



The Economy

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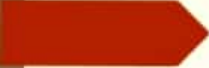
What is economy?

Economy is the system which provides a means to work to earn the livelihood.

Or

It is a frame work with in which economic activities are performed.






Economic activity: Economic activity are those activity through which we earn money, here economic objective or financial objectives are involved. For e.g. Doctor provide their services in return he get money from his patient.

Basic economic activities are:

- **Production:** Production is that economic activity which is concerned with manufacturing of goods and services under through a process. It means that conversion of raw materials into a final product.
- **Consumption:** It is that economic activity which is concerned with the use of goods and services for the direct satisfaction of individuals and collective wants.
- **Investment:** It is that economic activity which is concerned with production of capital goods for further production of goods and services.
- **Exchange:** It is that economic activity which is concerned with sell and purchase of commodities. This buying and selling of goods and services in terms of money which becomes the medium of exchange between sellers and buyers.



Central problems of an economy:

It is the problem of allocation of resources and problem of making choices which is created due to the **limited resources, wants unlimited human and alternative uses of resources.**

It has three variants, as these:

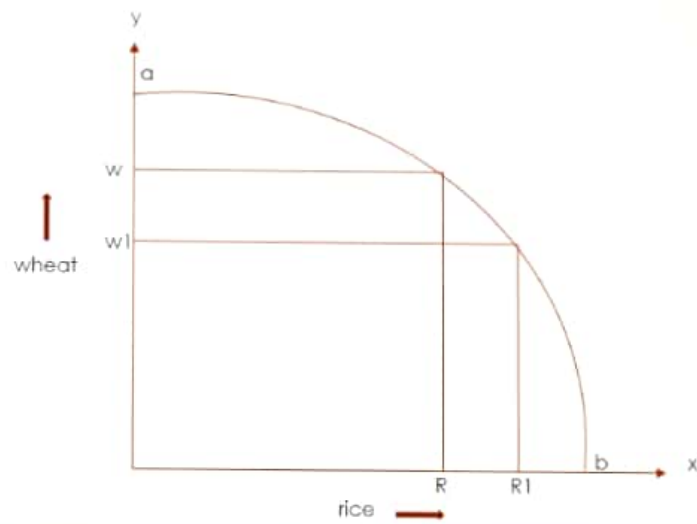
1. What to produce?
2. How to produce? And
3. For whom to produce?

What to produce?

This has two dimensions that what goods and services are to be produced, and In what quantity goods and services are to be produced.

As we know that with the given resources limited, greater production of goods-X must imply lower production of goods-Y (if resources are used in the production of goods X and Y).

Fig1. is drawn on the assumption that the given resources are devoted to the production of wheat and rice. It shows that if output of rice is increased, some resources must be shifted from production of wheat to the production rice. Hence, the problem of choice.



ab is Production Possibility Curve. It shows different combinations of wheat and rice that can be produced with the given resources.
 Production of wheat must be cut from OW to OW1 if that of rice is to increase from OR to OR1.



How to produce?


'How to produce' refers to the technique of production. The problem of choice emerges because there are more than one way of producing. Broadly there are two techniques of production: (i) labour intensive technique and (ii) capital intensive technique.

Labour intensive technique means greater use of labour than capital whereas in capital intensive technique greater use of capital than labour. capital intensive technique promotes efficiency. Labour intensive technique, on the other hand, is less expensive, particularly countries like india where labour the choice between s abundant in relation to capital. **The choice between the labour intensive and capital intensive techniques becomes a problem because the producers need to minimize their cost at the same time, maximize their efficiency.** At the level of economy labour intensive technique helps reduce unemployment, while capital intensive technique pushes up the pace of growth.



For whom to produce?

It relates with the distribution of output (or income) in the economy. Who gets how much? It has two aspects (i) factoral distribution of income, and (ii) inter-personal distribution of income. Factoral distribution relates to the distribution of income share between different factors of production, i.e. wages for labour, interest for capital, and rent for land. Whereas interpersonal distribution refers to income share of individuals and households in the society. Whether it is factoral distribution or interpersonal distribution, the basic question revolves around equality or inequality in the society. The problem is whether allocation of resources is promoting equality or inequality.



Types of economy

Capitalist economy : Capitalist economy is also known as market economy where all the decisions regarding what, how and for whom to produce are taken by the producers of the country on the basis of supply and demand forces in the market

Socialist economy: It is also known as centrally planned economy, in this all the decisions what, how and for whom to produce are taken by the central authority or central government of the country. The basic objective is to provide social welfare.

Mixed economy: In this economic system what, how and for whom to produce each and every decisions will be taken by the central authority as well as the producers of the country. The basic objective of this is to provide social welfare along with economic growth.