many problems and hence the effective growth was zero percent.
- Land settlement system was totally in favors of the British.
- Agricultural system was stagnant; however, later there was a gradual growth, but that was not because of improvement and development of the agricultural system, but because of the expansion of agricultural land.\

Features of Indian Economy

During the last five and half year decades a number of significant changes have taken place in the Indian economy. These changes point to the fact that the economy should be called a developing Economy:

Some feature of Indian Economy

1. **Low Per Capita Income:** Underdeveloped economies have low per capita income. India has no exception to it. In 1947-48, per capita income was Rs. 230. People were poor. They were not getting fair square meals a day. They had no shelter and clothing. Most of the people were unemployed
2. **Predominance of Agriculture:** Indian economy was predominantly agricultural. In 1948, about 70% population was engaged in agriculture. Moreover, agriculture constituted 50% of national income. But agriculture itself was backward. Regarding productivity, it was 110 kg/hectare for rice in 1947 as against 748 kg in Japan.
3. **Unemployment and Underemployment:** Unemployment is a phenomenon of all economies whether developed or
4. underdeveloped. But nature and degree of unemployment is different in developed and underdeveloped economies. In developed economics most of the unemployment is cyclical which arises because of fluctuations in business cycles. In underdeveloped economies like India, chronic unemployment is found which results from the structural defects in the economy. Moreover, underemployment is widespread in underdeveloped countries. Underemployment is a condition in which a person is getting work but not according to his/her capacity and qualifications.
5. **Inequality:** Inequality in distribution of income and wealth is found in every country but this is wider in underdeveloped economies. In India bottom 40% of rural population possess only 5% of rural assets while 8% top households possess 46% of total rural assets. This disparity is more intensive in urban areas.

6. **Scarcity of Capital:** Capital is considered as the most important factor in the development of an economy. In underdeveloped economies like India, capital availability per person is very low which results in low productivity and low per capita income. Low per capita income again results in low savings, low investment and low capital formation.Thus Underdeveloped Countries (UDCs) are caught in the grip of vicious circle of poverty. Lack of capital does not allow an economy to introduce the latest technologies. Thus, economy becomes technologically backward and internationally in competitive.

7. **Balance of Payments (BoP):** BoP is the systematic record of all economic transactions like trade of goods, trade of services, unilateral transfers, foreign investment, etc. between a country and rest of the world. BoP of a country is also an indicator of development or underdevelopment of the country. Bop of UDCs like India shows that these countries export primary (agricultural) products and raw materials and import final products and technologies from developed countries.

8. **Social Peculiarities:** High illiteracy rate, male dominated society, joint family system, fatalism, lack of entrepreneurship, casteism, communalism, widespread child labour, etc. are some characteristics of Indian society which distinguish it from developed societies.

Trends of Population Growth

India is second most populous country in the world, next to China. According to 2001 Census, Indian population was 1027 million while according to 2011 census; India's population was 1210.2 million. India has 17.2% of the total world population (so one in every six people in the world is an Indian), but in terms of land area, India stands at the seventh place and has only 2.42% of total land area of the world, while land area of U.S.A. is about 4.8%. India's population is about three times than that of U.S.A., twenty-one times than that of Canada and about six times than that of Japan.

Size and Growth of Population Growth

. The size and composition of a country's population can exert a powerful influence on a country's development. The population size, composition, and distribution influence the range of industries a country can support and the pool of talent that are available in the country. In size of population, India is the second largest country in the world after China, constitutes 2.4 per cent of the world's land area and supports 16.25 per cent of the world's population. The population growth in India has proved to be more an obstacle to its development efforts rather than a contributory factor in economic growth.

Population Explosion

Population Explosion refers the sudden and rapid rise in the size of population, especially human population. It is an unchecked growth of human population caused as a result of:

- increased birth rate,
- decreased infant mortality rate, and
- Improved life expectancy.

A drastic growth in population beyond normal limits is called population explosion. It is more prominent in under-developed and developing countries than in developed countries.

Population explosion mainly refers to the surge in population post-World War II. However, in context to India, it refers to the rapid increase in population in post-Independent era.

Population explosion refers to the rapid and dramatic rise in world population that has occurred over the last few hundred years. Between 1959 and 2000, the world's population increased from 2.5 billion to 6.1 billion people. According to United Nations projections, the world population will be between 7.9 billion and 10.9 billion by 2050.

Most of the growth is currently taking place in the developing world, where rates of natural increase are much higher than in industrialized countries. Concern that this might lead to over population has led some countries to adopt population control policies

According to a report by the United Nation Population fund, total population is likely to reach 10 billion by 2025 and grow to 14 billion by the end of the next century unless birth control use increases dramatically around the world within the next two decades.

Effects of Populations Explosion

The effects of population explosion in India are as follows:

1. **Over-population:** Population explosion may lead to overpopulation, i.e., a condition where population surges to a level that the earth cannot accommodate comfortably, and poses a threat to the environment.

2. **Unemployment:** In developing countries like India, with a backward economy and little scope for fruitful employment, millions of people find no work to do. The unemployed, having nothing to do and without an ensured living, are left frustrated and demoralize, losing their faith in life itself. As it happens in India and several underdeveloped countries in Asia and Africa, the unemployed threatens the very process of development and plunge the country in gloom. It is only natural. Those who are born with two hands consider it a curse when they are denied the simple right to work and earn a living. While their numbers go on multiplying and the growth rate becomes menacing, the fruits of development are found to be too inadequate to bridge the yawning gulf.

3. **Poverty:** High birth rate, both historically and statistically, is associated with poverty and low standard of living. It may be noted that poverty is both the cause and effect of population explosion. Due to poverty, there has been massive growth of population. On the other hand, the large masses of people live in poverty due to over population. It may sound queer, but the law is that the poorer a country the greater is the growth rate of its population. India, caught in the morass of her age-old poverty, finds herself in the midst of a population explosion. The population that was less than 400 million in the forties was found to be about 1.21 billion in 2011 census. As a result of this even the six plans completed by now have so far failed to cope with the enormous problem of unemployment.

4. **Illiteracy:** The resources available are fixed. In theory and in practice, the total available resources are shared by the people using them. Population explosion is the key reason for illiteracy in India. People prefer engage their children in economic activities, rather than providing them education.

5. **Poor Health:** If people do not get adequate food and nutrition, then they may suffer from poor health.

6. **Economy:** People need food, clothes, shelter, and occupation to make their living. The demand for consumption should never exceed the production or resource limit. The economy of any country is negatively impacted, if there is massive population explosion beyond the tolerance limit.

7. **Pollution and Global warming:** Too much population causes too much pressure on earth. There arises excessive demand for finished products leading to over-industrialization and over-utilization of resources. The industrial discharges, and fumes are the chief causes for water and air pollution. Further, the poisonous gases released because of burning of fossil fuels in factories is widely responsible for Global warming.

Causes of Population Explosion

The causes of population explosion are as follows:

- **Accelerating birthrate:** Due to lack of awareness about the positive impact of using birth-control method, there has been a steady growth in birthrate.

- **Decrease in infant mortality rate:** An improvement in medical science and technology, wide usage of preventive drugs (vaccines), has reduced the infant mortality rate. There has been great improvement in medical and health-care facilities during the past few decades.
- **Increase in life expectancy:** Due to improved living conditions, better hygiene and sanitation habits, better nutrition, health education, etc. the average life expectancy of human population has improved significantly. Steady supplies of good quality food make sure that the population is well nourished. Populations grow when they are adequately nourished.
- **Increased immigration:** An increase in immigration often contributes towards population explosion, particularly in developed countries. It happens when a large number arrive at an already populated place with the intention to reside permanently.
- **Less space than required:** In urban cities, it is often found that there is very less scope for making available extra space to absorb the additional population. In such cases, a large population is seen packed into a smaller space.

Indian Scenario

Alarming growth of population is one of the most formidable problems India is facing today, and is seriously threatening its economic development. In 1921, the India Population was 25 crores. It reached 84 crores in 1991: crossed the one billion mark with the billionth India born on August 15, 1999; and is expected to jump to 1.4 billion by 2030 AD. The population explosion through a worldwide phenomenon, poses a serious threat to India as it has to maintain 16.9% of world's population on only 2.4% of the world area. The present growth rate of 1.7% is much higher than the world population growth rate of 1.3%, which is of great concern.

National Population Policy 2000

The population policy of the Government of India has Passes through the following five phases

1. The period of Indifference;
2. The period of neutrality (1947-51)
3. The period of experimentation (1951-61)
4. The beginning of the policy of control 9from 1961 onwards);
5. Paradigm shift

National Population Policy of India was formulated in the year 2000 with the long term objective of achieving a stable population by 2045, at a level consistent with the requirements of sustainable economic growth, social development, and environmental protection. The immediate objective of the policy is to address the unmet needs for contraception, health care infrastructure, and health personnel, and to provide integrated service delivery for basic reproductive and child health care. The medium-term objective is to bring the TFR (Total Fertility Rate) to replacement levels by 2010, through vigorous implementation of inter-sectoral operational strategies. TFR is the average number of children each women would have in her life time.

National Population Policy pursues to achieve following Socio-Demographic goals by 2010:

- Address the unmet needs for basic reproductive and child health services, supplies and infrastructure.
- Make school education up to age 14 free and compulsory, and reduce drop outs at primary and secondary school levels to below 20 percent for both boys and girls.
- Reduce infant mortality rate to below 30 per 1000 live births.
- Reduce maternal mortality ratio to below 100 per 100,000 live births.
- Achieve universal immunization of children against all vaccine preventable diseases.
- Promote delayed marriage for girls, not earlier than age 18 and preferably after 20 years of age.
- Achieve 80 percent institutional deliveries and 100 percent deliveries by trained persons.
- Achieve universal access to information/counseling, and services for fertility regulation and contraception with a wide basket of choices.
- Achieve 100 per cent registration of births, deaths, marriage and pregnancy.
- Contain the spread of Acquired Immunodeficiency Syndrome (AIDS), and promote greater integration between the management of reproductive tract infections (RTI) and sexually transmitted infections (STI) and the National AIDS Control Organization.
- Prevent and Control communicable diseases.12. Integrate Indian Systems of Medicines (ISM) in the provision of reproductive and child health services, and in reaching out to households.
- Promote vigorously the small family norm to achieve replacement levels of TFR.
- Bring about convergence in implementation of related social sector programs so that family welfare becomes a people centered programme.

Objective of National Population Policy

1. To provide or undertake activities aimed to achieve population stabilization, at a level consistent with the needs of sustainable economic growth, social development and environment protection, by 2045.
2. To promote and support schemes, programmers, projects and initiatives for meeting the unmet needs for contraception and reproductive and child health care.
3. To promote and support innovative ideas in the Government, private and voluntary sector with a view to achieve the objectives of the National Population Policy 2000.
4. To facilitate the development of a vigorous people’s movement in favor of the national effort for population stabilization.
5. To provide a window for canalizing contributions from individuals, trade organizations and other within the country and outside, in furtherance of the national cause of population stabilization.

6. There shall be no discrimination on the ground of religion, community, caste or class, carrying out the objects of the Kosh.

Suggestions to Popularise Family Planning

The success of the family planning programme depends ultimately on both demand for smaller families and supply of family planning services.

- Demand represents the basic determinants of fertility. There are five categories of variables that ultimately determine the level of demand for smaller families; education, economic status, health, and urbanization, status of women.
- Supply represents the necessary mechanism through which demand gets expressed in actual reproductive behavior.

Some of the important suggestions that can be made to popularize family planning are as follow

The family planning programme in India has been in operation for more than five decades. But it has not been able to reduce the infantile mortality rate, crude birth rate and total fertility rate to a level which should achieve the objective of population stabilization even in the next 50 years. The need is to motivate, educate and spread the family planning programme among the masses, to strengthen the Government programme and to rope in non-government organizations (NGOs).

1. Motivation:

For the success of family planning programme, there is need to motivate the people. India lives in villages where people are illiterate, ignorant and tradition bound. They think and act according to the rural value system. Even in urban areas, vast sections of the population hold on to old beliefs, traditions and values. The traditional joint family system is a barrier to the small family norm.

.On the other hand, an additional child in rural areas and among the urban poor is looked upon as an asset. Similarly, a male child is considered essential in Indian families, even if there are many female children. Thus such beliefs, attitudes, values and traditions perpetuate large families.

2. Population Education:

A UNESCO Report defines population education as “an educational programme which provides for a study of the population situation in the family, community, nation and the world with the purpose of developing in the students, rational and responsible attitudes and behaviour towards coping with that situation.”

The aim of population education is to create awareness and understanding of the causes and consequences of population growth among students, teachers, parents, social workers, and other sections of the society. Population education is essential to motivate parents and prospective parents to limit the size of their families and to adopt appropriate family planning methods and techniques. For this, the following measures are suggested at various levels.

3. Raising the Status of Women:

Even though a beginning has been made in women empowerment in India, the status of women is still very low in the family and society, especially in rural areas and traditional families. Their role in the family has been largely confined to giving birth to children, rearing them and carrying out daily household work.

Being overburdened, they are malnourished and give birth to weak children leading to large infantile mortality. The lack of economic independence and the absence of education, training and professional career among the majority of women have a direct effect on family size and population growth in India.

4. Voluntary Agencies:

Voluntary agencies can play a very important role through non-formal programmes in rural areas and poor urban areas. In this context, the service youth clubs, labour unions, women's organisations, religious and social societies, Panchayats and Gram Sabhas (village level societies) can go a long way in educating the people towards the importance of the small family norm.

Students studying in medical colleges can be entrusted with the task of training and other Para-medical workers in health centres. Funds can also come from voluntary agencies which should be distributed on non-sectarian basis. Such voluntary agencies should work in close co-operation with government family planning department. Besides, there is the need for international cooperation both in terms of funds and transfer of modern family planning technology to India.

5. Incentives and Disincentives:

Incentives and disincentives play an important role in the family planning programme. Incentives may be in the form of social or economic rewards paid to an individual to delay or limit the size of the family. Incentives in cash and kind, especially to the poor and illiterate sections of the society, encourage the couples to undergo sterilization.

Since such a measure involves large funds, the Government can seek the help of the organised sector and NGOs to finance or raise funds, and also hold special camps for the purpose. The Government should also give suitable tax exemption for specified family planning activities to such institutions. But those who are educated and working in government, semi-government and private organisations may be given incentives in the form of advance increments if they undergo sterilization after two children.

6. Economic Growth:

The aim of family planning is not only to bring about a decline in fertility rates but also to improve the quality of life of the people. These are possible through rapid economic growth. It is not an illusion to believe that a reduction in population growth will automatically raise living standards. In fact, an effective family planning policy should be integrated with measures to accelerate economic development.

As the Ninth Five Year Plan observes: “Several of the South Asian countries have been able to achieve economic prosperity and improvement in quality of life inspite of population growth. This has been attributed to the increase in productivity due to development and utilisation of innovative technologies by the young educated population who formed the majority of the growing population. These countries have been able to exploit the dynamics of demographic transition to achieve economic growth by using the human resources as the engine driving the economic development, improved employment with adequate emoluments has promoted saving and investment which in turn stimulated growth.”

National Income

Meaning and definition of National Income

National income is an uncertain term which is used interchangeably with national dividend, national output and national expenditure. On this basis, national income has been defined in a number of ways. In common parlance, national income means the total value of goods and services produced annually in a country.

In other words, the total amount of income accruing to a country from economic activities in a year’s time is known as national income. It includes payments made to all resources in the form of wages, interest, rent and profits.

The definitions of national income can be grouped into two classes: One, the traditional definitions advanced by Marshall, Pigou and Fisher; and two, modern definitions.

The Marshallian Definition:

According to Marshall: “The labour and capital of a country acting on its natural resources produce annually a certain net aggregate of commodities, material and immaterial including services of all kinds. This is the true net annual income or revenue of the country or national dividend.” In this definition, the word ‘net’ refers to deductions from the gross national income in respect of depreciation and wearing out of machines. And to this, must be added income from abroad.

For example, a peasant sells wheat worth Rs.2000 to a flour mill which sells wheat flour to the wholesaler and the wholesaler sells it to the retailer who, in turn, sells it to the customers. If each time, this wheat or its flour is taken into consideration, it will work out to Rs.8000, whereas, in actuality, there is only an increase of Rs.2000 in the national income.

The Pigouvian Definition:

A.C. Pigou has in his definition of national income included that income which can be measured in terms of money. In the words of Pigou, “National income is that part of objective income of the community, including of course income derived from abroad which can be measured in money.”

This definition is better than the Marshallian definition. It has proved to be more practical also. While calculating the national income now-a- days, estimates are prepared in accordance with the two criteria laid down in this definition.

First, avoiding double counting, the goods and services which can be measured in money are included in national income. Second, income received on account of investment in foreign countries is included in national income.

according to this definition, in the backward and underdeveloped countries of the world, where a major portion of the produce is simply bartered, correct estimate of national income will not be possible, because it will always work out less than the real level of income. Thus the definition advanced by Pigou has a limited scope.

Fisher’s Definition:

Fisher adopted ‘consumption’ as the criterion of national income whereas Marshall and Pigou regarded it to be production. According to Fisher, “The National dividend or income consists solely of services as received by ultimate consumers, whether from their material or from the human environments. Thus, a piano, or an overcoat made for me this year is not a part of this year’s income, but an addition to the capital. Only the services rendered to me during this year by these things are income.”

Fisher’s definition is considered to be better than that of Marshall or Pigou, because Fisher’s definition provides an adequate concept of economic welfare which is dependent on consumption and consumption represents our standard of living.

Estimation of National Income

The national income of a country can be measured by three alternative methods: (i) Product Method (ii) Income Method, and (iii) Expenditure Method.

1. Product Method:

We calculate the money value of all final goods and service produced in an economy during a year. The money value of these goods and service is calculated at market prices. The sum total is called the GDP at market Price.

2. Income Method:

We estimate the income earned by various factor services engaged in the process of production. The sum of these incomes provides us the measure of gross National Income at factor cost.

3. Expenditure Method:

We sum up the flow of expenditure in an economy to arrive at National Income estimate. If we add the values of expenditures on all these items we get value of gross National expenditure at market prices.

Relation between Economics welfare and National Income

Pigou establishes a close relationship between economic welfare and national income, because both of them are measured in terms of money. When national income increases, total welfare also increases and vice versa.

The effect of national income on economic welfare can be studied in two ways:

(1) By change in the size of national income, and

(2) By change in the distribution of national income.

Change in the Size of National Income:

The change in the size of national income may be positive or negative. The positive change in the national income increases its volume. As a result, people consume more of goods and services, which lead to increase in the economic welfare.

Whereas the negative change in national income results in reduction of its volume. People get lesser goods and services for consumption which leads to decrease in economic welfare. But this relationship depends on a number of factors.

1. Change in Prices:

Is the change in national income real or monetary? If the change in national income is due to change in prices, it will be difficult to measure the real change in economic welfare. For example, when the national income increases as a result of increase in prices, the increase in economic welfare is not possible because it is probable that the output of goods and services may not have increased. It is more likely that the economic welfare would decline as a result of increase in prices. It is only the real increase in national income that increases economic welfare.

2. Working Conditions:

It depends on the manner in which the increase in national income comes about. The economic welfare cannot be said to have increased, if the increase in national income is due to exploitation of labour e.g., increase in production by workers working for longer hours, by paying them lesser wages than the minimum. Forcing them to put their women and children to work, by not providing them with facilities of transport to and from the factories and of residence, and their residing in slums.

3. Per Capita Income:

National income cannot be a reliable index of economic welfare, if per capita income is not kept in mind. It is possible that with the increase in national income, the population may increase at the same pace and thus the per capita income may not increase at all. This is because the economic welfare of people depends not on capital goods but on consumption goods used by them. Similarly, when the national income and the per capita income rise sharply during war time, the economic welfare does not increase because during war days the entire production capacity of the country is engaged in producing war material and there is shortage of consumption goods. As a result, the standard of living of the people fall and the economic welfare decreases.

4. Method of Spending:

The influence of increase in national income on economic welfare depends also on the method of spending adopted by the people. If with the increase in income, people spend on such necessities and facilities as milk, ghee, eggs, fans, etc. which increase efficiency, the economic welfare will increase.

But on the contrary, the expenditure on drinking, gambling etc. will result in decreasing the economic welfare. As a matter of fact, the increase or decrease in economic welfare as a result of increase in national income depends on changes in the tastes of people. If the change in fashions and tastes takes place in the direction of the consumption of better goods, the economic welfare increases.

Conclusion:

It is clear from the above analysis that though the national income and economic welfare are closely inter-related, yet it cannot be said with certainty that the economic welfare would increase with the increase in national income and per capita income.

The increase or decrease in economic welfare as a result of increase in national income depends on a number of factors such as the rate of growth of population, the methods of earning income, the conditions of working, the method of spending, the fashions and tastes, etc.

New Economics Policy 1991

In 1990s the govt. of India in order to come out of the economic crisis decided to devite from its previous economic policies and learn towards Privatization. In July 1991 when the devaluation of Indian currency took place the govt. started announcing its new economic polices one after another. Though these polices pertained to different aspects of the economic field they had one thing in common. The economic element was to orient the Indian system towards the world market it is in this context the govt. launched its new economic policy which consisted of among other things three important features.

Liberalization, Privatization and Globalization .Liberalization of the economy means to free if from direct or physical control imposed by the Govt. Economic reforms were based on the assumption that marten forces could guide the economy in amore effective manner Than Government.

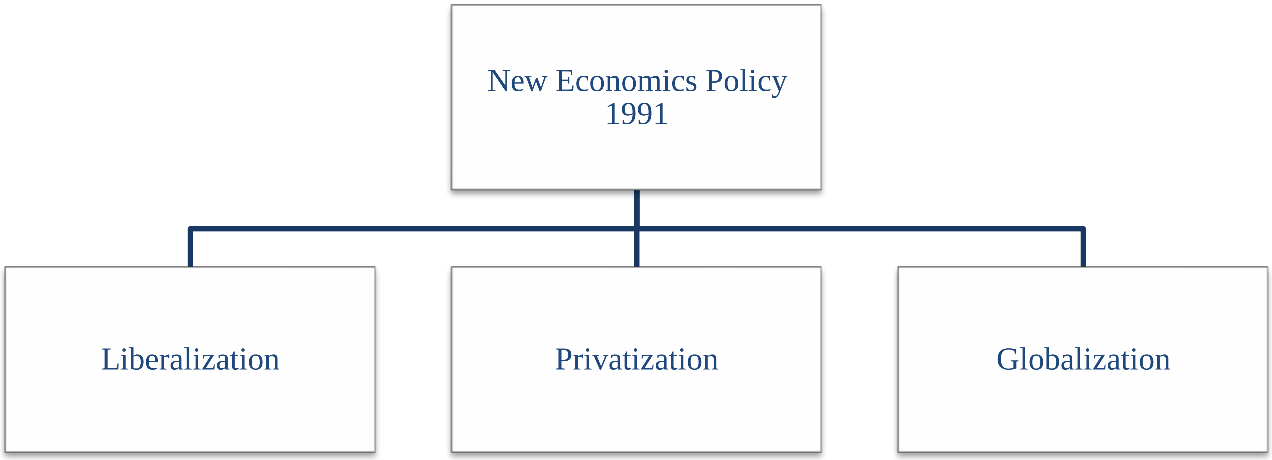
Main objectives of New –Economic Policy – 1991

The main objectives behind the launching of the new –economic policy (NEP) in 1991 by the union finance minister Dr. Manmohan Singh, could be stated as follows:

- The main objective was to plunge Indian economy in to the arena of 'Globalization and to give it a new thrust on market orientation.
- The NEP intended to bring down the rate of inflation and to remove imbalances in payment.
- It intended to move towards higher economic growth rate and to build sufficient foreign exchange reserves.
- It wanted to achieve economic stabilization and to convert the economic in to a market economy by removing all kinds of unnecessary restrictions.
- It wanted to permit the international flow of goods, services, capital, human resources and technology, without many restrictions.

Beginning with mid-1991, the govt. has made some radical changes in its policies bearing on trade, foreign investment exchange rate, industry, fiscal of fairs etc…The various elements, when put together, constitute an economic policy which marks a big departure from what has gone before.

Branches of New Economics Policy



The term "liberalization" in this context implies economic liberalization. "Economic liberalization" constitutes one of the basic elements of the new Economic policy (NEP) which the Indian Government launched in the middle of the year 1991. The other important aspects of the policy are –Privatization of the public sector, Globalization and market friendly state.

The main trust of the new economic policy is "liberalization". The essence of this policy is that greater freedom is to be given to the entrepreneur of any industry, trade or business and that governmental control on the same is reduced to the minimum.

MAIN FEATURES OF THE POLICY OF LIBERALISATION:

Following are main features of liberalization.

Lessened Government control and freelance to private Enterprises.

- Capital Markets opened for private Entrepreneurs
- Simplification of Licensing policy
- Opportunity to purchase foreign exchange at market prices
- Right To Take Independent Decisions Regarding The Market
- Better opportunity for completion
- Widened Liberty in the Realm of Business and Trade

PRIVATIZATION

Privatization is a managerial approach that has attracted the interest of many categories of people academicians, politicians, government employee players of the private sector and public on the whole. Privatization has an adverse impact on the employee morale and generates fear of dislocation or termination more likely it also adds on to the apprehension pertaining to accountability and quality. Experts both advocate and criticize Privatization making it more or less provocative decision that calls for diligent scurrying by the decision makers in assessment of process and cons attached to the concerned policy.

In India Privatization has been accepted with a lot of resistance and has been dormant initially during the inception period of economic Liberalization in the country. The article intends to analyze the present status of Privatization in India and summarize its advantages and disadvantages in context with the Indian economy. Privatization is also one of the aspects other new economic policy which came to take shape in the decade 1990. The term "Privatization " can notes wide range of ideas. But the broad meaning of Privatization is that in the economic field much broader role is to be agencies and the role of the public sector activities is to be limited.

MAIN OBJECTIVEOF PRIVATIZATION

The process of Privatization has been triggered with the main intention of improving industrial efficiency and to facilitate the inflow of foreign investments.

1. It also wants to make the public sector undertakings strong able efficient companies. It recommends a change in the role of the government from that of the "owner manager" to that of a mere "controller" or "regular".
2. It also intend to ensure efficient utilization of all types of resources including human resources.
3. Privatization insists on the government to concentrate on the area such as education administration and infrastructure and to give up the responsibility of looking after business and running industries. It is expected to strengthen the capital market by following appropriate trade policies.

GLOBALIZATION

Globalizations represent one of the aspects of the new economic policy lunched in the decades of 1980 and 1990s. The new economic policy has also made the economy out wardly oriented such that its activities are now to be governed both by domestic market and the world market.

The tem Globalization was first coined in 1980s . But even before this there were interaction among nations. But in the modern days Globalization has launched all spheres of life such as economy, education, technology, cultural phenomenon , social aspects etc……the term global village is also frequently used to high light the significance of the Globalization . " Globalization of production refers to the integration of economic activities by units of private capital on awaked scale ."S.K

Misra and V.K Pury “stated that in simple terms Globalization means integrating economy of a country with the world economy.”

In simple words” Globalization is refers to a process of increasing economic integration and growing economic interdependence between countries in the world economy”

New Industrial Policy 1991

The industrial policy means the procedures, principles, policies rules and regulations which control the industrial undertaking of the country and pattern of industrialization. It explains the approach of Government in context to the development of industrial sector. In India the key objective of the economic policy is to achieve self-reliance in all sectors of the economy and to develop socialistic pattern of society. The industrial policy in the pre-reform period i.e. before1991 put greater emphasis on the state intervention in the field of industrial development. These policies no doubt have resulted into the creation of diversified industrial structure but caused a number of inefficiencies, distortions and rigidities in the system. Thus during late 70’s and 80’s, Government initiated liberalization measures in the industrial policy framework. The drastic liberalization measures were however, carried out in 1991.

OBJECTIVES:

The New Industrial Policy,1991 seeks to liberate the industry from the shackles of licensing system Drastically reduce the role of public sector and encourage foreign participation in India’s industrial development. The broad objectives of New Industrial Policy are as follows:

(i) Liberalising the industry from the regulatory devices such as licenses and controls.

(ii) Enhancing support to the small scale sector.

(iii) Increasing competitiveness of industries for the benefit of the common man.

(iv) Ensuring running of public enterprises on business lines and thus cutting their losses.

(v) Providing more incentives for industrialisation of the backward areas, and

(vi) Ensuring rapid industrial development in a competitive environment.

UNIT- 4

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The idea of Five year planning was taken from the erstwhile Soviet Union under socialist influence of first Prime Minister Jawaharlal Nehru.

An overview of all plans implemented in India is given below. The first eight plans had their emphasis on growing the public sector with massive investments in basic and heavy industries, but since the launch of the Ninth Plan in 1997, attention has shifted towards making government a facilitator in growth.

Planning without an objective is like driving without any destination. There are generally two sets of objectives for planning, namely the short-term objectives and the long-term objectives. While the short-term objectives vary from plan to plan, depending on the immediate problems faced by the economy, the process of planning is inspired by certain long term objectives. In case of our Five Year plans, the long-term objectives are:

(i) A high rate of growth with a view to improvement in standard of living.

(ii) Economic self-reliance;

(iii) Social justice and

(iv) Modernization of the economy

(v) Economic stability

(i) High Rate of Growth

All the Indian Five Year Plans have given primary importance to higher growth of real national income. During the British rule, Indian economy was stagnant and the people were living in a state of abject poverty. The Britishers exploited the economy both through foreign trade and colonial administration. While the European industries flourished, the Indian economy was caught in a vicious circle of poverty. The pervasive poverty and misery were the most important problem that has to be tackled through Five Year Plan.

During the first three decades of planning, the rate of economic growth was not so encouraging in our economy Till 1980, the average annual growth rate of Gross Domestic Product was 3.73 percent against the average annual growth rate of population at 2.5 percent. Hence the per-capita income grew only around 1 percent. But from the 6th plan onwards, there has been considerable change in the Indian economy. In the Sixth, Seventh and Eight plan the growth rate was 5.4 percent, 5.8 percent and 6.8 percent respectively. The Ninth Plan, started in 1997 targeted a growth rate of 6.5 percent per annum and the actual growth rate was 6.8 percent in 1998 - 99 and 6.4 percent in 1999 - 2000. This high rate of growth is considered a significant achievement of the Indian planning against the concept of a Hindu rate of growth.

(ii) Economic Self Reliance

Self reliance means to stand on one's own legs. In the Indian context, it implies that dependence on foreign aid should be as minimum as possible. At the beginning of planning, we had to import food grains from USA to meet our domestic demand. Similarly, for accelerating the process of industrialization, we had to import, capital goods in the form of heavy machinery and technical know-how. For improving infrastructure facilities like roads, railways, power, we had to depend on foreign aid to raise the rate of our investment.

By the end of the fifth plan, Indian became self-sufficient in food-grain production. In 1999-2000, our food grain production reached a record of 205.91 million tons. Further, in the field of industrialization, now we have strong capital industries based on infrastructure. In case of science and technology, our achievements are no less remarkable. The proportion of foreign aid in our plan outlays have declined from 28.1 percent in the Second Plan to 5.5 percent in the Eighth Plan. However, in spite of all these achievements, we have to remember that hike in price of petroleum products in the international market has made self-reliance a distant possibility in the near future.

(iii) Social Justice:

Social justice means to equitably distribute the wealth and income of the country among different sections of the society. In India, we find that a large number of people are poor; while few lead a luxurious life. Therefore, another objective of development is to ensure social justice and to take care of the poor and weaker sections of the society. The Five-Year Plans have highlighted four aspects of social justice. They are:

(i) Application of democratic principles in the political structure of the country;

(ii) Establishment of social and economic equity and removal of regional disparity;

(iii) Putting an end to the process of centralization of economic power; and

(iv) Efforts to raise the condition of backward and depressed classes.

Thus the Five Year Plans have targeted to uplift the economic condition of socio-economically weaker sections like scheduled caste and tribes through a number of target oriented programmes. In order to reduce the inequality in the distribution of landed assets, land reforms have been adopted. Further, to reduce regional inequality specific programmes have been adopted for the backward areas of the country.

In spite of various efforts undertaken by the authorities, the problem of inequality remains as great as ever. According to World Development Report (1994) in India the top 20 percent of household enjoy 39.3 percent of the national income while the lowest 20 percent enjoy only 9.2 percent of it. Similarly, another study points out that the lowest 40 percent of rural household own only 1.58 percent of total landed asset while the top 5.44 percent own around 40 percent of land. Thus the progress in the field of attaining social justice has been slow and not satisfactory.

(iv) Modernization of the Economy:

Before independence, our economy was backward and feudal in character. After attainment of independence, the planners and policy makers tried to modernize the economy by changing the structural and institutional set up of the country. Modernization aims at improving the standard of living of the people by adopting a better scientific technique of production, by replacing the traditional backward ideas by logical reasoning's and bringing about changes in the rural structure and institutions.

These changes aim at increasing the share of industrial output in the national income, upgrading the quality of products and diversifying the Indian industries. Further, it also includes expansion of banking and non-banking financial institutions to agriculture and industry. It envisages modernization of agriculture including land reforms.

(v) Economic Stability:

Economic stability means to control inflation and unemployment. After the Second Plan, the price level started increasing for a long period of time. Therefore, the planners have tried to stabilize the economy by properly controlling the rising trend of the price level. However, the progress in this direction has been far from satisfactory.

Thus the broad objective of Indian plans has been a non-inflationary self-reliant growth with social justice.

Need of Economic Planning for the rapid economic development, the under developing and developing countries have taken the shelter under economic planning. Thus, the arguments in favour of economics planning in underdeveloped and developing countries may be started as under:

1) Weak, Private Sector:

In an underdeveloped country, private enterprise is weak and may fail to take the necessary risks of pioneering those industries which are necessary for rapid economic development of the country.

Therefore, the State must come to the forefront action. The underdeveloped countries have remained almost stationary.

This task of their development is a big task. These countries need a big push. It is only possible through a comprehensive planning. Thus the Government should follow comprehensive planning for the development of underdeveloped countries.

(2) Inequalities of Income:

Inequalities of income and wealth exist in underdeveloped economies. Private enterprise system does not secure an equal distribution of the benefits of economic development among different classes of the community. The developing social conscience of the people cannot tolerate the existence of such grave inequalities. This would secure a better distribution of national income among all classes of people in the country.

(3) Problem of Unemployment:

Another reason why the underdeveloped countries need a plan is that the working of pricing system has failed to solve the problem of mass unemployment. The mass unemployment which existed during 1930's was horrible. No country wanted to experience such as mass unemployment again. There is also the acute problem of disguised unemployment in under-developed countries. The mass unemployment, particularly disguised unemployment, which exists in underdeveloped countries, cannot be dealt with unless a comprehensive economic plan for development is formulated.

(4) Change in Attitude:

All underdeveloped countries have become development-minded. Now they want to pack the development of centuries into a few years. They like to raise the standard of living of their people. Therefore, these countries require quick economic development.

(5) Need of More Capital:

Higher rate of growth of development requires huge capital investment. It involves a considerable degree of central planning and control. Among the underdeveloped countries, higher rates of growth have been registered in those countries where there is a planned development. In the last 15-20 years, the rate of growth of income in poor countries has been on the whole, higher than it was before they adopted planned development.

(6) Foreign Aid:

In modern economic activities the progress of one nation is related directly or indirectly to the progress of other nations. Thus, the detailed plan, mentioning specific output projects and investment projects, is very useful in creating favorable atmosphere for bilateral and multi-lateral agreements of foreign aid. Thus, carefully designed plan outlay is essential for increasing foreign trade and thereby improving development prospects.

(7) Structural Changes:

In an un-developed or under- developed country, the main economic sector is predominantly agriculture. The secondary and tertiary sectors are substantially less developed. This results into structural dis-equilibrium. Thus, for increasing the overall productivity, it is very essential that optimum labor force be diverted and employed on secondary and tertiary sectors of the economy. This is possible only by proper planning in different sectors of the economy.

(8) Economies of Scale:

The structured changes encourage and facilitate the setting up of new industrial units, which invariably created external economies. But these newly create economies are not usually taken into account by the private entrepreneurs under the market system. In case of external economies, role of public sector along with planning is essential.

Thus, the overall gains are maximized by making proper plan adjustments. Thus a specified investment can be best utilized taking a macro-economic view to have appropriate social as well as private gains. This strongly favors a planned development specially in case of less developed countries.

(9) Future Requirements:

In an attempt to maximize the current profit, the producers exploit the natural resources without considering the future requirement. Therefore, it is evident that if exhaustible natural resources are not properly utilized, less will be available for future generations. To conserve the natural resources carefully it is important to make and execute proper plans.

Role of Agriculture in Indian Economy

Agriculture plays a vital role in the Indian economy. Over 70 per cent of the rural households depend on agriculture as their principal means of livelihood. Agriculture, along with fisheries and forestry, accounts for one-third of the nation's GDP and is its single largest contributor. Agriculture provides food to all the citizens of our country.

SHARE IN NATIONAL INCOME

Agriculture is India's big economy. Although the share of agriculture in the total national income has been gradually decreasing on account of development of the secondary and tertiary sectors its contribution continues to be significant. IN 1950, the share of agriculture was 57% but it is only 26% now. The more developed a country is the lesser is the contribution of agriculture.

Source of Employment

Today almost 60% of the population depends directly or indirectly on agriculture. The greater independence of working population on agriculture indicates the underdevelopment of non-agricultural activities in the country.

Importance in industrial development

Agriculture provides raw materials to pour leading industries such as cotton textiles and sugar industries. Not only have this workers in industries depended on agriculture for their food. Agriculture also provides the market for a variety of goods.

Importance in international trade

A number of the agricultural commodities like tea, coffee, spices and tobacco constitute our main items of exports. This amount to almost 15% of our total exports. Hence agriculture provides foreign exchange which helps us to buy machines from abroad. It also maintains a balance of payments and makes our country self-sufficient.

Development of tertiary sector

Tertiary sector provides helpful services to the industries and agriculture like banking, warehousing etc. Internal trade is mostly done in agricultural produce. For example, various means of transport get bulk of their business by the movement of agricultural goods.

Revenue to the government

State government get a major part of their revenue in terms of land revenue, irrigation charges, agricultural income tax etc.Central government also earns revenue from export duties on the agricultural production. Moreover our government can raise substantial revenue by imposing agricultural income tax. However this has not been possible due to some political reasons.

International importance

Our agriculture has brought fame to the country. India enjoys first position in the world as far as the production of tea and groundnuts are concerned.

Internal trade

Agriculture plays a important role in the internal trade. It is because of the fact that 90% of our population spends 60% of their income on the purchase of the items like food, tea, milk

etc.
Prof. Gunar Myrdal has rightly remarked, "It is the agricultural sector that the battle for long term economic development of India will be won or lost."
IN fact the prosperity of agriculture is the prosperity of Indian economy. We should not build industries at the cost of agricultural land
and livestock on a farm. .

INTERDEPENDENCE BETWEEN AGRICULTURE AND INDUSTRY

Industry is not the substitute of agriculture; rather they are complementary to one another. Both these sectors are so attached with each other that it is not possible to increase the growth of one sector without the improvement of the other sector. If agriculture is considered as the ‘heart’ of the country, then obviously industry must be consider as the ‘brain’.

The interdependence of these sectors is listed below:

(A) Impact of Agriculture on Industry:

Agriculture has huge positive impacts on the industrial development, such as:

(a) It regularly supplies raw materials like sugarcane , jute cotton, oilseeds, tea, spices, wheat; paddy etc. to the consumer goods industries.

(b) It supplies cereals, vegetables and other food items to the industrial labourer and fodders for the domestic animals in the dairy industries on a regular basis.

(c) Farmer-households used to save their money in the bank and other financial institutions which ultimately is used by the industry owners in the form of investment.

(d) Both for consumer and capital goods Industries agriculture sector gives a ready market for the finished products.

(e) It regularly supplies manpower to the industries

(B) Impact of Industry on Agriculture:

This is needless to mention the impact of industry on agriculture.

The impact of industry on agriculture as follows:

(a) It regularly supplies scientific tools and equipment's like tractors, harvesters, pump-sets chemical fertilizers etc. to agriculture increase the per hectare production.

(b)To increase the market for finished agricultural goods some infrastructural development like roads, railway, storage etc. are very essential. In this connection industry plays a vital role.

CHOICE OF TECHNOLOGY

According to Frenkel, "Technology change is not a mere important in the technical know – how. It means much more than this. It should be preceded by sociological change also, a willingness and desire on the part of the community to modify their social, political and administrative institution so as to make them fit with new techniques of production and faster tempo of economic activity." But the absence of technological change means end of growth after a point.

However, the modern technology is changing rapidly and today no country can hope to maintain steady advancement unless it keeps pace with modern technological advancement or change. Today, the main problems of underdeveloped and developing countries are:

1. Low production
2. Low productivity
3. High cost of production
4. Increases in demand existence of traditional technology

The economic development of a country lies in technological change because both are closely related with each other.

LABOUR INTENSIVE TECHNIQUES

Labor intensive refers to a process or industry that requires a large amount of labor to produce its goods or services. The degree of labor intensity is typically measured in proportion to the amount of capital required to produce the goods or services; the higher the proportion of labor costs required, the more labor intensive the business.

According to Prof. Myint, "labour intensive methods of production are those that require a large quantity of labour with a given unit of capital." With this method of production, it is possible to raise output by using the same amount of capital but greater amount of labour.

ARGUMENT IN FAVOUR OF LABOUR INTENSIVE TECHNIQUES

(1) More Employment Generation:

It needs no argument to say that labour intensive techniques are more employment generating. Underdeveloped countries face the scarcity of capital and abundance of manpower. The capital labour ratio in these countries is very low. So, labour intensive technique is indispensable if the problem of unemployment and disguised unemployment is to be resolved.

(2) Utilization of Scarce Capital:

Underdeveloped countries suffer from an acute shortage of capital and entrepreneurial resources. Keeping these facts in mind they will have to select a technique which can economies the use of these scarce resources. Thus, the adoption of these methods of production is more suitable in underdeveloped countries as it will release the scarce capital resources for other important uses.

(3) Decentralisation:

The use of labour intensive techniques will confer the benefits of decentralisation and avoid the evils of factory system. As these techniques are invariably associated with small and cottage industries and hence they can be fruitful in the establishment of an economically decentralised society. The present democratic governments have desired to attain decentralisation with social justice.

(4) Favourable Effect on Distribution of Income:

Labour intensive technique is also favored because it has favourable effect on distribution of income. A labour intensive project will tend to raise the income level of a relatively large number of low income workers. By providing more employment these methods of production tend to provide higher degree of economic equality to a common man.

(5) Higher Level of Consumption:

Labour intensive technique will be a useful method to raise the present level of consumption. These techniques tend to raise the level of wages. These increased wages will automatically be spent on consumption. In a sense labour intensive technique will ensure a higher level of consumption of the working classes.

(6) More Production at Cheaper Rate:

Another argument advanced in favour of labour intensive technique is that it provides the cheaper way of raising output in less developed countries. In a poor country, the social price of labour is likely to be below or even zero compared with the high price of capital. Therefore, the most efficient use of resources in a poor country will tend to favour labour intensive methods.

(7) Creation of Economic and Social Overheads:

It is also argued that labour intensive technique would also mean a considerable saving in expenditure on the development of economic and social overheads. Industries using these techniques are usually set up in villages. Less spending is made on the building of houses, development of roads and other means of transport and providing civic amenities. Thus, there is a considerable scope of saving of expenditure on economic and social overheads.

(8) Control on Inflationary Pressures:

Labour intensive techniques have a counter-inflationary effect and hence they are preferred in developing countries. These techniques ensure quick and rapid increase in the supply of consumer goods which in turn is helpful in combating the inflationary pressure which has become a common feature in most of the underdeveloped countries.

(9) Saving of Foreign Exchanges:

The adoption of labour intensive techniques would mean a considerable saving of foreign exchange resources. In short, these techniques are helpful to solve the problem of foreign exchange.

(10) Social Equality:

It is also pointed out by some supporters of labour intensive technique that it provides social justice as it is helpful to increase the income of a common man at village level.

(11) Better Utilization of Local Resources:

Labour intensive techniques are adopted in small scale and rural industries. Thus, there is ample scope of utilization of local resources.

(12) Scope for Employment to Children and Women:

Labour intensive technique is also supported on the ground that it provides employment opportunities to children and women.

Arguments against Labour Intensive Techniques:

Some critics have opposed labour intensive technique on the following grounds.

(i) Labour intensive technique is static and of short term in nature which cannot be applied in the long run period.

(ii) As this technique leads the redistribute incomes in favour of those who have low marginal propensity to save, this result low rate of capital formation.

(iii) There is no possibility of improved and more advanced skill during the course of labour intensive techniques.

(iv) The production process is very costly.

(v) No possibility of research, modernisation.

UNIT -5

MEANING AND DEFINITION OF PUBLIC SECTOR/PUBLIC ENTERPRISE

Public sector consists of undertaking which are directed either by a branch of Government itself or by a body set up by Government to direct the Undertaking in Public Interest. “An enterprises where there is no private ownership where its function are not merely confined to the maximization of profits to he promotion of the private interest of the enterprise but are governed by the public or social interest and where the management is responsible to the Government either directly as a departmental undertaking or indirectly as in Government companies and corporations.”

Growth of Public Sector in India:

The public sector undertaking is growing at a rapid rate after independence. At present in our country, there are 750 State public sector enterprises and 225 central public sector enterprises approximately employing nearly about 1,00,000 managers.

During 7th Five year plan, on an average 50,000 crore of rupees were invested at the beginning in public sector enterprises which brought a remarkable contribution in the field of economic development Needless to mention here that these public sector enterprises covered all economy sector.

Objectives of Public Sector:

The general objectives of public sector are:

(a) To provide required investment and promotion of industrial activity by way of indirect public investment either by supplying financial assistance to private sector or to supply infrastructural and basic activities;

(b) To supply socio-economic developmental opportunities this should not be transferred to private sector undertakings;

(c) To nationalize those companies which are foreign dominated,

(d) To supply activities relating to import-substituting and export-promoting which are essential for the development of the country;

(e) To develop savings by mobilizing resources with the help of proper public sector prices more quick than others;

(f) To introduce certain activities to take the benefit of foreign aid and co-operation in the public sector;

(g) To make a balanced regional development by establishing regional promotional undertakings in less developed regions, e.g., D V. C (Damodar Vally Corporation);

(h) To protect the interest of small farmers by transferring all private licenses to the corporations of agricultural reforms;

(i) To control the concentration of economic power and wealth as well;

(j) To make a social control on long term capital by supplying the necessary financial assistance through public financial institutions which are quite justified?

(k) To supply necessary finance for various development programmes which are essential for the development of the country?

(l) To make opportunities for employment and to form a rational society this is absolutely desired;

(m) To re-distribute incomes either by rising wage levels and checking higher salary level or by supply outputs at a concessional rate to the poor etc.

(n) To generate surplus resources for future growth and development; and

(o) To use human resources and material resources in a better way.

Role of Public Sector

1. Rapid Economic Development

The prerequisite of faster economic development is the creation of infrastructure and the growth of basic industries like power, steel transportation; communication, banking etc. These industries require huge capital investment and involve long-gestation period and so private sector may not be interested to undertake the development of such industries. Further, the private sector lack financial and technical skills to develop such industries. In other words, reluctance on the part of private entrepreneurs to develop key industries due to high risk and low returns necessitated the establishment of PSEs. Government with its capacity to mobilize huge economic resources can develop the industries that are significant for growth prospects of the country. Thus in the earlier phase of development heavy state spending on investment in basic infrastructural sectors and service facilities(for example financial institutions, telecommunication banking etc.) is essential for providing a congenial atmosphere to the private sector to facilitate the process of accelerated development of the economy.

2. Reduction of Concentration of Economic Powers

Private Public Sector reduces inequalities of income through welfare programmes, favorable pricing policy towards small industries and supply of cheaper goods to the consumer. Private sector may manipulate the price of essential goods and indulge into quick profit-making by controlling the volume and price of such goods. PSEs prevent such concentration of economic power.

3. Balanced Regional Growth

Private sector generally neglects backward regions that lack infrastructure and other basic facilities such as power, roads, telecommunication, skilled labor etc. PSEs set up large projects in these areas and spend huge cost to develop such areas. In this manner PSEs help to achieve balanced regional growth.

4. Employment Generation

The adequate generation of employment opportunities is a major objective of the public sector enterprises. This sector has provided direct employment to more than 80 percent of organized labor.

5. Import-Substitution and Export-Promotion

In the initial period of development foreign exchange constraints exist due to huge imports of capital goods and low exportable surplus. PSEs produce importable goods domestically which tend to save precious foreign exchange and facilitate exports.

6. Resource Mobilization

PSEs mobilize savings through large network of banking and financial institutions. The profits of PSEs are ploughed back into developmental activities of the country. Further, PSEs contribute to the Government's exchequer through payment of tax and divided.

PROBLEMS OF PRIVATE SECTOR

1. Poor project planning:

Investment decisions in many public enterprises are not based upon proper evaluation of demand and supply, cost-benefit analysis and technical feasibility.

Lack of a precise criterion and flaws in planning have caused undue delays and inflated costs in the commissioning of projects. Sometimes, projects are launched without clear-cut objectives and serious thought.

Many projects in the public sector have not been finished according to the time schedule. Barauni Refinery was commissioned two years behind schedule and the Trombay Fertilizer plant was delayed by three years thereby causing an increase of Rs. 13 corers in the original cost estimates.

There is lack of clear-cut objectives and managers in the public sector often find themselves torn between conflicting goals of profitability and social service.

2. Over-capitalization:

Due to inefficient financial planning, lack of effective financial control and easy availability of money from the Government, several public enterprises suffer from over-capitalisation.

The Administrative Reforms Commission found that Hindustan Aeronautics, Heavy Engineering Corporation and Indian Drugs and Pharmaceuticals Ltd., were overcapitalized. Such over-capitalization resulted in high capital-output ratio and wastage of scarce capital resources.

3. High establishment costs:

Public enterprises incur heavy expenditure on social infrastructure such as schools, hospitals, etc. Location in backward regions and the desire to make the undertaking a model employer lead to huge capital outlay on housing and other amenities for labour.

Recurring expenditure is required to maintain these facilities. High establishment costs, overhead costs and other expenses reduce the profitability of public enterprises.

4. Overstaffing:

Manpower planning is not effective due to which several State enterprises like Bhilai Steel have excess manpower. Recruitment is not based on sound labour projections. On the other hand, posts of Chief Executives remain unfilled for years despite the availability of required personnel.

5. Under-utilisation of capacity:

One serious problem of the public sector has been low utilisation of installed capacity.

In the absence of definite targets of production, effective production planning and control, proper assessment of future needs, adequate supply of power and industrial peace, many undertakings have failed to make full use of their fixed assets.

The average capacity utilisation in more than 50 per cent of the public enterprises has been less than 75 per cent. There is considerable idle capacity. In some cases productivity is low on account of poor materials management or ineffective inventory control.

6. Lack of a proper price policy:

There is no clear-cut price policy for State enterprises and the Government has not laid down guidelines for the rate of return to be earned by different undertakings.

State enterprises are expected to achieve various socio-economic objectives and in the absence of a clear directive, pricing decisions are not always based on rational analysis.

In addition to dogmatic price policy, there is lack of cost-consciousness, quality consciousness, and effective control on waste and efficiency.

7. Unsatisfactory industrial relations:

In several State enterprises relations between management and labour are far from cordial. There has been serious and frequent labour trouble in Durgapur Steel Plant, Bharat Heavy Electricals, Bhopal, and in Bangalore-based undertakings.

Millions of days and output worth crores of rupees have been lost due to strikes and gheraos. Wage disparities have been the main cause of labour trouble in the public sector.

The percentage increase in the per capita emoluments of public sector employees has been higher than the percentage increase in consumer price index.

8. Lack of coordination:

Various state enterprises are dependent on one another as the output of one enterprise is the input of another. For instance, the efficient functioning of power and steel plants depends on the production and transportation of coal which in turn is dependent upon supplies of heavy equipment and machinery.

Despite such interdependence; effective coordination between different undertakings in the areas of personnel, finance, materials management and research has not been achieved.

9. Lack of motivation:

Directors and managers of public enterprises have little personal stake. There is little incentive to work hard and improve efficiency. Centralisation of authority and rigid bureaucratic control hamper initiative, quick decisions and flexibility of operations. Personal touch with employees and sensitivity to consumers' needs are lacking.

10. Political interference:

There is excessive influence and interference by political leaders and civil servants in the functioning of public enterprises. Parliamentary control reduces the autonomy of these enterprises.

SUGGESTIONS FOR IMPROVING THE PERFORMANCE OF PUBLIC SECTOR /ENTERPRISES

- Controlling the cost at every level of public sector enterprises.
- Increase the production.
- Reforms in capital base.
- Increase the standard of public sector enterprises to manage the competition from both domestic and foreign competitors.
- Identifying redundant manpower and dealing with it through means a retraining, redeployment and encouraging self–employment etc.

Reasons for the Poor Performance of Public Sector Enterprises

1. Lack of Importance to Profit Motive:

In the working of public enterprises profitability criteria was not given proper place.

Some of the persons and economists associated with our Planning Commission who formulated policies on public sector enterprises as well as those who were entrusted with setting them up and running them played down the idea of profit making by public enterprises and unduly emphasized the social obligations of public enterprises. It is only recently that profit aspect of public enterprises has been given due recognition.

2. Inappropriate Location:

An important reason for the low profitability of public enterprises is their uneconomic location. Usually, public enterprises are set up on the basis of political considerations rather than economic criteria. There is clamor for locating these enterprises in certain regions on the part of the ruling party bosses, influential ministers and public leaders even at the threat of fasts.

3. Underutilization of Installed Capacity:

Low utilisation of capacity has been a very important reason for the low profitability of the public undertakings. Enormous installed capacities have been created with the help of foreign credits and know-how on easy terms, but fuller use of them has not been made. The phenomenon of underutilization of capacities has arisen on account of overestimating demand, administrative deficiencies, lack of proper working techniques, labour troubles or failure to install balancing equipment or making technical improvement essential for fuller utilisation of capacity.

4. Not Making Proper Technical Feasibility Studies:

The technical factors determine the scale of operations of production enterprises. Technical considerations require that there should be a thorough investigation into the processes to be used and the availability of the essential factors of production like raw materials, fuel, power, water supply, skilled and unskilled labour, credit facilities, transport, proximity of the markets, etc.

In several cases, there is no evidence that a proper study of these aspects was made before the project was launched. The scale was determined more by a bias for launching a big project rather than on the basis of economic calculation of production potential and likely demand. The Committee on Public Undertakings pointed out that tenders were invited without any project reports in the case of Trombay Fertilizer Project, Hindustan Insecticides and Indian Telephone Industries.

5. Delay in Project Completion:

Also, very little consideration is given to the time-schedule in the construction of the public sector projects. The inevitable result is that the projects are commissioned much later than scheduled. It unnecessarily raises the cost of construction. Trombay Fertilizer Project, for instance, took 6-7 years to complete against time schedule of 3 years and this heavily raised the cost of the project.

6. Absence of Professional Management:

The composition of the Boards of Directors indicates the absence of professional managers. These boards are dominated invariably by IAS officers from the civil service, a number of who owe their position to political patronage rather than their professional managerial abilities.

7. Overstaffing, Defective Recruitment and Promotion Policy:

With regard to staffing, recruitment and promotion policy a deplorable situation exists in our public sector. Recruitment is haphazard; there is overstaffing, drift of personnel and a lack of regular schemes of ‘executive development’. The Committee on Public Undertakings pointed out the bureaucratic approach to the administration of these undertakings and warned against the regular practice of dumping retired and superannuated Government officials into their service.

8. Lack of Rational Pricing Policy:

The public enterprises in India have failed to evolve an appropriate pricing policy for their products. Should public enterprises follow marginal cost pricing or average cost pricing or the mark-up pricing policy? In the absence of an appropriate pricing policy, optimal utilisation of resources and profitability cannot be achieved.

Most of the public enterprises are regulated by the Government and do not aim at maximising profits. It is worth noting that most of the products produced by the public enterprises such as steel, fertilizers, oil etc. are essential inputs for other industries or sectors of the economy.

9. Political Interference:

The political interference has been forcing the management of public enterprises to give up sound commercial principles in arriving at vital decisions pertaining to investment, location, production and pricing policies of public enterprises.

Most often political considerations guide the decision making of the public enterprises. Ministers and Members of Parliament put pressure on the government about the location of the public sector projects in their constituencies regardless of any economic criteria and feasibility studies made. This leads to considerable wastage of capital resources.

Conclusion:

The relatively low surpluses created by the public enterprises are attributed to their long gestation period, the lack, in the initial period, of expert and trained personnel, defective planning, wrong selling policies and monopolistic nature of various public enterprises which produced lethargy among the managerial staff.

It is true that there may be losses in the initial stages but the losses should not have become a permanent phenomenon. The public enterprises suffer from inefficiency and low productivity due to lack of an effective system of accountability. It is the system of accountability in the private sector which leads to an efficient utilisation of resources which ensures profitability.

Private Sector

Private sector includes all different types of individual or corporate enterprises, both domestic and foreign, engaged in different fields of productive activity. Private sector enterprises are owned and managed by the private sector. These private sector enterprises are mostly characterized by certain common characteristics like private initiative, profit motive and ownership and management in private hands.

In 18th and 19th century, most of the countries of the world adopted the policy of laissez faire where the Governments followed a policy of non-interference in economic activity by the State. This had led to huge expansion of private sector in almost all the countries of the world. In recent times, the private sector has changed its character and is now quite different from the private enterprises of the past.

Growth of Private Sector in India:

At the dawn of independence, almost the entire productive activities and trade were owned and managed by the private sector. At that time, the role of public sector was insignificant, and its activity was very much confined to irrigation, power, railways, ports, ordinance, posts and telegraphs etc. But the activity of the public sector was gradually expanded in different new fields by both the Centre and the States.

Accordingly, the public sector started to play a significant role in different areas; in terms of investment, turnover, capital formation, import substitution, contribution to export etc. Even after the huge expansion of the public sector, the private sector still continued to play a dominant role in all spheres and thereby accounting nearly 80 per cent of the gross domestic product and about 90 per cent of the total employment. In a narrow sense, private corporate sector provides a picture about the private sector. Thus, it is quite important to study the growth of private corporate sector in comparison to that of public sector.

The Government Support and Control and the Private Sector:

In order to provide necessary support and finance to the private sector, the Government of India has set up a huge network of development banking and financial institution since independence. These institutions include Industrial Finance Corporation of India (IFCI), the State Financial Corporation's (SFCs), the Industrial Development Bank of India (IDBI), the Industrial Credit and Investment Corporation of India (ICICI), the EXIM Bank, the National Bank for Agricultural and Rural Development (NABARD) etc.

These institutions are providing adequate financial support to different large, medium and small scale industries, agricultural sector, traders, export oriented units etc. In addition to these institutions, the Government has set up some other institutions to assist the private sector in the form of infrastructure, technological development, raw material supply, marketing arrangements etc.

Role Of Private Sector

1. Industrial Development:

During the pre-independence period, the private sector has played a responsible role in Indian economy where it set up and expanded cotton and jute textiles, sugar, paper, edible oil, tea etc. After independence, the national government gave sufficient stress on industrialization.

The private sector also made a serious attempt to invest on industries producing wide range of intermediate products which include machine tools, chemicals, paints, plastic, ferrous and non-ferrous metals, automobiles, electronics and electrical goods etc. In this way, the private sector has developed the consumer goods industry, producing both durables and non-durables and became self- sufficient in the production of different types of consumer goods.

2. Agriculture:

In India agriculture and other allied activities like animal husbandry, dairying, poultry etc. are playing a dominant role as it contributes nearly 30 per cent of GDP and it provided employment to nearly 67 per cent of the total working population of the country. Such a big sector is completely owned and managed by the private sector.

3. Trading:

Both the wholesale and retail trade in India are in the hands of private sector. In a big country like India, having a huge size of population, the entire trading activities are managed by the private sector in a best possible manner. But in case of scarcity of any essential commodities, the private businessmen have their natural tendency in resorting to hoarding and black marketing of such commodities leading to exploitation of the consumers.

4. Infrastructure:

Private sector is also providing an active support to the infrastructural sector of the country. Although, the major areas of the infrastructural sector lies in the hands of public sector but still the private sector is participating in those areas which remain open for it. Private sector has been playing dominant role in respect of road transport, water transport etc. from the very beginning.

5. Services Sector:

The services sector of the country is almost totally under the control of the private sector. The entire community and personal services, which contributed nearly 11.1 per cent of GDP in 1994-95, is entirely managed by the private sector. The entire professional services, repairing services, domestic services, entertainment services etc. are solely rendered by the private sector throughout the country.

6. Role in the Indian Economy:

The private sector is playing an important role in Indian economy. The importance of this sector in the economy of the country can be visualized from the fact that it contributes to the major portion of national income and employment.

Again, as per 1991 census, the percentage of population working in the government sector, including public enterprises and government administration was only 7 per cent and the remaining 93 per cent of the working population are engaged in the private sector. Thus, even after making a huge volume of investments in the public sector and completing more than 50 years of planning, Indian economy is still broadly based on the private sector.

7. Small Scale and Cottage Industry:

In India, small scale and cottage industries are playing an important role in the industrial development of the country. The entire small scale and cottage industry is owned and managed by the private sector. As these industries are mostly labour-intensive in nature, thus they can utilize the local employment opportunities suitably.

The importance of these industries can be visualized from the fact that in 2001-02 the small scale and cottage industries, numbering 34.42 lakh units, have generated employment to the extent of 192.23 lakh, produced output worth Rs. 6,90,316 crore and contributed nearly 29 per cent of the total exports of the country.

Joint Sectors

The joint sector represents a new ideology of economic management geared to sub serve a new economic system.

The term is applied to an undertaking only when both its ownership and control are effectively shared between public sector agencies on the one hand and a private group on the other. The basic idea underlying the concept is combination of joint ownership, joint control and professional management.

DEFINITION OF JOINT SECTOR

The joint sector would include units in which both public and private investments have taken place and where the state takes an active part in direction and control.

According to JRD Tata a joint sector enterprise is intended to form a partnership between the private sector and the Govt. in which the govt. participation of the capital will not be less than 26 p.c., the routine management will be normally in the hands of the private sector partner and control and supervision will be duly exercised by a governing board on which Government is adequately represented.

The Tata concept of joint sector is heavily private sector oriented, whereas the Dutt Committee concept of the joint sector was public sector oriented and aimed at curbing concentration of industries in the private sector

FEATURES OF JOINT SECTOR:

(i) The Central Govt. and private entrepreneurs may jointly set up new enterprises. Sometimes the Central Govt. and one or more State Govts, together may set up enterprises in partnership with the private sector.

(ii) The State Govt. or their industrial development corporations may set up new companies jointly with private partners, involving equity participation by both the partners.

(iii) Public financial institutions may, through equity participation or conversion of loans or debentures into equity, transform enterprises promoted by private entrepreneurs into joint sector companies.

GOVERNMENT POLICY:

The Govt. accepted the concept of joint sector in its industrial policy decision in 1970 and 1973. The concept of joint sector became very popular after the Report of the Industrial Licensing Policy Inquiry Committee was submitted in 1969.

However, this is not a new idea. The industrial policy pronouncements even before the Dutt Committee Report had conceived the idea of joint sector. Indeed, the joint sector as a form of business existed in India even before Independence.

The idea of the joint sector was implicit in the Industrial Policy Resolutions of 1948 and 1956. The Industrial Policy Resolution of 1948 indicated the possibility of the state securing the cooperation of private enterprise for the establishment of new units even in the 6 industries where only the state was to have the right to set up new units, subject to such control and regulation as the Central Govt. might prescribe.

The Industrial Policy Resolution of 1956 indicated the possibility of the state securing the cooperation of private enterprises in the establishment of new units when the national interest so requires in the industries listed in Schedule A (i.e., industries the future development of which had been exclusively reserved for the state).

Role of Joint Sector

The basic objective of the joint sector is that public funds should primarily be used to sub serve the public interest and that their deployment should not result in undue benefits to a few individuals or business houses. The joint sector has also acquired other objectives such as serving as an instrument of state initiative in the development of priority industries, in dispersal of ownership and control over industries and in creating a new class of entrepreneurs.

The joint sector is conceived as a marriage between the managerial expertise of the private sector and the financial resources and social orientation of the public sector. It is viewed as an effective means of achieving a mixed economy. In a sense, joint sector enterprises represent an application of the concept of mixed economy at the micro level.

PROBLEMS OF THE JOINT SECTOR:

1. While in principle the concept appears acceptable, guidelines in terms of the roles of the Govt. and private partners in managing and controlling joint sector enterprises still remain to be spelt out. From the point of view of private investors, uncertainty about their role in management and control has been a major inhibiting factor.

2. The rationale for setting up joint sector projects was mainly for developing backward areas, reducing concentration of economic power and to accelerate industrial development. But in reality, often the purpose for which the joint sector projects were set up was unrelated to these basic objectives.

The joint sector enabled private entrepreneurs to promote large projects with less of equity participation; it also enables them to obtain certain concessions which were denied to projects in the private sector. Similarly, the main motive for the State in setting up joint sector projects was to

3. The inter-facing between a purely Govt. agency whose commitment and accountability are vastly different and a private group whose main motivation is likely to be commercial profitability is not always smooth.

There is always the dilemma between “over control” of a unit to satisfy the rigor of Govt. audit on the one hand which, over time, stifles initiative and makes it difficult to operate; on the other, there is a well-recognized accountability to the public and legislature where Govt. funds are invested that they are expended wisely.

One, therefore, has to steer clear of these two extremes and ensure that the right “mix” of freedom and interference which will make the unit grow and expand is achieved.

Small Scale Industry

In Indian economy small-scale and cottage industries occupy an important place, because of their employment potential and their contribution to total industrial output and exports.

Government of India has taken a number of steps to promote them. However, with the recent measures, small-scale and cottage industries facing both internal competition as well as external competition.

These are the industrial undertakings having fixed investment in plant and machinery, whether held on ownership basis or lease basis or hire purchase basis not exceeding Rs. 1 crore.

Characteristics of Small-Scale Industries:

(i) Ownership:

Ownership of small scale unit is with one individual in sole-proprietorship or it can be with a few individuals in partnership.

(ii) Management and control:

A small-scale unit is normally a one man show and even in case of partnership the activities are mainly carried out by the active partner and the rest are generally sleeping partners. These units are managed in a personalised fashion. The owner is activity involved in all the decisions concerning business.

(iii) Area of operation:

The area of operation of small units is generally localised catering to the local or regional demand. The overall resources at the disposal of small scale units are limited and as a result of this, it is forced to confine its activities to the local level.

(iv) Technology:

Small industries are fairly labour intensive with comparatively smaller capital investment than the larger units. Therefore, these units are more suited for economics where capital is scarce and there is abundant supply of labour.

(v) Gestation period:

Gestation period is that period after which teething problems are over and return on investment starts. Gestation period of small scale unit is less as compared to large scale unit.

(vi) Flexibility:

Small scale units as compared to large scale units are more change susceptible and highly reactive and responsive to socio-economic conditions.

They are more flexible to adopt changes like new method of production, introduction of new products etc.

(vii) Resources:

Small scale units use local or indigenous resources and as such can be located anywhere subject to the availability of these resources like labour and raw materials.

(viii) Dispersal of units:

Small scale units use local resources and can be dispersed over a wide territory. The development of small scale units in rural and backward areas promotes more balanced regional development and can prevent the influx of job seekers from rural areas to cities.

OBJECTIVES OF SMALL SCALE INDUSTRIES:

The objectives of small scale industries are:

1. To create more employment opportunities with less investment.

2. To remove economic backwardness of rural and less developed regions of the economy.

3. To reduce regional imbalances.

4. To mobilise and ensure optimum utilisation of unexploited resources of the country.

5. To improve standard of living of people.

6. To ensure equitable distribution of income and wealth.

7. To solve unemployment problem.

8. To attain self-reliance.

9. To adopt latest technology aimed at producing better quality products at lower costs.

LARGE SCALE INDUSTRIES

In the nineteenth century, India saw the emergence of **large** factories, machinery, and government regulation of industrial work—three features that **define** a **large-scale industry**. ... It also examines major **industries**, labour, capital, technology, entrepreneurship, management, and the princely states.

(A) ADVANTAGES OF LARGE SCALE PRODUCTION:

The following are the merits of large scale production:

1. Internal Economies:

Internal economies arise within the firm because of the expansion of the size of a particular firm.

They are called the economies of scale.

2. External Economies:

External economies arise with the expansion of the industry. These are generally the result of large scale production and are associated with the advantages of localisation.

3. Division of Labour:

The large scale production is always associated with more and more division of labour. With the division of labour per worker output increases. Hence, per unit labour cost is reduced in large scale production.

4. Use of machines:

The large scale production always makes use of machines. So, all the advantages of the use of machinery are available.

5. More Production:

The large scale industries can produce more goods. For instance, a big sugar factory can use molasses to make spirits and thus can reduce the cost of production of sugar.

6. Economies of Organisation:

With an increase in the size of the firm, the cost of management is reduced.

7. Low Cost of Production:

The large scale production gives many types of economies. Suppose, there are two different factories, each producing 500 units of a c

ommodity. For these two factories, there must be two managers. But if the scale of production is enlarged and in one factory we start producing 1000 units of the same commodity, the work can be supervised by one manager. In this way, in the large scale production, the salary of one manager is saved. So, the cost of production is reduced.

8. Cheap and Easy Loans:

A large business can secure credit facilities at cheaper rates, because these firms enjoy credit and reputation in the market due to their fixed assets. Banks and other financial institutions willingly advance loans to these enterprises at a very low rate of interest.

9. Ancillary Industries:

With the development of large scale production, there arise many small industries which use its by-products or supply inputs to it. Suppose, when the production of steel is increased, many other auxiliary industries develop. The development of auxiliary industries contributes to the industrialisation of the area and the industry itself.

10. Standard Goods:

The production of standardised goods is possible on account of the large-scale production. Only a big motor company can produce standardised motor parts. Besides, it is possible to sell and transport these goods to distant places only by big business houses.

11. Advertisement and Salesmanship:

A big concern can afford to spend large amounts of money on advertisement and salesmanship. Ultimately, they do bear fruit. The amount of money spent on advertisement per unit comes to a low figure when production is undertaken on a very large scale. The salesmen can make a careful study of the individual markets and thus acquire a hold on new markets or strengthen it on the old ones. Thus, a large scale producer has a greater competitive strength.

12. Research:

The large scale production is conducive for the development of technology also. With larger amount of capital and financial resources, the large scale firms can afford to spend more on research and experiments which ultimately lead to the discovery of new machines and cheaper techniques of production.

13. Economy of Buying and Selling:

A large concern usually buys things in large quantities and therefore, at low rates. It also sells things in large quantities and can secure better terms.

14. Economies of Indivisibility:

Many factors of production are not perfectly divisible. For instance, assume that one machine can produce 100 units of a commodity, but we are producing only 50 units by that machine. The machine is indivisible. If the scale of production is increased and we start producing 100 units, per unit cost will be reduced. This is the economy of the indivisible machines.

(B) DISADVANTAGES OF LARGE SCALE PRODUCTION:

The following are the demerits of large scale production:

1. Evils of Factory System:

The large scale production is accompanied by all the evils of the factory system like over-crowding, density, pollution, bad morals, etc. Dirty habits of drinking and gambling spread very easily.

2. Danger of Over-Production:

The large scale organisation results in over production at times, so demand cannot be properly estimated. At last, prices fall and depression sets in.

3. Less Supervision:

A large scale producer cannot pay full attention to every detail in various departments. Costs often rise on account of the dishonesty of workers. Thus, due to inefficient and inadequate supervision, the cost of production goes up.

4. Monopoly:

The large scale production results in the localisation of industries. As a result, the bigger fish swallows the smaller ones, and cut-throat competition and monopolies result.

5. Class Struggle:

The large scale production gives rise to class struggle, the struggle between the labourers and the capitalists. Their interests cannot go together, as they are very different from each other. As a result, there is a struggle between the two groups.

6. Dependence on Foreign Markets:

A large producer has generally to depend on the foreign markets. The foreign markets may be cut off by wars, etc. This makes the business risky.

7. Possibility of War:

The large scale production increases the possibilities of wars. Big producers make attempts to sell their goods in the foreign markets and try to capture them by fair and foul means, thereby exposing the world to wars and struggles.

8. Lack of Adaptability:

As huge capital is invested in the large scale production, it is very difficult to bring about a change in the scale of production according to the circumstances.

9. Individual Tastes Ignored:

The individual tastes and interests stand completely ignored in large scale production. Goods of uniform quality are turned out irrespective of the requirements of the individual customers. Individual tastes are not, therefore, satisfied. This results in the loss of customers to other competitors.

10. Unequal Distribution of Wealth:

All wealth and incomes of the country get concentrated in the pockets of big producers due to large scale production. There is unequal distribution of wealth and resources on account of the large scale production. The rich become richer and the poor become poorer.

CAPITAL FORMATION

Capital formation is a term used to describe the net capital accumulation during an accounting period for a particular country, and the term refers to additions of capital stock, such as equipment, tools, transportation assets and electricity. Countries need capital goods to replace the current assets that are used to produce goods and services, and if a country cannot replace capital goods, production declines. Generally, the higher the capital formation of an economy, the faster an economy can grow its aggregate income.

PROCESS OF CAPITAL FORMATION:

(i) Creation of saving;

(ii) Mobilisation of saving; and

(iii) Investment of saving.

1. Creation of Saving:

The creation of saving is the first stage of capital formation. It means that there must be an increase in the volume of real savings, so that the sources may be used for the production of consumption purposes and further may be released for other purposes. Therefore, for capital formation, some current consumption has to be sacrificed for obtaining a larger part of the flow of consumer goods in the near future.

For instance, if a community saves nothing and consumes whatsoever it produces, no new capital will come into existence which will result in fall in the production of consumer goods in future with the wearing out of the existing capital assets. Therefore, it is essential that people should save from the present consumption. The creation of savings depends upon the power to save, will to save and facility to save.

2. Mobilisation of Saving:

The next process of saving is that it must be mobilised by converting into investible funds. For this purpose, the existence of banking and other financial institutions are must. Banking facilities give considerable help to promote high rate of mobilisation and channelization of saving. In brief, sound and efficient banking system enables investors to invest more and more.

3. Investment of Saving:

The final stage is the investment of saving into capital goods. It needs a class of efficient, dynamic, daring and skilled entrepreneurs. An able and efficient entrepreneur is always ready to make investments for the production of capital goods. In short, both saving and investment are crucial for capital accumulation.