UG EC S6
(DSC)

FOUR YEAR BACHELOR'S DEGREE COURSE
(CBCS in Accordance with NEP 2020)
SEMESTER VI

ECONOMIC SYSTEM AND PLANNING

ECONOMIC

Surya Kumar Bhuyan School of Social Science
KRISHNA KANTA HANDIQUI STATE OPEN UNIVERSITY

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July, 2026 ISBN: .....

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Printed and published by Registrar on behalf of the Krishna Kanta Handiqui State Open University.

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COURSE INTRODUCTION

The course entitled **"Economic System and Planning"** is one of the core courses of the BA Economics programme of this University. In the previous semesters, you have already been introduced to various concepts of Economics, including Microeconomics and Macroeconomics. To understand how economic activities are organized and managed in different countries, it is essential to study the nature and functioning of various economic systems and the role of planning in economic development. This course has been designed to provide learners with a comprehensive understanding of different economic systems, their characteristics, advantages, limitations, and the significance of economic planning in promoting growth and development.

This course consists of **fourteen units**. The first unit introduces the meaning and concept of an economic system. It discusses the definitions, types, features, and basic functions of an economic system. The second unit deals with **Capitalism**. It discusses the meaning, evolution, institutions, features, merits, and demerits of the capitalist economic system. The third unit examines the **Pre-capitalist Economic System: Feudalism**. This unit explains the features of feudalism, the organization of feudal society, the mode of production under feudalism, its relationship with capitalism, and the factors responsible for its decline.The fourth unit discusses the **Price Mechanism under Capitalism**. It explains the meaning, working, functions, conditions necessary for its success, and limitations of the price mechanism. The fifth unit introduces the concept of **Socialism**, its evolution, features, merits, and demerits. The sixth unit examines the important issues of **resource allocation and incentives under socialism**, highlighting the challenges of efficient resource distribution and motivation in a socialist economy. The seventh unit focuses on the **Mixed Economy**, discussing its features, advantages, and limitations. The eighth unit specifically examines the **Mixed Economy in India**, tracing its evolution, functioning, and future prospects. The ninth unit introduces the concept of **Economic Planning**. It discusses the meaning and need for planning, plan formulation, requisites for successful planning, features of a planned economy, and the relationship between planning and development.The tenth unit discusses **Types of Planning – I**, including structural and functional planning, physical and financial planning, and perspective and short-term planning, along with their merits and demerits. The eleventh unit continues the discussion through **Types of Planning – II**, covering planning by direction and inducement, centralized and decentralized planning, and democratic and totalitarian planning.The twelfth unit focuses on **Planning in Underdeveloped Countries**. It highlights the need for planning in such economies and discusses the prerequisites for successful planning. The thirteenth unit examines **Economic Planning in India**, including the history of planning, the Planning Commission, the objectives, achievements, and failures of different Five-Year Plans, and the reasons for the abolition of the Planning Commission. The final unit discusses **NITI Aayog**, its aims, objectives, functions, and organizational structure.

While studying the units, you will find explanatory boxes that clarify important concepts and technical terms. Various activities have been included to encourage independent thinking and application of concepts. "Let Us Know" sections provide additional information and insights related to the topics discussed. At the end of each section, "Check Your Progress" questions have been included to help you assess your understanding. It is advisable to answer these questions after completing each section and compare your responses with the answers provided at the end of the unit. This will help you evaluate your progress and strengthen your understanding of the subject.

UNIT 1: MEANING OF ECONOMIC SYSTEM

UNIT STRUCTURE

1.1 Learning Objectives
1.2 Introduction
1.3 Meaning and Definition of Economic System
1.4 Features of Economic System
1.5 Types of Economic System
1.6 Basic Functions of Economic System
1.7 Let Us Sum Up
1.8 Further Reading
1.9 Answer to Check Your Progress
1.10 Model Questions

1.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- acquire understanding on Economic System and its basic characteristics.
- gain knowledge on various types of Economic Systems.
- understand the basic functions of Economic System.

1.2 INTRODUCTION

Different sciences approach the concept of a system in their own unique way. For example, the science of Biology views ‘human body’ as a ‘system’; the science of Astronomy views the entire universe with the sun, the stars and planets as a system. In Economics, we know that wants are unlimited and the resources to fulfill the unlimited wants are limited. When a man tries to satisfy his unlimited wants by producing various types of goods and services with the help of various factors of production, he builds a number of institutions and all such institutions constitute an ‘Economic System’.An economic system is an aggregation of the numerous economic institutions, both tangible and intangible, which are concerned with production, exchange, distribution and consumptions of various goods and services. It is a network that establishes the economic relationships between individuals in a community.

An economic system is the means by which economic resources are held and distributed.Based on the ownership and distribution of resources, the economic system can be divided into three categories, as seen in Figure-1:

Economic System	1. Capitalist economy 2. Socialist economy 3. Mixed economy

Figure: Different types of Economic System

CHECK YOUR PROGRESS

Q 1: What do you mean by Economic System?

Q 2: How many economic systems are there in present world?

1.3 MEANING AND DEFINITION OF ECONOMIC SYSTEM

Today all economies are facing with the same economic problem that is unlimited wants and limited or scarce resources. As a result, every society must ensure the best use of their available limited resources. Because of these two economic problems, all economies have to concerned with three fundamental economic questions i.e.

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

An economic system refers to the institutional and legal framework within which the people perform their economic activities.An economic system is a set of rules that control how resources are used to produce, distribute, consume and exchange goods and services in an economy.

DEFINITION OF ECONOMIC SYSTEM

Mrs. Joan Robinson writes: "*Any economic system requires a set of rules, an ideology to justify them, and a conscience in the individual which makes him strive to carry it out."*

According to Loucks, *"Economic system consists of those institutions which a given people or nation or group of nations has chosen or accepted as the means through which resources are utilized for the satisfaction of human wants."*

In the words of Gruchy, *"Economic system is an evolving pattern or complex of human relations which is concerned with the disposal of scarce resources for the purchase of satisfying various private and public needs for goods and services."*

Carl Landauer defines an economic system as "*the sum total of the devices by which preferences among alternatives purposes of economic activity is determined and by which individual activities are co-ordinated for the achievement of these purposes."*

From the definitions mentioned above it can be summarized that an economic system is a system which consists of various economic institutions and concerned with the disposal of scarce resources for satisfying unlimited human wants. Any country of the world can adopt any type of economic system. But whatever the type of an economic system a country adopts, it has and must have an institutional base and idealistic base or foundation.

1.4 FEATURES OF ECONOMIC SYSTEM

An economic system has the following features:

- An economic system governs the ownership and distribution of economic resources.
- It is a system that governs the economic decisions related to utilization of resources for the production, distribution, consumption and exchange of goods and services in an economy.
- Economic system is a man-made phenomenon.
- It is the set of principles by which problems of economics are addressed. With the help of economic system any country can allocate its resources in a barter and efficient way so that problems can be reduces.
- An economic system addresses three questions: what to produce, how to produce, and for whom to produce.
- An economic system is a mechanism which deals with production, distribution and consumption of goods and services in a particular society.

1.5 TYPES OF ECONOMIC SYSTEM

The economic system is an essential component of economic environment of a country. Economic system affects the economic environment of a country since it influences all economic decisions and policies. In present world, we found **the following broad types of economic systems:**

(a) Capitalist economy

(b) Socialist economy

(c) Mixed economy.

Capitalist Economy

A Capitalist Economy is an economic system where the means of production of goods and services is owned and controlled by private enterprise rather than the government. The government's main function is to regulate the market and to protect private property rights. Individuals and businesses in a capitalist economy are motivated by profit and they have freedom to take economic decisions, and the market determines the prices of goods and services based on supply and demand.

Capitalism is the dominant economic system prevailed in most developed countries worldwide. The United States, Japan, The United Kingdom, Germany, Hong Kong, Singapore etc. are some examples of capitalist economy.

Features of Capitalist Economy

- **Private Ownership** is a significant feature of capitalist economy. Here, the factors of production are privately owned and production occurs at private initiative through demand and supply forces.
- In capitalist economy, the **Market mechanism** controls the economy.

- Businesses and entrepreneurs in capitalist economy are mostly profit-motivated.
- In capitalist economy, there is **minimum Government Intervention**.
- Consumers in this economic system enjoy **economic freedom** to choose the goods and services according to their preference.
- Prevalence of **income inequalities** is another important feature of Capitalist economies.

Merits of Capitalist Economy:

- **Economic Efficiency:** Capitalist economy strives for economic efficiency by encouraging competition and innovation.
- **Economic Growth:**Capitalist economycan increase economic growth by promoting entrepreneurship and investment.
- **Individual Freedom:**In a Capitalist economy, individuals enjoy a high degree of personal and economic freedom.
- **Consumer Choice**: Individuals in a Capitalist economy are able to purchase a wide variety of goods and services according to their choice which increases consumer's satisfaction.
- **Innovation and Progress:** Capitalist economyboosts innovation and progress by rewarding entrepreneurs and businesses for developing new products, services, and technologies.
- **International Trade:**Capitalist economy encourages international trade and investment, which increases economic growth and development.

Demerits of Capitalist Economy:

- **Economic Inequality:**A Capitalist economy can lead to income and wealth inequality because of the economic freedom of individuals and businesses to accumulate as per their ability.
- **Market Failures:**In Capitalist economy, markets can fail to efficiently allocate resources in certain situations such as market monopolies or existence of externalities.
- **Environmental Impact:** Capitalist economy often gives importance on economic growth over environmental sustainability which may lead to negative environmental impacts such as pollution and resource depletion.
- **Business Cycles:**Since Capitalist economy is prone to business cycles, therefore it can lead to economic uncertainty and fluctuations in employment, income, and production.
- **Global Economic Inequality:** Capitalist economymay increase global economic inequality by unequal distribution of wealth and resources between developed and developing countries.

Socialist Economy

Socialist Economy is just opposite of capitalist economy. A Socialist economy is one in which the state- owned factors of production are used to produce goods and servicesin accordance with the needs of the society. Here the state or Central Planning Authorities of the government takes economic decisions with the goal to create an equal distribution of

wealth amongst all its citizens. The Socialist economy is also known as the Command Economy.

China, Cuba, North Korea, Vietnam, Laos etc. are some examples of socialist economies prevalent in the world where the government owns and controls all means of production.

Features of a Socialist Economy

- **Collective Ownership of Resources:** In a socialist economy, all means of production are collectively owned and controlled by the state itself in the interest of its citizens.
- **Central Economic Planning:** There is always a central planning committee in a socialist economy which formulates long-term and short-term plans for the economy to fulfil the socio-economic aims of the country.
- **Fully Planned Economy:**All socialist economies are essentially a fully planned economy.
- **Equal Distribution of Income:** It is one of the key features of a socialist economy. The main goal of socialist economy is to create an equal distribution of income among its citizens.
- **Absence of Market Forces:** A socialist economy gives considerably less importance to market forces. Here the means of production are controlled and owned by the state for promoting the welfare of the people.

Merits of Socialist Economy:

- **Greater Control:** In a socialist economy, the government has greater control over the economy which can allow for more efficient allocation of resources.
- **Equitable distribution of wealth:** A socialist economy is worked for creating more equal distribution of wealth and resources which can lead to a more equitable society.
- **Social Welfare:** A socialist economy gives more emphasis on social welfare where government provides universal access to healthcare, education, and other basic needs for its citizens.
- **Economic stability:** A socialist economy has economic stability. Due to the planned nature of the economy, it can prevent economic instability through proper allocation of its resources.
- **Rapid Economic Development:** A socialist economy can experience rapid economic development due to its scientific planning and proper utilization of resources.
- **Sustainable development**:A socialist economy can help in attaining sustainable development by conserving the natural resources of the country for its future generations by preparing plans for conservation the non-renewable resources like coal, petroleum, forests and soil of the country.

Demerits of Socialist Economy:

- **Concentration of Power:** In a socialist economy, all power is concentrated in the hand of the State and it takes all major decisions. Since there is no scope for making economic decisions by the private parties, therefore, misuse of power can take place in this economy.
- **Inefficiency:** The central planning authority of a socialist economy makes all economic

decisions and therefore, central planning can be slow and inefficient.

- **Lack of consumer's freedom:** In a socialist economy, consumers have limited individual freedom. Consumers do not enjoy freedom to consume the commodities on their choice. Prices are also fixed by the government and consumers have no right to do anything on it.
- **Lack of Innovation:** Since there is lack of competition in a socialist economy, it can lead to a lack of innovation and motivation to improve its products and services.
- **Limited Economic Growth:** A socialist economy is not profit- motivated. Therefore, economic growth can be limited without the profit motive and it can create difficulty for the economy to retain the demands of a growing population.
- **Bureaucracy and Red-Tapism:** A socialist economy alleged to be a bureaucratic economy. Because every bit of the plan is to be cleared by bureaucrats which leads to red-tapism. Therefore, it fails to provide necessary initiatives to the people to work hard.

Mixed Economy

A mixed economy is an economic system that has the characteristics of both capitalist and socialist economy. It is the one in which there is private as well as public ownership of the factors of production. The means of production are owned by both private firms and public or state entities. In a mixed economy, the private sector and public sector co-exist and both play important roles in economic decision-making.

India is widely regarded as the world's best example of a Mixed Economy. Canada, Germany, Japan, Sweden, UK etc. are all examplesof countries that follows mixed economies, in which both the government and the private sector play key roles in economic decision-making.

Features of Mixed Economy

- Private sector, public sector, and joint sector, **all three sectors coexist** in harmony in a mixed economy. The joint sector is controlled by the government and private firms, with the state owning at least 51 percent.
- In a mixed economy, **means of production** are owned by the private entrepreneurs as well as the government.
- All individuals have the **economic freedom** to produce goods and products, hold property, choose their occupation according to their choice in mixed economy.
- In a mixed economy, a central planning authority prepare **economic planning** to achieve various targets and goals and all the three sectors have to follow the economic planning.
- **Social Welfare** is the main goal of mixed economy. It aims to reduce poverty and unemployment in a country. It also aims to reduce the wealth gap in the country and fight the inequalities of our society.

Merits of a Mixed Economy

- **Encouragement to Private Sector:** A mixed economy provides encouragement to private sector which helps in increasing capital formationin the country.

- **Flexibility:**Since a mixed economy combines the advantages of both private and public sector, it allows for a high degree of flexibility.
- **Innovation:**By providing supportive environment for private sector and investing in public goods and services, mixed economies can promote innovation and entrepreneurship.
- **Stability**: A mixed economycombines market mechanisms with government intervention to lessen the risks and uncertainties of the business cycle. Therefore, it can provide a stable economic environment in the country.
- **Social Welfare:**A mixed economy can provide a high level of social welfarethrough implementation of effective economic planning.
- **Balanced Growth:** Mixed economies can promote balanced economic growth in the country.
- **Freedom**: In a mixed economy, we found both economic and occupational freedom where every individual has freedom to choose any occupation of his choice and every producer has liberty to take decisions regarding production and consumption.
- **Optimum Use of Resources:**Both the private and the public sectorswork for efficient use of resources in a mixed economy.

Demerits of Mixed Economy:

- **Balance between Private and Public sector:** One of the main challenges of mixed economies is to maintain proper balancing between private enterprise and government intervention. Improper balancing can createinstability between private and public sector in this economy.
- **Political Pressure:**Political pressure is another important issue faced by the mixed economies, as this can lead to inefficiencies and distortions in the economy.
- **Fiscal Challenges:**Mixed economies require significant public investment for infrastructure, social welfare programs, and other public goods and services. This can create fiscal issues, especially if public spending is not matched by tax receipts.
- **Inefficient Planning:**A mixed economy lacks comprehensive planning that leads to inefficiencies.
- **Delay in Economic Decisions:**In a mixed economy, delays in economic decisions are more common, particularly in the public sector. This type of delay always causes significant disruption in the smooth operation of the economy.
- **Corruption and Black Marketing:**Corruption and black marketing are always existed in this economic system. Emergence of various types of illicit activities like black money, bribe, tax evasion and other illegal activities bring red-tapism

CHECK YOUR PROGRESS

Q 3: What is the primary focus of capitalism in terms of individual freedom?

a) Restricted to protect social equality

b) Emphasized, allowing individuals to make choices in the market

c) Governed by collective decisions

d) Controlled by central planning

Q 4: Mention two merits of a mixed economy?

1.6 BASIC FUNCTIONS OF ECONOMIC SYSTEM

All economic systems have to perform the following important economic functions:

- **What to produce:** It refers to which goods and services a society chooses to produce and in what quantities to produce them. No society can produce all the goods and services it desires;therefore, it must decide which to produce and which to forgo. Therefore, every economy has to decide what and how much goods and services to produce at any particular time.
- **How to produce:** It refers to the way in which resources or inputs are organized to produce the goods and services that consumers want. This is about the choice of techniques that need to be adopted and used in the production of goods and services. Labour- intensive technique and Capital- intensive technique are the two most widely used techniques in any economic system. Every economic system must decide which alternative methods of production are best suited to it.
- **For whom to produce:** It deals with the way that the output is distributed among the members of society. It is one of the most important functions of the economic system. Every economic system has to decide which commodities shall be produced for which sections of society and how the produced goods and services will be distributed among different sections of society.
- **Economic Growth and Development:** In all but most primitive societies there is still another function that the economic system must perform is that it must provide for the growth of the country. The mechanism to nurture the economy and raise average standard of living is determined in each economic system.
- **Economic Stability:** An economic system must allocate a given quantity of commodity over time. Rationing over time is accomplished by the price system. Every economic system has mechanisms designed to control fluctuations in the level of economic activity, e.g. using fiscal and monetary policies.

1.7 LET US SUM UP

- An economic system is the means by which economic resources are held and distributed.
- **There are three types of economic systems in present world. They are:** Capitalist economy, Socialist economy and Mixed economy.

- A Capitalist Economy is an economic system where the means of production of goods and services is owned and controlled by private enterprise rather than the government. The United States, Japan, The United Kingdom, Germany, Hong Kong, Singapore etc. are some examples of capitalist economy.
- A Socialist economy is one in which the state- owned factors of production are used to produce goods and services in accordance with the needs of the society. China, Cuba, North Korea, Vietnam, Laos etc. are some examples of socialist economies
- A mixed economy is an economic system that has the characteristics of both capitalist and socialist economy. India, Canada, Germany, Japan, Sweden, UK etc. are all examples of countries that follows mixed economies.
- What to produce, how to produce, for whom to produce, economic growth and development, economic stability etc. are the basic functions of an economic system.

1.8 FURTHER READING

1) Tyagi, D. B. (1986). *Economic Systems.* Meerat: Jai Prakash Nath & Co.
2) Desai, S. S. M. (1987). *Economic Systems*. Bombay: Himalaya Publishing House
3) Orr, Tamra B. (2012). *Understanding Economic Systems:* New York: The Rosen Publishing Group, Inc.

1.9 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: An economic system is the means by which economic resources are held and distributed. It is a network that establishes the economic relationships between individuals in a community.

Ans to Q No 2: There are three economic systems in present world. They are: Capitalist economy, Socialist economy and Mixed economy.

Ans to Q No 3: B) Emphasized, allowing individuals to make choices in the market.

Ans to Q No 4: Two merits of mixed economy are:

a) A mixed economy provides encouragement to private sector which helps in increasing capital formation in the country.
b) A mixed economy can provide a high level of social welfare through implementation of effective economic planning.

? 1.10 MODEL QUESTIONS

Short Questions (Answer the questions within 150 words)

Q 1: State some of the advantages of a socialist economy?

Q 2: How does capitalist economy contribute to economic growth?

Q 3: What are the challenges of a mixed economy?

Long Questions (Answer each question in about 300-500 words)

Q 1: Explain the merits and demerits of a mixed economy in the context of India's economic development.

Q 2: What are the features of a capitalist economy? How does a mixed economy differ from a capitalist or socialist economy?

*** ***** ***

UNIT 2: CAPITALISM

UNIT STRUCTURE

2.1 Learning Objectives
2.2 Introduction
2.3 Definition of Capitalism
2.4 Evolution of Capitalism
2.5 Institutions of Capitalism
2.6 Features of Capitalism
2.7 Merits and Demerits of Capitalism
    2.7.1 Merits of Capitalism
    2.7.2 Demerits of Capitalism
2.8 Let Us Sum Up
2.9 Further Reading
2.10 Answer to Check Your Progress
2.11 Model Questions

2.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- how to define Capitalism.
- how capitalism has evolved over time.
- private property, markets and firms are the key institutions defining capitalism.
- what are the main features of Capitalism
- what are the merits and demerits of Capitalism.

2.2 INTRODUCTION

Capitalism is an economic system characterised by private ownership and control of property and capital assets, such as factories, mines, and railroads, where prices are determined by supply and demand in free markets. The central feature of capitalism is the profit motive, driving individuals and businesses to act in their own self-interest. As Adam Smith, the father of modern economics, explained, economic transactions are driven by mutual self-interest, which can lead to broader economic prosperity. In a capitalist economy, labor is hired for wages, and private owners accrue capital gains, with prices allocating resources efficiently among competing uses. Despite capitalism being the dominant economic system today, it was historically one of two major economic approaches, the other being socialism, where the state owns the means of production and enterprises aim to maximise social welfare rather than profit.

Capitalism as an economic system has undergone substantial changes since it emerged in West European countries and in the USA after the second half of the 18th century. Boardly we can say that it was 'Laissez Faire capitalism' that prevailed between 1815 (end of Napoleonic war) and 1914 (the beginning of World War I). After 1914 and especially after their Great Depression of 1929 - 33, the type of capitalism that has come to prevail in Western countries and even in the USA may be called 'Managed Capitalism' or 'Guided' or 'Regulated Capitalism' or 'Welfare Capitalism'.

2.3 DEFINITION OF CAPITALISM

There is no universally accepted definition of capitalism. It remains ambiguous whether capitalism characterises an entire society, a specific type of social order, or crucial components of a society. Even societies explicitly founded in opposition to capitalism, such as the Soviet Union, have sometimes been argued to exhibit capitalist traits. Nancy Fraser notes that many authors use the term "capitalism" more as a rhetorical device than a well-defined concept. Scholars who are uncritical of capitalism rarely use the term, and some question its scientific validity. Mainstream economics often avoids the term altogether, with economist Daron Acemoglu suggesting it should be abandoned entirely. As a result, our understanding of capitalism is largely shaped by its critics and the followers of Karl Marx.

Adam Smith (1723–1790) is widely recognized as one of the earliest advocates of the free market and is often considered the founding father of capitalism. His insights into the benefits and challenges of globalization, along with his unwavering commitment to preserving human dignity, make his work as pertinent today as it was in the eighteenth century.

Capitalism is an economic system characterized by the decentralized and competitive organization of production and resource distribution. Unlike socialism or feudalism, where economic decisions are made through centralized political methods, capitalism relies on voluntary decisions made by individuals and businesses. In this system, the means of production—such as factories, tools, machines, and raw materials—are owned by capitalists who organize and manage these resources. Workers are employed by capitalists to operate the means of production in exchange for wages, but they do not have ownership rights to the means of production or the profits generated from their labor; these remain the property of the capitalists.

Prof. R. T. Bye has defined capitalism as "that system of economic organisation in which free enterprise, competition and private ownership of property generally prevail." Thus, the definition hints at the major features of capitalism.

In the words of Prof. Loucks "Capitalism is a system of economic organisation featured by the private ownership and the use for private profit of man-made and nature-made capital." Similarly, Ferguson and Kreps has written that "in its own pure form, free enterprise capitalism is a system in which privately owned and economic decision are privately made".

Capitalism from Mc Connell view is "A free market" or capitalist economy may be characterised as an automatic self-regulating system motivated by the self interest of individuals and regulated by competition."

CHECK YOUR PROGRESS

Q.1: What are the key characteristics of capitalism, and how do they differentiate it from socialism?

Q.2: How has capitalism evolved from 'Laissez Faire capitalism' to 'Managed Capitalism'?

Q.3: Why is there no universally accepted definition of capitalism, and how do scholars' views on the term differ?

2.4 EVOLUTION OF CAPITALISM

Capitalism is an economic system where private individuals or businesses own the things used to produce goods and services. This system developed over time, and here are the three main stages of its evolution:

(i) First Stage: From Mercantilism to Commercial Capitalism

Early capitalism is sometimes called mercantilism. During this time, merchants were very important. They argued that their businesses benefited the government, even if it meant sending gold and silver abroad. Mercantilism relied on some government control onprices and wages.

Later came commercial capitalism. This is closer to what we think of today as capitalism. Businesses were no longer under strict government control. Instead, supply and demand determined prices and wages. The government's main role was to provide national defense, maintain order, and build public works. Businesses competed with each other, and this competition helped the economy grow.

(ii) Second Stage: From Commercial to Industrial Capitalism

The next big change in capitalism came with the Industrial Revolution. This is when machines began to be used more and more in production. Factories became the main places where goods were produced. This led to a big increase in the production of goods, but it also led to harsh working conditions for many people.

One of the results of industrial capitalism was that the standard of living for many people began to rise. This is because more goods were being produced, which meant that more people could afford to buy them. However, industrial capitalism also led to economic instability, with periods of boom and bust.

(iii) Third Stage: From Industrial to State Capitalism

The Great Depression of the 1930s was a very bad economic downturn that caused many people to question the stability of capitalism. In response, governments began to play a larger role in the economy. They provided social programs such as unemployment benefits and pensions. They also began to regulate businesses more in order to protect workers and consumers.

This new role for government is why this stage of capitalism is sometimes called state capitalism. Today, capitalism still relies on private businesses and competition. However, governments also play a role in regulating the economy and providing social programs.

2.5 INSTITUTIONS OF CAPITALISM

In everyday conversation, “capitalism” is often interpreted variously due to differing opinions about it. However, in economics, capitalism refers to a specific economic system characterised by distinct institutions governing production and distribution.Private property, markets, and firms are the key institutions defining capitalism.

(i) Private Property:

Private property grants individuals the right to enjoy, exclude others, and transfer ownership of possessions. Throughout history, the extent of private property ownership has varied, from limited ownership among hunter-gatherers to more comprehensive ownership in modern societies. Notably, certain individuals, such as enslaved people, have been considered as private property.

(ii) Markets:

Markets serve as platforms for voluntary exchanges of goods and services among individuals seeking mutual benefit. Unlike other means of transfer like theft or gifts, market transactions involve reciprocal exchanges, voluntary participation, and competitive pricing.

(iii) Firms:

Firms represent organised entities for production characterised by private ownership of capital goods, employment of labor, and pursuit of profit through the sale of goods and services in markets. While private property and markets have historical precedents, firms are a more recent development in the capitalist economy.

Various types of firms, including restaurants, banks, farms, and industrial establishments, contribute to capitalist economies. However, other forms of productive organisations, such as family businesses, non-profits, cooperatives, and government-owned entities, also play roles, albeit lesser, in the economic landscape.

In essence, capitalism is defined by the interplay of private property, markets, and firms, which together form the backbone of modern economic systems.

2.6 FEATURES OF CAPITALISM

Following are the main features of Capitalism:

i. **Individual is the best judge of self-interest:** It is assumed that every individual is the best judge of what is in his best interest and therefore he should be left free to do what he wants to do as a consumer and producer, as a saver and investor and so on. He should not be dictated by the State to do this or not to do that, either as a consumer or as a producer.

ii. **Consumer’s Sovereignty:** This implies that under capitalism, consumer with his

unlimited freedom to spend his income as he likes is sovereign and decisions by numerous producers as to what to produce and what not to produce are taken on the basis of preferences expressed by the free choice of consumers.

iii. **Freely Functioning Price Mechanism:** Consumers express their preferences through freely operating price-mechanism. Consumers are prepared to pay more for goods for which they have higher preferences and less for goods of lower preferences. Price-mechanism thus acts as a signaling system indicating allocation of resources.

iv. **Profit-Motive and Freedom of Private Enterprise:** Under the capitalism system, all production is carried on with a view to maximise personal profit. Naturally it would be in the interest of producers to produce those goods and services for which consumers show higher preference than goods of lower preference as the former would help them maximise personal profit. Personal profit motive is the most powerful incentive under capitalism that influences the allocation of resources among various alternative uses.

Thus, freely operating price-mechanism while on the one hand ensures maximum satisfaction to consumers, on the other hand, ensures the most efficient use of the community's scarce resources.

v. **Institution of Private Property:** Freedom of producers and entrepreneurs assumes existence of private ownership of means of production. Under capitalism, the institution of private property (in land,Capital and other sources of production) is sacrosanct. Under capitalism, owners of private property are free to use their resources as they like and there is no restraint on such use by the State.

vi. **Existence of Competition:** Competition among consumers and producers is the very soul of capitalism. The efficient functioning of the price mechanism depends on active competition—consumers striving to gain maximum satisfaction from goods, and producers aiming to earn maximum personal profit. This competition ensures both the optimal satisfaction of consumers and the most efficient allocation of society's scarce resources.

vii. **Harmony between Personal Interest and Welfare of Society:** Even as each individual works for maximising his personal profit under competitive regime (say by producing new commodities or inventing new processes to produce old commodities cheaply and sell them at lower prices in competitive market, or by trying to become the best doctor, or surgeon or architect), he will, at the same time, as said by Adam Smith, through unseen hand of providence, be serving the cause of maximising social welfare which was no part of his intention. Thus under capitalism, where each individual tries to carry on activities for his own interest under competitive regime, there appears to be perfect harmony between individual welfare and welfare of society. There appears to be no conflict between the two.

viii. **Non-interference by the State:** If under Capitalism, an individual acting for his personal interest or profit automatically ensures maximum social welfare, if there is thus no conflict between individual welfare and social welfare, and if freely operating price-mechanism under competitive system automatically ensures maximum satisfaction of

consumers and the most efficient use of community's scare resources, there is no point whatsoever in State trying to interfere and regulate economic activities of the people. people should be left free as consumers and produces, as savers and investors to do what they like without any direction or interference by the State.

CHECK YOUR PROGRESS

Q.4: What were the main characteristics of the first stage of capitalism, from Mercantilism to Commercial Capitalism?

Q.5: How did the Industrial Revolution change the nature of capitalism?

Q.6: What is State Capitalism, and how did it emerge?

2.7 MERITS AND DEMERITS OF CAPITALISM

2.7.1 Merits of Capitalism

Capitalism offers several merits and benefits:

i. **Consumer-Centric Production:** In a capitalist system, producers prioritise meeting consumer needs and preferences. This focus ensures maximum satisfaction for consumers through the production of goods tailored to their tastes.

ii. **Increased Capital Formation and Economic Growth:** Individuals in a capitalist economy have the freedom to accumulate and pass on property through inheritance. This encourages saving and investment, leading to higher rates of capital formation and accelerated economic growth.

iii. **Freedom of Choice:** Capitalism allows for economic freedom, including the right to earn, retain property, and choose occupations. This results in the efficient allocation of human resources across various sectors without the need for coercion.

iv. **Optimal Resource Utilization:** Competition among producers and entrepreneurs drives the efficient use of limited resources, minimizing waste. Every producer strives to maximize profit by employing resources in the most economical manner.

v. **Efficient Production:** Competition incentivizes entrepreneurs to produce goods at lower costs while maintaining quality. This drive for efficiency leads to the adoption of superior production techniques, ensuring consumers receive high-quality goods at competitive prices.

vi. **Variety of Consumer Goods:** Competition extends beyond price to include product design, variety, and packaging. Consumers benefit from a wide range of choices, enhancing their overall satisfaction.

vii. **Self-Regulating Mechanism:** In a capitalist system, efficient producers are naturally rewarded with higher profits, while inefficient ones face consequences through market mechanisms. There's no need for external inducements or punishments.

viii. **Encouragement of Risk-Taking and Innovation:** Capitalism incentivizes entrepreneurs

to take risks and pursue bold policies in search of higher profits. This fosters technological progress and innovation, driving economic growth.

ix. **Promotion of Inventions:** Entrepreneurs actively seek out new ideas and innovations to gain a competitive edge. This culture of innovation leads to rapid expansion, increased employment, and income growth. Intellectual property rights such as copyrights and patents further incentivize innovation.

x. **Flexibility:** Capitalism demonstrates adaptability to changing circumstances. During times of war, regulations may be imposed to support the war effort, but the economy can seamlessly transition back to free-market principles during peacetime.

In summary, capitalism's emphasis on consumer satisfaction, freedom of choice, efficient resource allocation, and innovation fosters economic growth and prosperity.

2.7.2 Demerits of Capitalism

While capitalism has its proponents, it also faces criticism and challenges:

i. **Wealth and Income Inequality:** Capitalism often leads to widening disparities in wealth and income. The system of private property favors those with existing wealth, enabling them to accumulate more resources and start large enterprises, while the working class struggles with lower wages and limited property ownership.

ii. **Class Struggle:** Critics argue that capitalism inherently fosters class conflict between the wealthy property-owning class and the property-less wage earners. This tension can result in labor unrest, strikes, and other disruptions, negatively impacting production and employment.

iii. **High Social Costs:** The pursuit of profit in a capitalist economy can come at the expense of social well-being. Industrialization and development may lead to environmental pollution, inadequate housing for workers, and the growth of urban slums, reflecting a disregard for social welfare.

iv. **Excessive Competition:** While consumer choice and variety are touted as benefits of capitalism, excessive competition can drive up production costs, leading to wasteful advertising and the proliferation of substandard goods. Consumers may be misled by aggressive marketing tactics.

v. **Economic Instability:** Capitalist economies are prone to instability, characterized by recurring business cycles of boom and bust. Fluctuations in economic activity can result in unemployment, factory closures, and resource misallocation, hindering long-term growth.

vi. **Unemployment and Underemployment:** Despite the dynamism of capitalist economies, unemployment remains a persistent issue. Market mechanisms may fail to quickly adjust to changing conditions, leaving workers unemployed or underemployed, particularly during economic downturns.

vii. **Lack of Social Security:** Workers in capitalist economies often lack adequate social security benefits, such as pensions or accident relief, leading to financial hardship for

families affected by unemployment or workplace accidents.

viii. **Slow and Uneven Growth:** While capitalism promotes economic freedom, growth rates may be slow, and development uneven. Some sectors may experience rapid expansion while others lag behind, perpetuating poverty and inequality.

ix. **Exploitation of Labor:** In a capitalist economy, workers may be paid wages below their productivity, with limited bargaining power to demand fair compensation. Women and children are often subject to particularly low wages and poor working conditions.

x. **Rise of Monopolies:** Despite notions of competition, capitalism can give rise to monopolistic practices, where large firms dominate markets, stifling competition and exploiting consumers. This concentration of power undermines the efficiency and fairness of the capitalist system.

In conclusion, while capitalism offers incentives for innovation and growth, its inherent flaws, such as inequality, instability, and exploitation, necessitate ongoing scrutiny and potential reforms to ensure a more equitable and sustainable economic system.

CHECK YOUR PROGRESS

Q.7: How does capitalism encourage innovation and technological progress?

Q.8: What are some of the major criticisms of capitalism related to social inequality?

2.8 LET US SUM UP

i. Capitalism is an economic system characterized by private ownership, profit motive, and market-driven allocation of resources, evolving from laissez-faire to managed capitalism over time.

ii. Capitalism remains a contested concept, with varying definitions and interpretations. While some see it as a decentralized system of production and resource distribution based on voluntary decisions and private ownership, others view it more critically, emphasizing issues of exploitation and inequality. Despite differing perspectives, capitalism's influence on society and economics is undeniable, with figures like Adam Smith recognized as early proponents.

iii. Capitalism evolved from mercantilism to commercial capitalism, then to industrial capitalism with the Industrial Revolution, and finally to state capitalism, characterized by increased government intervention and regulation alongside private ownership of production.

iv. Capitalism is an economic system defined by private property, markets, and firms, where individuals have the right to own, exchange, and enjoy possessions, markets facilitate voluntary exchanges for mutual benefit, and firms organize production for profit through private ownership of capital goods and employment of labor.

v. Capitalism is characterized by individual autonomy, consumer sovereignty, a freely functioning price mechanism, profit motive driving private enterprise, the institution

of private property, competition, harmony between personal interest and societal welfare, and non-interference by the state in economic activities.

vi. Capitalism's benefits include promoting consumer satisfaction, freedom of choice, and economic growth, yet its shortcomings, like inequality and instability, require continual evaluation and potential reforms for a fairer and more sustainable system.

2.9 FURTHER READING

1) Desai, S.S.M. (1989). *Economic Systems,* Bombay: Himalaya Publishing House.

2) Acemoglu D. & Robinson J. A. (2013). *Why Nations Fail: The Origin of Power, Prosperity and Poverty*, London: Profile Books.

2.10 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No. 1: Capitalism is characterised by private ownership and control of property and capital assets, such as factories, mines, and railroads. Prices in capitalism are determined by supply and demand in free markets, with the central feature being the profit motive. In contrast, socialism involves state ownership of the means of production, with enterprises aiming to maximize social welfare rather than profit. Under capitalism, labor is purchased for wages, and private owners accrue capital gains, while prices efficiently allocate resources among competing uses. Socialism relies on centralized political methods for economic decisions, as opposed to the voluntary, decentralized decisions made by individuals and businesses in capitalism.

Ans to Q No. 2: Laissez Faire capitalism' prevailed between 1815 and 1914, characterized by minimal government intervention in economic affairs. After World War I and particularly following the Great Depression of 1929-33, capitalism evolved into 'Managed Capitalism' or 'Regulated Capitalism'. This form involves more government intervention to regulate markets, ensure economic stability, and provide welfare support. This shift aimed to address the economic challenges and inequalities that pure laissez-faire practices failed to manage effectively.

Ans to Q No 3: There is no universally accepted definition of capitalism because it is ambiguous whether it describes an entire society, a specific social order, or crucial societal components. Even societies opposed to capitalism, like the Soviet Union, have been argued to exhibit capitalist traits. Nancy Fraser points out that the term is often used more as a rhetorical device than a well-defined concept. Scholars critical of capitalism, such as followers of Karl Marx, have shaped much of our understanding of it. Meanwhile, uncritical scholars and mainstream economists, like Daron Acemoglu, often avoid the term, questioning its scientific validity and suggesting it should be abandoned altogether.

Ans to Q No 4: The first stage of capitalism, known as Mercantilism, was characterized by merchants' significant influence and some government control over prices and wages. This transitioned to Commercial Capitalism, where businesses operated

with less government interference, and supply and demand determined prices and wages. The government focused on providing national defense, maintaining order, and building public works, while competition among businesses drove economic growth.

Ans to Q No 5: The Industrial Revolution marked the shift from Commercial to Industrial Capitalism, characterized by the increased use of machines in production and the rise of factories as the primary production sites. This led to a significant increase in goods production, a rising standard of living for many, and harsh working conditions. However, industrial capitalism also introduced economic instability, with cycles of boom and bust.

Ans to Q No 6: State Capitalism emerged in response to the economic instability of the Great Depression of the 1930s. In this stage, governments began to play a larger role in the economy by providing social programs like unemployment benefits and pensions and regulating businesses to protect workers and consumers. While private businesses and competition remained central, the government's role in regulation and social welfare became more pronounced.

? 2.11 MODEL QUESTIONS

Short Questions (Answer each question in about 150 words)

Q 1: How did Adam Smith's views contribute to the foundational principles of capitalism?

Q 2: What are the key institutions defining capitalism, and how do they contribute to its functioning?

Long Questions (Answer each question in about 300 - 500 words)

Q 1: How does capitalism's focus on competition and consumer choice potentially lead to economic instability and social costs?

Q 2: What are the benefits of capitalism in terms of resource allocation and consumer satisfaction?

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UNIT 3: PRE-CAPITALISM ECONOMIC SYSTEM-FEUDALISM

UNIT STRUCTURE

3.1 Learning Objectives
3.2 Introduction
3.3 Features of Feudalism
3.4 Organisation of Feudal Society
3.5 The Mode of Production under Feudalism
3.6 Feudalism and Capitalism
3.7 Causes responsible for the Breakdown of Feudalism
3.8 Let Us Sum Up
3.9 Further Reading
3.9 Answers to Check Your Progress
3.10 Model Questions

3.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- what are the features of Feudalism
- what are the organisation of Feudal Society
- what are the Mode of Production under Feudalism?
- transition from Feudalism to Capitalism
- what are the principal causes responsible for the Breakdown of Feudalism?

3.2 INTRODUCTION

Feudalism was the system that dominated European medieval societies from the 10th to the 13th centuries, characterised by a hierarchical structure based on local governance and the allocation of land into units known as fiefs. In this system, a landowner, or lord, granted a fief to a vassal in exchange for a commitment of military and legal protection. In return, the vassal provided payment, which typically consisted of feudal services such as military support or regular contributions of produce or money. Both the lord and the vassal were free individuals. It is important to note that the term feudalism usually does not refer to the relationship between unfree peasants (serfs or villeins) and the higher-ranking individuals on whose land they worked.

Despite the frequent use of the terms ‘feudalism’ and ‘feudal society’ in historical texts, scholars have never reached a consensus on their precise meanings. These terms

were first applied to European medieval society in the 16th century and later extended to describe other societies, such as the Zhou period in China (1046-256 BCE) and the Edo period in Japan (1603-1868). The people who lived during the Middle Ages did not use the term feudalism. Furthermore, even when defined, the feudal system cannot be uniformly applied across different European states due to variations in laws and customs across regions and centuries. Consequently, many historians argue that the term feudalism has limited utility in understanding medieval societies.

The Oxford English Dictionary provides one of the most concise definitions of feudalism, acknowledging its various levels of application.

> *"The dominant social system in medieval Europe, in which the nobility held lands from the Crown in exchange for military service, and vassals were in turn tenants of the nobles, while the peasants (villeins or serfs) were obliged to live on their lord's land and give him homage, labour, and a share of the produce, notionally in exchange for military protection."*

3.3 FEATURES OF FEUDALISM

After the break-up of the Roma Empire, it was the Feudalism or Feudal System that came into existence and remained in existence practically in the whole of Europe from about 5th century to 15th century.

The main features or characteristics of Feudalism or the Feudal system are as follows:

We can illustrate the features of Feudalism by taking the illustration of England and the type of economy that prevailed there under Feudalism. It should be noted that for all practical purposes this analysis holds good in the case of other countries also where Feudalism was prevailing during 5th to 15th century.

i) There was during the Feudal days hardly any feeling of nationalism or national unity among the people of England. England was divided into several Manors and there was a Manorial Lord in each case. Agriculture was the chief occupation of the people and the Manorial Lord was for all practical purposes the owner of the land in the Manor (though it was supposed to be held on behalf of the King of England whose authority was for all practical purposes only nominal). As noted already, agriculture was the main occupation of the people and each Manor as far as possible tried to be self-sufficient both because of the extremely unsatisfactory state of the means of transport and communication, and also because of rivalry and continual welfare that used to go on among neighbouring Manorial Lords.

ii) The Manorial Lord got the land in his Manor cultivated with the help of vessels some of whom enjoyed certain rights but most of whom belonged to the class of serfs. Agriculture was carried on in a traditional manner with a view to make the Manor or sometimes even villages self-sufficient in respect of important foodgrains. Agriculture was of the open-field system. All land was divided into two or three strips, each being left fallow every year to enable land to recover its fertility. Naturally agricultural productivity was very low.

iii) The vassals and serfs were closely bound to the Manorial Lord to whom they paid annual rent partly in the form of services. In return the Manorial Lord gave serfs livery and maintenance and it was his responsibility to see that they did not face undue-hardships or distress. A Manor was thus a close-knit and more or less self-sufficient economic unit with agriculture as the predominant occupation of the people.

iv) In each Manor and even in every village there were small-scale industries producing mainly for the local market essential goods like cloth, pots and pans and agricultural implements. Markets were mostly local and limited and therefore production of goods was carried on in households and on a very small scale.

v) Since no village or Manor could be self-sufficient in all respects, there were held weekly bazaars on specified days at specified places and often there were annual fairs where agriculturists sold their surplus for various articles like salt and metal ware not available locally. Prices of most goods were governed by tradition. All disputes were settled in Manorial courts where the Manorial Lord presided often with wide powers over his vassals and serfs sometimes including the power of sentencing a person to death for specified crimes.

vi) Once the harvesting season was over, there was generally continual welfare among different Manorial Lords, the vassals and serfs being required to duty-bound to render military service for specified number of days in return for the Manorial Lord's land which they were permitted to cultivate.

vii) Continual political disturbances and mutual welfare, predominance of traditional type of agriculture, small-scale industries mostly producing for local markets all meant that during thousand years or so of Feudalism, the economic conditions in different countries of Europe where Feudalism prevailed were for all practical purposes stagnant. Agricultural and industrial efficiency was very low and majority of people on the whole lived a miserable type of living compared to present standards of living in Western Europe.

CHECK YOUR PROGRESS

Q 1: What were the main characteristics of Feudalism in medieval England?

Q 2: How did the feudal system impact economic activity in medieval Europe?

3.4 ORGANISATION OF FEUDAL SOCIETY

A) Feudalism in 12th-Century England

Feudalism in 12th-century England stood out as one of the most structured and established systems in Europe at the time. The king was regarded as the absolute owner of all land, with nobles, knights, and other tenants, referred to as vassals, merely holding land from him. This placed the king at the apex of the feudal pyramid.

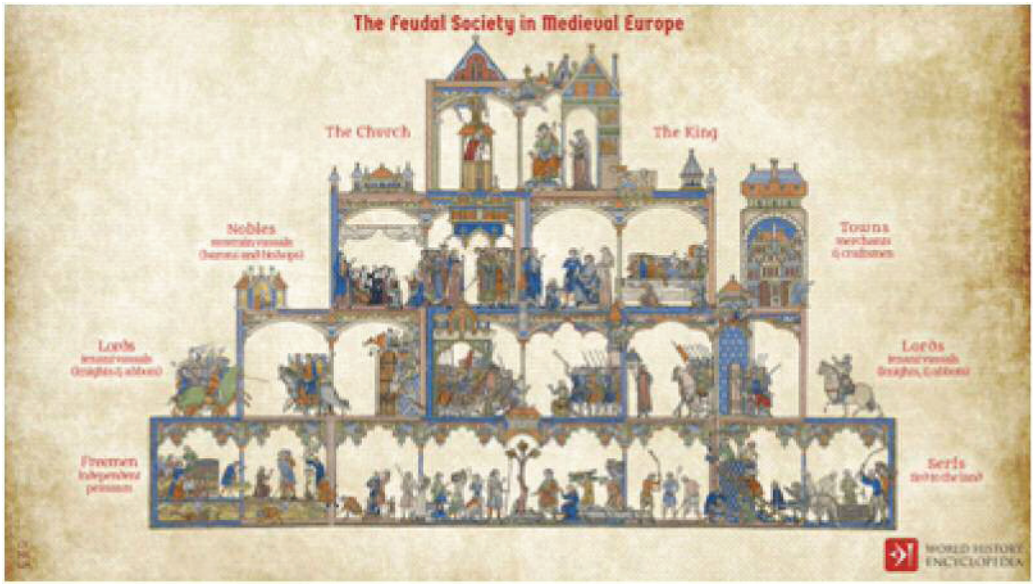
The Feudal Pyramid

Below the king was the tenant-in-chief, typically a baron or knight, who held land directly from the crown. These tenants-in-chief could also hold the status of mesne tenants, barons, or knights who held land from a tenant-in-chief while simultaneously being tenants-in-chief for other fiefs. The hierarchical structure continued with further mesne tenants holding land from each other in succession.

Vassalage and the Commendation Ceremony

A lord could not grant land, or a fief, to an individual without first establishing a vassalage relationship through a commendation ceremony. This ceremonial event

Figure 3.1 Organisation of Feudal Society



Source: https://www.worldhistory.org/

comprised two critical parts: homage and the oath of fealty. During the homage, the lord and the prospective vassal entered into a formal contract. The vassal pledged to fight for the lord on command, while the lord committed to providing protection from external threats.

Upon completion of the commendation ceremony, the lord and vassal were bound by their feudal relationship, entailing mutual obligations. The vassal's principal duty was providing "aid," specifically military service. Using equipment funded by the revenues from the fief, the vassal was obliged to respond to the lord's calls for military support. This assurance of military assistance was a primary incentive for lords to engage in feudal relationships.

Additional Obligations

Beyond military service, vassals had other responsibilities, such as attending their lord's court, whether manorial or baronial, or the king's court. Vassals were also expected to offer "counsel" to their lord, meaning they would be summoned to deliberate on significant decisions. At the manor level, this might involve routine agricultural policies or judicial matters, including criminal sentencing, sometimes extending to capital punishment. In the king's feudal court, deliberations could encompass critical issues like declarations of war.

Feudal customs and practices varied by period and region, illustrating the diversity and adaptability of feudal systems across Europe.

B) Feudalism in France

The origins of feudalism in France can be traced to a system where land grants were initially understood as personal bonds between a lord and a vassal. Over time, as fiefs transformed into hereditary holdings, the system evolved into a "politics of land." The 11th century in France witnessed what historians term a "feudal revolution" or "mutation," leading to a fragmentation of powers unique compared to the feudal developments in England, Italy, or Germany.

In France, the breakdown of counties and duchies into smaller holdings marked this period. Castellans and lesser seigneurs seized control of local lands, much like the earlier comital families. These lesser lords privatized various state prerogatives, particularly the lucrative rights of justice, along with travel dues, market fees, woodland usage fees, and obligatory use of the lord's mill. Consequently, power became more personal and decentralised.

Manorialism: The Bedrock of Feudal Society

Manorialism, a critical component of feudal society, was the organizing principle of the rural economy. Originating in the villa system of the Late Roman Empire, manorialism was widespread in medieval Western Europe and parts of central Europe. It gradually gave way to a money-based market economy and new forms of agrarian contracts.

Manorialism vested legal and economic power in the lord of a manor. The lord's economic support came from his direct landholdings and obligatory contributions from peasants under his jurisdiction. These obligations could be met through labor, kind, or, occasionally, coin. Manorial structures were prevalent across medieval Europe, including Italy, Poland, Lithuania, the Baltic nations, Holland, Prussia, England, France, and the Germanic kingdoms.

Stabilization Through Manorialism

The development of manorialism aimed to stabilize society following the decline of the Roman imperial order. With a falling birthrate and population, labor became the crucial production factor. Successive administrations attempted to stabilize the economy by maintaining the social structure: sons followed their fathers' trades, councilors could not resign, and coloni, the land cultivators, were bound to their land. This arrangement set the foundation for serfdom, as workers of the land moved towards becoming serfs. With the Germanic kingdoms succeeding Roman authority in the West during the 5th century, Roman landlords were often replaced by Gothic or Germanic ones, with little disruption to the existing system or population displacement.

The Manor System

A manor typically consisted of three classes of land:

i) Demesne: Land directly controlled by the lord, benefiting his household and dependents.

ii) Dependent Holdings: Land held by serfs or villeins, who owed the lord labor services or a portion of their output.

iii) Free Peasant Land: Land held without labor obligations but still subject to manorial jurisdiction and customs, with rents fixed at the time of the lease.

Lords also derived income from charges for using mills, bakeries, or wine-presses, hunting rights, and woodland use, alongside court revenues and payments upon tenant changes. However, manorial administration was costly, often leading smaller manors to rely less on villein tenure.

Serfdom

Under feudalism, particularly manorialism, serfdom represented the status of peasants bound to the land. Serfs were required to work for the lord of the manor in exchange for protection, justice, and the right to exploit certain manor fields for subsistence. Their duties extended beyond fields to mines, forests, and roads. Despite the restrictions, serfs had some freedoms. They could accumulate personal property and wealth, with some even purchasing their freedom. Serfs could grow their own crops, though taxes often had to be paid in wheat, and sell surplus produce at markets.

Landlords could not dispossess serfs without legal cause, were supposed to protect them from robbers and other lords, and were expected to provide charity in times of famine. Many of these rights were enforceable by the serf in the manorial court.

Villeins

Villeins, the most common type of serf, had more rights and a higher status than the lowest serfs, though they faced legal restrictions differentiating them from freemen. Villeins generally rented homes with or without land and were obliged to work on the lord's fields as part of their contract. This requirement was often seasonal and not overly burdensome. Villeins could hold personal property and typically had better living conditions than slaves. Villeinage provided access to land and protection from theft, making it preferable to being a vagabond, slave, or un-landed labourer.

A villein could gain freedom by escaping to a city or borough and living there for over a year, though this meant forfeiting land rights and an agricultural livelihood, a significant deterrent unless faced with a particularly tyrannical lord or dire village conditions.

CHECK YOUR PROGRESS

Q 3: What distinguished the feudal system in 12th-century England, and what was the structure of the feudal pyramid?

Q 4: What were the key components of vassalage and the commendation ceremony in feudal relationships?

Q 5: How did manorialism function as the bedrock of feudal society, and what were the roles of serfs and villeins within this system?

3.5 THE MODE OF PRODUCTION UNDER FEUDALISM

In Marxist terminology, the feudal mode of production—commonly referred to as feudalism—describes the socio-economic organization that dominated medieval society in the West and other regions of the world. In these societies, political power was decentralized

and wielded independently by feudal lords: the aristocracy or nobility, who inherited power and owned arable land.

According to Karl Marx's theories, feudalism historically precedes the capitalist mode of production. It was characterized by the economic exploitation of the peasantry by the aristocracy and landowners. Feudal lords, though dominant within their territories, were themselves subject to higher political authority: the crown. In return for political autonomy and control over their lands, they pledged loyalty and military support to the monarch.

Characteristics of the Feudal Mode of Production

The feudal mode of production was primarily an agricultural system. It relied on a peasant workforce responsible for producing goods, governed by a feudal lord who imposed order while exercising political and legal power, often with the intervention of the Church. Peasants paid a significant portion of their produce to the feudal lord in exchange for military protection, order, and legal rights. They were allowed to live on small plots of land to sustain their families. Though peasantry conditions sometimes resembled slavery, there were no formal slavery laws. Instead, vassalage linked peasants to the fiefs they inhabited, creating a system of mutual obligation. Fiefs, the smallest productive units, were divided into:

Stately or Demesne Lands: Used to generate tribute for the feudal lord.

Peasant Holdings: Where peasants produced goods for their own subsistence.

This model lacked a unified currency or economic system, and cities were underdeveloped compared to rural areas.

CHECK YOUR PROGRESS

Q 6: How does Marxist theory characterise the feudal mode of production?

Q 7: What were the main characteristics of the feudal mode of production?

3.5 FEUDALISM AND CAPITALISM

Feudalism was a socio-economic system that prevailed in Europe from the 5th to the 15th century. It was characterised by a hierarchical structure in which the king granted lands to nobles in exchange for military service, and peasants worked the land in return for protection and a place to live. This system created a static, stratified society focused on localism and exclusivity, with each feudal estate operating almost independently.

Capitalism, on the other hand, is an economic system where trade, industries, and the means of production are largely or entirely privately owned and operated for profit. The transition from feudalism to capitalism was not instantaneous but occurred over several centuries, influenced by a combination of economic, political, and social changes

Factors Leading to the Transition from Feudalism to Capitalism-

i) The Crusades (11th to 13th centuries): The Crusades were a series of religious wars initiated by European Christians to reclaim the Holy Land from Muslim control. Although they ultimately failed to secure permanent Christian control over the Holy Land, they

had significant socio-economic impacts. They disrupted the feudal order by fostering trade and contact between different regions, weakening the isolation of feudal estates. The Crusades facilitated the rise of towns and trade, marking the beginning of a shift towards a more market-oriented economy.

ii) Rise of Trade and Commerce: The 12th and 13th centuries saw a significant increase in trade and commerce, both within Europe and between Europe and other regions such as the Middle East and Asia. The emergence of trade zones like the Northern Trade Zone and the Mediterranean Trade Zone fostered economic activity on a larger scale, promoting a money economy over the traditional barter system. This shift was a crucial step towards capitalism, as it enabled the accumulation and investment of capital.

iii) Formation of Nation-States: The rise of nation-states between the 12th and 15th centuries contributed to the decline of feudalism. As monarchs centralised power, they diminished the influence of feudal lords. Nation-states became active promoters of trade and commerce, seeing them as means to enhance state revenue and personal wealth. This centralisation and promotion of economic activity laid the groundwork for the capitalist system.

vi) Mercantilism: Mercantilism emerged as the first stage of capitalism, characterised by state control and regulation of trade. The state monopolised trade to enhance national wealth, reflecting the growing importance of commerce. This period saw the rise of a wealthy merchant class and a new economic dynamic that gradually undermined the feudal order.

v) Geographical Discoveries: The discovery of new trade routes and lands from the late 15th century onwards, including the Americas and sea routes to Asia, had profound impacts on European economies. These discoveries expanded global trade networks, leading to a massive influx of wealth and commodities into Europe. This expansion promoted mercantile capitalism, further eroding feudal structures and fostering a capitalist economy.

The transition from feudalism to capitalism was a complex, multi-faceted process driven by significant economic, political, and social changes. The Crusades, the rise of trade and commerce, the formation of nation-states, mercantilism, and geographical discoveries collectively dismantled the feudal order and paved the way for the capitalist system. This transformation fundamentally altered the structure of European society, setting the stage for the modern economic world.

3.7 CAUSES RESPONSIBLE FOR THE BREAKDOWN OF FEUDALISM

Feudalism, a hierarchical system of land use and patronage, dominated Europe between the 9th and 14th centuries. Monarchs divided their kingdoms into agricultural estates called manors, controlled by nobles who oversaw agricultural production and swore loyalty to the king. Despite the social inequality it fostered, feudalism helped stabilise European society.

However, by the 14th century, various factors such as warfare, disease, and political changes led to its decline.

i) Feudalism Contained the Seeds of Its Own Destruction: Feudalism inherently contained the mechanisms for its eventual downfall. As historian Henry Martin observed, "Feudalism concealed in its bosom the weapons with which it would be itself one day smitten." Over time, as feudal lords increasingly asserted their power, kings sought to bring them under control. They received support from the emerging middle classes and freemen, who were not under the lords' control. These middle classes, consisting of traders and businessmen, provided the king with the financial resources to maintain independent armies. The discovery of gunpowder and cannons further enabled kings to subjugate the feudal lords, reducing their dependence on them.

ii) Growth of Trade and Commerce: The growth of trade and commerce significantly contributed to the decline of feudalism. This economic expansion led to the development of new cities and towns, providing serfs with opportunities to escape the control of feudal lords. According to feudal laws, a serf could become a freeman if he stayed away from the manor for more than a year, a fact that many exploited as they moved to burgeoning urban centres.

iii) The Crusades: The Crusades, or Holy Wars, also played a crucial role in undermining feudalism:

   a) Europeans learned the use of gunpowder from the Muslims during these wars, diminishing the defensive value of feudal castles and undermining the power of feudal lords.

   b) Many feudal lords lost their lives in the Crusades, which weakened the feudal system. Some who survived were forced to sell charters of liberties to towns under their control, leading to an increase in the number of free serfs.

   c) The Crusades opened up trade routes between Europe and cities like Constantinople and Alexandria, boosting commerce and industry. This economic boost led to the rise of significant urban centres where merchants and artisans sought to free themselves from feudal obligations. They either purchased their freedom or fought for it, securing self-government and freedom from feudal dues and taxes. These liberated cities maintained their own militias and fortified their defenses, further diminishing the power of feudal lords.

iv) The Hundred Years' War: The Hundred Years' War (1337-1453) between England and France required substantial manpower, drawing vassals and serfs away from the manors. This military engagement not only weakened the manorial system but also enhanced the value of commoners by providing them with military skills, which in turn undermined the feudal hierarchy.

v) The Black Death:The bubonic plague, or Black Death, which struck Europe in the mid-14th century, claimed at least a third of the population. This demographic catastrophe

severely affected agricultural production, already strained by the ongoing war. Many manors faced devastating losses, prompting waves of labourers to flee to larger cities, further weakening the feudal system.

vi) Political Changes:Feudalism's coercive nature, which limited individual liberties, faced increasing challenges over time. Legal reforms and political developments, particularly in England, gradually eroded the foundations of feudalism. The 12th-century reforms of Henry II expanded legal rights for individuals facing trial, and the Magna Carta of 1215 forced King John to uphold common law. By the late 13th century, Edward I extended parliamentary membership to commoners, making the concept of agricultural servitude increasingly untenable.

vii) Social Unrest: The combination of war and disease reduced Europe's population to the extent that peasant labor became highly valuable. Despite this, serfs continued to face heavy taxation and low wages, leading to widespread revolts across Europe between the 1350s and 1390s. Notably, after the English Peasants' Revolt of 1381, Richard II promised to abolish serfdom, a promise he ultimately failed to fulfil. However, the institution of serfdom nonetheless declined in the following century.

viii) The End of the Middle Ages:The decline of serfdom marked the end of feudalism. Without a labor supply, manorial systems could no longer function. Feudalism was gradually replaced by early capitalist structures during the Renaissance. Landowners shifted to privatised farming for profit, and labourers began to demand—and receive—better wages and additional liberties. This transition spurred the growth of urbanisation and fostered the cosmopolitan worldview characteristic of the Renaissance.

CHECK YOUR PROGRESS

Q 8: How did the Crusades contribute to the transition from feudalism to capitalism?

Q 9: What role did the rise of trade and commerce play in the transition from feudalism to capitalism?

3.8 LET US SUM UP

- Feudalism, the dominant social system in medieval Europe from the 10th to the 13th centuries, was characterized by a hierarchical structure where lords granted land (fiefs) to vassals in exchange for military and legal support, with both parties being free individuals, while serfs or villeins, who worked the land, were not part of this feudal relationship. Despite its widespread use in historical texts, the term "feudalism" lacks a precise, universally accepted definition and was not used by contemporaries, limiting its utility in understanding medieval societies.
- After the fall of the Roman Empire, Feudalism emerged and dominated Europe from the 5th to the 15th century, characterised by a lack of national unity, self-

sufficient manorial estates, low agricultural productivity, local markets, and stagnant economic conditions due to political instability and traditional practices.

- In 12th-century England, Feudalism was notably structured and established, with the king as the absolute owner of all land. Nobles, knights, and other tenants, known as vassals, held land from the king, positioning him at the top of the feudal hierarchy.
- In Marxist terms, the feudal mode of production, which preceded capitalism, was an agrarian-based socio-economic system dominated by decentralised political power held by feudal lords, who exploited the peasantry in exchange for protection and order, under the overarching authority of the crown.
- The transition from feudalism to capitalism in Europe from the 5th to the 15th century was driven by the Crusades, the rise of trade and commerce, the formation of nation-states, mercantilism, and geographical discoveries, collectively dismantling the feudal order and paving the way for a capitalist economy.
- Feudalism, which dominated Europe from the 9th to the 14th centuries, declined due to inherent weaknesses, the growth of trade and commerce, the impact of the Crusades, the Hundred Years' War, the Black Death, political changes, social unrest, and the transition to early capitalism during the Renaissance.

3.9 FURTHER READING

1) Desai, S.S.M. (1989). *Economic Systems,* Bombay: Himalaya Publishing House.
2) Acemoglu D. & Robinson J. A. (2013). *Why Nations Fail: The Origin of Power, Prosperity and Poverty*, London: Profile Books.

3.10 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No. 1: Feudalism in medieval England was characterized by the division of the land into manors, each governed by a manorial lord. Agriculture was the primary occupation, with the manorial lord essentially owning the land. Serfs, who formed the labor force, were bound to the manorial lord and paid rent through services. Small-scale industries produced goods for local markets, and periodic markets and fairs facilitated trade.

Ans to Q No. 2: The feudal system led to a stagnant economy in medieval Europe, characterized by traditional agriculture, small-scale local industries, and limited markets. Continuous political disturbances and mutual warfare further hindered economic growth. Agricultural and industrial efficiency remained low, resulting in a

generally poor standard of living for the majority of people.

Ans to Q No. 3: In 12th-century England, the feudal system was highly structured, with the king at the apex of the feudal pyramid, considered the absolute owner of all land. Below the king were tenants-in-chief, typically barons or knights, who held land directly from the crown. These tenants-in-chief could also hold mesne tenancies and grant land to other vassals, creating a hierarchical structure of land tenure.

Ans to Q No. 4: Vassalage in feudal relationships required a commendation ceremony, consisting of homage and the oath of fealty. During homage, the lord and prospective vassal entered into a formal contract, with the vassal pledging military support and the lord providing protection. This ceremony established mutual obligations between the lord and vassal, with military service being the primary duty of the vassal.

Ans to Q No. 5: Manorialism was the organizing principle of the rural economy in feudal society, with the lord of the manor holding legal and economic power over the land and its inhabitants. Serfs and villeins, bound to the land, provided labor services in exchange for protection and the right to exploit certain fields for subsistence. Villeins, a type of serf, had more rights and a higher status than the lowest serfs, renting homes and working on the lord's fields as part of their contract. Both serfs and villeins could gain freedom through various means, such as escaping to a city or borough.

Ans to Q No. 6: According to Marxist theory, the feudal mode of production, commonly known as feudalism, was the socio-economic organization dominant in medieval societies. Feudalism was characterized by decentralized political power held by feudal lords, who owned land and exploited the peasant workforce for economic gain.

Ans to Q No. 7: The feudal mode of production relied primarily on agriculture, with peasants working the land under the authority of feudal lords. Peasants paid a portion of their produce to the lord in exchange for protection and legal rights. This system was characterized by mutual obligations between lords and peasants, with landholding linking peasants to their fiefs.

Ans to Q No. 8: The Crusades disrupted the feudal order by fostering trade and contact between different regions, weakening the isolation of feudal estates. This led to the rise of towns and trade, promoting a more market-oriented economy and laying the groundwork for capitalism.

Ans to Q No. 9: The increase in trade and commerce during the 12th and 13th centuries promoted economic activity on a larger scale, fostering a money economy and enabling the accumulation and investment of capital. This shift towards a market-oriented economy was a crucial step in the transition to capitalism.

⑦ 3.11 MODEL QUESTIONS

Short Questions (Answer each question in about 150 words)

Q 1: What role did manorial lords play in the feudal system?

Q 2: How did the feudal mode of production differ from slavery, according to Marxist analysis?

Q 3: How did the formation of nation-states contribute to the decline of feudalism and the rise of capitalism?

Long Questions (Answer each question in about 300 - 500 words)

Q 1: How did the Crusades contribute to the transition from feudalism to capitalism?

Q 2: What role did manorialism play in the organisation of feudal society, and how did it contribute to economic stability during the medieval period?

Q 3: What are the causes responsible for the Breakdown of Feudalism? Explain.

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UNIT 4: PRICE MECHANISM UNDER CAPITALISM

UNIT STRUCTURE

4.1 Learning Objectives
4.2 Introduction
4.3 Concept of Price Mechanism
    4.1.1 Meaning of Price Mechanism
    4.1.2 Important Elements of Price mechanism
    4.1.3 Advantages of Price Mechanism
4.4 Working of Price Mechanism
4.5 Functions of Price Mechanism
4.6 Conditions Necessary for the Success of Price Mechanism
4.7 Price Mechanism as a Tool to Solve the Economic Problems
4.8 Limitations of Price Mechanism
4.9 Let Us Sum-Up
4.10 Model Questions

4.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- meaning of price mechanism
- the advantages of price mechanism
- how price mechanism works?
- the functions of price mechanism
- price mechanism as a tool to solve economics problems
- limitation of price mechanism.

4.2 INTRODUCTION

To be precise, price mechanism is an economic tool which helps to determine the price of good or service through the interaction of demand and supply in a free market economy. It can also be understood as an economic systemwhere price plays a key role in directing activities of economic agents be it a producer, a resource owner and a consumer. Capitalism or free market economy isan economic system in which individuals or economic agents are free to maximise their own means of production and consumption to pursue their self-interests i.e., in free market economy, consumers are free to consume anything and producers are also free to decide what to produce, how to produce and for whom to produce without state intervention. These decisions are guided by the price mechanism. So under capitalism or free market economy, the price mechanism is a fundamental aspect of how market allocates resources, determine prices and facilitate exchange of goods or services between economic agents. In short, in a free market economy or capitalism, the central problems of an economy

viz. to decide what, how and for whom to produce are solved by price mechanism.Under the free market economy or capitalism, market prices of commodities are determined without government intervention unlike regulated market.

4.3 CONCEPT OF PRICE MECHANISM

4.3.1 Meaning of Price Mechanism

In simple words, price mechanism refers to the system where the forces of demand for and supply of a commodity determine the price of that commodity without the intervention of the government. At the point of interaction between the demand for and supply of commodity, the equilibrium price of the commodity is established. A price mechanism which is part of the market system comprises various ways to match up buyers and sellers.

The process of price determination was first described by a Scottish philosopher-cum-economist 'Adam Smith' in the 18th century. Adam Smith described price mechanism as "invisible hand" where a producer is acting in his/her own self-interest and utilises scarce resources in a publicly beneficial way that satisfy the needs of an economy. According to him, an equilibrium will be automatically achieved where the demand for and supply of a commodity are equal.

Later on, neoclassical economist made considerable change and addition to the price theory. Samuelson wrote that the price mechanism working through supply and demand in competitive markets operates simultaneously to answer the three fundamental problems of economic organization in own mixed private enterprise system.

The economist Milton Friedman viewed the price mechanism as a powerful signalling system. Prices, according to him convey information about scarcity and demand which help individuals to make rational economic decisions. An economic decision is said to be rational if the agent pursues to maximise his/her objectives. For example, a consumer is said to be rational when he or she tries to maximize his or her satisfaction from the consumption of goods or services.

Price mechanism is also called as the market mechanism which determines prices of goods or services in the free market economy. Price of a good or service changes in response to change in demand for and supply of a good or service. Price of a good or service rises if demand for the good or service is increased or/and supply of the good or service is reduced in the market. Similarly, price falls if the demand for a good or service is decreased or/and supply of the good or the service is increased. When the demand for and supply of a good or service are equal, the market is in equilibrium and the price is known as the equilibrium price. Basically price mechanism is an economic tool that facilitates the determination of prices for goods and services through the interplay of supply and demand in a free market economy. It is also known as the "invisible hand", "market forces", or "market mechanism". Supply stands for the number of products or services available in the market while demand refers to the number of services or good that people can and are willing to purchase. Essentially, it can be thought of as how demand, supply and price interact for a specific service or good.

4.3.2 Important Elements of Price Mechanism

There are two important elements of price mechanism. These are:

a. **Price:** Prices are essence of price mechanism. Price mechanism works through prices in a free enterprise economy or market economy or capitalist economy, where all goods and services carry price tags with them. Consumers have to pay some prices if they want to buy some goods or services and producers are willing to sell goods and services only if they receive the appropriate price.

b. **Market:** Market constitutes an integral part of the price mechanism. A market refers to an institutional arrangement where the buyers and sellers can exchange some quantity of goods and services at a mutually agreeable price in a particular point of time. Forces of demand and supply that determine market prices operate within the framework of market.

4.3.3 Advantages of price mechanism

Some of the advantages of price mechanism are given below:

i. **Solving economic problems:** Price mechanism helps the capitalist economy in solving different economic problems like resource allocation, choosing methods of production, income distribution, economic growth etc. Price mechanism is the main instrument for deciding about production, consumption and investment decision of an economy.

ii. **Promotes social welfare:** The impersonal forces of price mechanism help in promoting social welfare. The advocates of free enterprise economy claims that the price mechanism works efficiently and effectively so as to ensure maximum welfare of the society. According to Adam Smith the invisible hand of price mechanism ensures that while promoting their self-interest individual promotes social welfare.

iii. **Consumers' Choice:** Price mechanism allows consumers to make choices based on their preferences and budgets. Lower priced alternatives are often available for thoselimited budget constraints.

iv. **Flexibility:** Price adjusts quickly to change in supply and demand enabling the economy to adapt external shocks and shifts in consumer preferences.

v. **Non-intervention by the Government.:** Price mechanism does not require government.'s intervention in day-to-day functioning of prices. It is a self-controlling and self-adjusting system. Price mechanism reduces bureaucratic control and promotes economic freedom of economic agents.

vi. **Individual freedom:** This system protects the absolute freedom of both producers and consumers regarding their economic decisions. Every producer is free to decide the level of his output and similarly every consumer is also free to decide about the amount of his/her consumption.

4.4 WORKING OF PRICE MECHANISM

The price mechanism is dynamic process where prices are determined by the forces of supply and demand and these prices guide the allocation of resources in the economy. The operation of price mechanism in a commodity market of a free enterprise economy is explained with the help of figure-1. In figure-1, quantity demanded and supplied of a good is being measured along the horizontal/X-axis and prices are measured on the vertical/Y-axis.

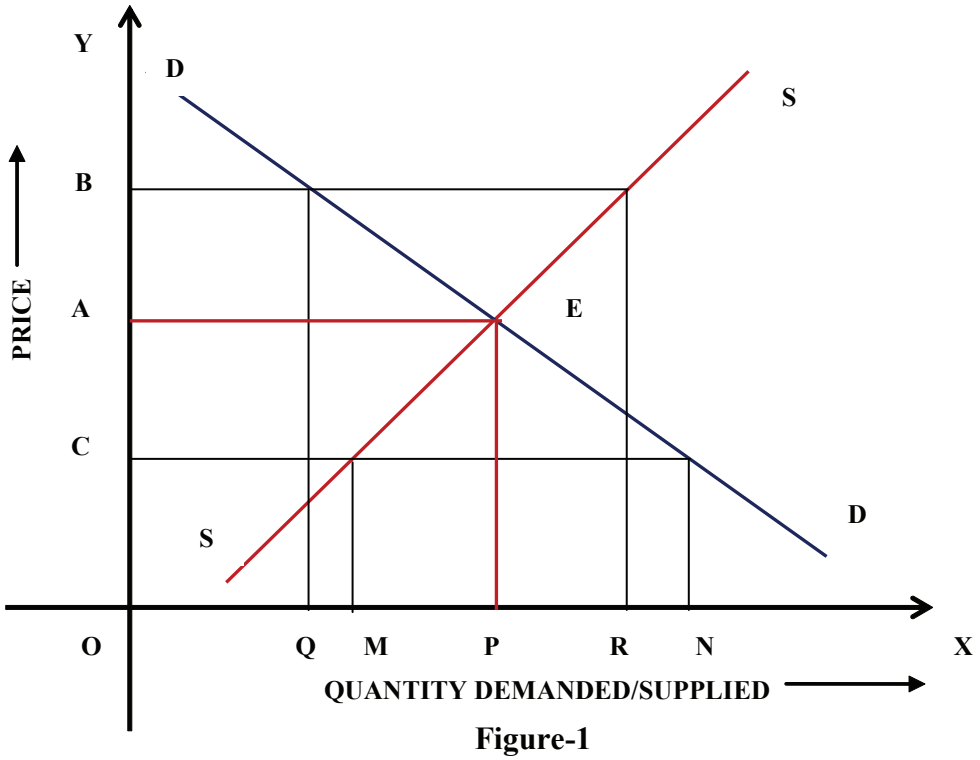


Figure-1

It is evident from Figure-1 that at OB price, the demand for the commodity is 'OQ' and the supply of the commodity is 'OR'. Here, the quantity supplied 'OR' is greater than the quantity demanded 'OQ' implying that there is an excess supply of the commodity in the market by 'QR' amount. Excess supply of the commodity will lead price to fall. The seller will try to sell his/her products by lowering prices. On the other hand, at 'OC' price, quantity demanded of the commodity is 'ON' and the quantity supplied is 'OM' amount implying quantity demanded is greater than the quantity supplied at the prevailing price in the market. In this case, quantity demanded is greater than quantity supplied implying that there is excess demand (equal to MN amount). In this situation, buyers enjoy the scope for increasing the price of the commodity resulting in rise in prices.

Equilibrium: a condition once achieved tends to persist.
Stable Equilibrium: An equilibrium condition where any deviation from it brings market forces into operation in such a manner that brings us back to the original equilibrium position.

At 'OA' price, quantity demanded is equal to quantity

supplied (OP amount). At this price, buyers are prepared to buy the quantity that the sellers are ready to sell as it will lead to competition among the buyers. Consequently, there will be no tendency for the price to change. If price rises or falls, then forces of demand and supply will interact in such a way that restores the OA price. Thus, OA price is the equilibrium price. The equilibrium shown in the figure is stable in the sense that any deviation from this position either to the right or left brings market forces in to action in such way that drives us back to the original equilibrium position. For example, for any price greater than OA, quantity supplied at that price is greater than the quantity demanded. Hence, sellers are bound to sell the commodity by lowering price until the level of price where quantity demanded is equal to the quantity supplied. Similarly, for any price less than the equilibrium price 'OA', the demand for the commodity is higher than the quantity supplied. This causes price to rise until the point where quantity demanded is equal to the quantity supplied. Thus OA price is the equilibrium price.

It is thus clear that prices are determined by the intersection of supply and demand in the market. When consumers demand a product or commodity or service and producers are willing to supply if they negotiate a price that both parties find acceptable and this price will be determined by the forces of demand and supply. This price at which quantity demanded equals to the quantity supplied is called the equilibrium price. At this price, there is neither excess demand nor excess supply.

4.5 FUNCTIONS OF PRICE MECHANISM

Price mechanism plays a very important role in the functioning of a free enterprise economy. The main functions of price mechanism are the following:

i. **Allocation of Resources:** Price helps to allocate resources efficiently by signalling where goods and services are in demand and where they are not. For example, when there is shortage of a product it indicates the increased price for which encourage producers to allocate more resources to produce that productand vice versa. So price mechanism helps in determining the allocation of resources to production of various goods and services so as to maximise total output. In this case, the market mechanism allocates scarce resources among production of different goods and services.

ii. **Rationing:** A commodity price will rise or fall based on the forces of demand and supply. When production of a good uses scarce resources, its price tends to increase. The increase in price discourages demand for the good and consequently rations resource so prices serve to ration scarce resources when market demand outstrips supply. For example, plane ticket might rise as seats are sold, because spaces are running out. This is a disincentive to some consumers to purchase the tickets which rations the tickets.

iii. **Incentive:** Prices encourage a change in behaviour of a consumer or a producer. A high price provides an incentive for producers to supply more to the market because it is more profitable to do so. The potential for profit motivates producers to produce more

of what consumers want. So when price of a product rises (or falls) the quantity supplied increases (or decreases) and this is due to the incentive functions of price mechanism.

iv. **Signalling:** The price acts as a signal to consumers and helps new firms to decide entering the market. The change in prices shows where resources are needed in the market. For example, a high price signals new firms to enter the market because it is profitable. However, this encourages consumers to reduce demand and therefore leave the market and opposite situation for fall in price. Also rise in price signals to producers to produce more. So market prices adjust to demonstrate where resources are required and when they are not.

v. **Competition:** Prices encourage competition among producers when prices are high. New firm may enter in the market which can lead to lower prices over time as competition increased.

vi. **Instrument for determining the level of economic activities:** Price mechanism is the main instrument for determining the level of economic activities like production, consumption, saving, investment etc.

vii. **Bringing flexibility in the economy:** Price mechanism incorporates flexibility in a free enterprise economy. Changes in tastes and preferences of the consumers, supply conditions etc. lead to changes in product and factor prices. Thus, the economy responds to various changes which ensure smooth functioning of them.

4.6 CONDITIONS NECESSARY FOR THE SUCCESS OF PRICE MECHANISM

The price mechanism would work more smoothly, efficiently and effectively when certain conditions are fulfilled. These are:

i. **Competition:** The very essential and first requirement for the success of price mechanism is existence of competition in the market. Competition refers to a market situation where there are innumerable numbers of sellers and no single buyers or seller can influence the price of commodity or inputs services. Mayer says, “the Price system will fulfil the functions only if competition prevails that is individual producer has to adapt himself to price changes and cannot control there”. A competitive market with multiple buyers and sellers ensures that prices are determined fairly by supply and demand forces.

ii. **Perfect knowledge:** Participants must have perfect knowledge and information about the product prices and market condition. This means that both buyers and sellers know well in advance the prices being charged in the product market and factor market. Based on this knowledge and information every participant in the market i.e. both consumers and producers make plan accurately.

iii. **Freedom of entry and exit:** For the successful functioning of price mechanism requires that firms and individuals should be able to enter and exit the markets freely or without any restriction to competition.

iv. **Mobility of resources:** It is also essential that resources should be perfectly mobile so that production can be changed quickly in response to change in demand. This would ensure flexibility of price mechanism.

v. **Cost reflecting the sacrifice:** For an efficient functioning of price mechanism, it is essential that the cost should be a true reflection of the sacrifice made by the society in terms of resources used in production of various commodities otherwise there is the possibility of misallocation of resources.

vi. **Demand reflecting need:** Demand should perfectly reflect the needs of the individuals. If demand should not reflect the needs then there is the possibility of misallocation of resources because we all know that production is guided by demands.

vii. **Correct anticipation of demand:**The efficient working of price mechanism requires that producers should be able to anticipate the demand correctly so that the right amount of commodities should be produced. Otherwise, there are chances of over production and underproduction of the goods.

viii. **Conducive non-economic conditions:**The smooth working of price mechanism also requires fulfilment of some of the non-economic conditions like a well-developed legal system protecting the property right, law and order in the country etc.

ix. **Absence of Government Control:**Price mechanism would be able to function efficiently only if it is allowed to operate freely. Government or state should not have any interference in the functioning of the price mechanism. Intervention by the govt. in various forms such that rations, licence system would obstruct the function of price mechanism.

4.7 PRICE MECHANISM AS A TOOL TO SOLVE ECONOMIC PROBLEMS

In a free enterprise economy, the price mechanism is an important tool for solving basic economic problems. The central problems of an economy, *viz. what to produce, how to produce and for whom to produce* are to be solved through a pricemechanism. We all know that price mechanism is a structure of relative prices of different goods and services in a market. As the producers are always trying to maximise their profits or they are guided by profit motive, they produce those goods whose prices are relatively high. They use those inputs and techniques of production which help them to minimise the cost of production. Consumers buy those goods the prices of which are relatively low and provide more satisfaction. Now, let us discuss the role of price mechanism to solve the various economic problems in details.

i. **What to produce:** What to produce refers to those goods and services that the economy should produce in a point of time, subject to availability of resources. Since resources are scarce, no economy can produce as much of every good or services as desired by the society. More of one good or service usually means less of others. Therefore, every society must choose exactly which goods and services are to be produced.

In the fee enterprise economy, price mechanism automatically solves the problem of what to produce. Since earning profit is the main motive of producers and therefore producers produce only those commodities which are demanded by the consumers and for which the consumers are willing to pay a price sufficiently high to cover at least the full cost of producing them in the long run. By paying high price, consumers can normally induce producers to increase the quantity supplied of a commodity and *vice-versa*. As we all know that in the capitalist or free enterprise economy,a consumer is sovereign so that the consumer determines what to produce. Thus, the operation of price mechanism in solving the problem of what to produce stands as increase in demand for a commodity will be followed by increase in commodityprice and profit which ultimately lead to increased level of production of the commodity and *vice-versa*. In this way, price mechanism helpsdecide what goods to be produced in an economy.

ii. **How to produce:** How to produce refers to the choice of the combinations of factors, subject to the techniques of production available. Since a good or service can normally be produced with different techniques, the problem arises as to which of these to use i.e. to identify the least cost combination of factors or production maximising combinationof factors for producing the good or service. Since resources are limited, when more of them are used to produce some goods, less are available to produce others. So each society faces the problem of choosing the technique which results in the least use of scarce resources to produce goods and services it wants.

In a market economy, the problem related to 'how to produce'" is solved by the price mechanism. As mentioned earlier, the price of a factor normally represents its relative scarcity. Thus the best technique to use in producing goods or services is the one that results in the least cost of production. In a capitalist economy, all the producers are forced to adopt the most efficient technique of production. In this way, price mechanism in a capitalist or free enterprise economy, helps in solving the problem of relative scarcity. Thus, the best technique to use in producing goods or services is the one that results in the least cost of production or maximisation of output using same combination of factors. In a capitalist economy all the producers are forced to adopt the most efficient methods of production. Thus price mechanism helps in solving the problem of relative scarcity of different factors of production without Government intervention.

iii. **For whom to produce:** 'For whom to produce' refers to how the total output is to be distributed among different consumers. Since resources are scarce, the goods and services are produced also in limited quantities in an economy. Therefore, a problem of choice arises. Price system determines the pattern of derived demand for factors of production. Given the supply of factors, market mechanism determines the prices of four factors i.e. rent, wages, interest and profits. Once factor prices are determined, the compositions of goods and services to be produced are also to be determined. Thus, the problem of 'for whom to produce' is also solved by the price mechanism in a free enterprise economy.

The price mechanism performs two closely related rationing in capitalist economy. These are: (a) it restricts the total level of consumption of available goods and services, and (b) it also restricts the current level of consumption so that consumption of various commodities last till new supply is available in the market.

iv. **Economic Growth:** The rate of growth of an economy depends on its resources and improvement in its techniques of production. In market economy, the price mechanism determines the rate of economic growth to a large extent. Whena firm increases profit through innovation,it helps in reduction in cost, improvement of the quality of products and enlargement of the size of the market. High factor prices motivate the factors of production to acquire more skills. Adam Smith believed that the price system works as a sort of 'invisible hands' to guide all the producers and consumer of an economy to take decisions about production and consumption in rational ways. So the price mechanism automatically leads to the allocation of resources which is in the best interest of the society.

4.8 LIMITATIONS OF PRICE MECHANISM

Theoretically price mechanism is supposed to function in a smooth and perfect manner. However, in practice the price mechanism does not perform or functions smoothly and perfectly. The price mechanism has failed to function efficiently on account of the following reasons:

i. **Decline of competition:** As pointed above, for effective working of price mechanism requires existence of perfect competition in the market. Competition acts as the efficient allocating mechanism under capitalism. Under perfect competition price is the lowest, output is maximum and resource allocation is optimal. But in the real world perfect competition rarely exists. In course of time, monopolistic and oligopolistic tendencies have developed due to the rise of mass production, growth of large markets and introduction of new techniques of production.Theimperfect market forms (i.e., other than perfect competition) lead to higher price, lower output and misallocation of resources.

ii. **Consumer sovereignty is a myth:** A Free enterprise economy believes in 'price' which is the prime market mover and is always determined by rational independent consumers' preferences and relative scarcity of resources. However, this is not true. In the modern world, consumers' sovereignty has turned out to be a myth. It is not always true that market produces those goods and services which are demanded by the consumers. Often those goods are produced and marketed particularly by the Multi-national Companies (MNCs) which they want to. With the growth of the oligopolistic nature of the market, powerful producers through continuous advertisement for creating brand value, multiplicity of brands and false propaganda etc. sell different goods and services often to the "confused' consumers.

iii. **Price mechanism is not anautomatic process:** It is argued that under-price

mechanism, supply of commodity responds to changes in demand conditions in such a way that supply-demand equality is automatically restored. However, this is not true because firms may plan to raise output when demand rises. Producers being profit maximisers may not increase output. They anticipate that buyers would buy product at higher prices and so their profits would be higher. As a result, demand-supply adjustment may take place often in a long interval.

iv. **Inequality:** The price mechanism can lead to inequality in the distribution of income and wealth. Producers produce goods and services forearning profits . Thus price mechanism cannot ensure social justice, rather it widens inequality in the distribution of income and wealth – 'the rich get richer and the poor poorer'.

v. **Economic instability:** A serious shortcoming of the working of price mechanism is that it tends to create economic instability. It leads to business or trade cycle i.e. alternative periods of booms and depressions. And we all know that booms and depression both are bad for an economy. So in certain situations, the price mechanism can contribute to economic instability

vi. **Wastages of resources:** The motivating force for free enterprise economy is profit. In such economy, all production decisions are made based on profit expectation. Thus the highest amount of those goods and services will be produced which mainly demanded by the rich. So price mechanism fails to bring equal development in all regions for private investment and concentrate only in prosperous areas. This will lead to underutilisation of local resources and creation of regional imbalance.

vii. Market failure takes place when price fails to allocate resources efficiently. It is a phenomenon in which the market solution does not lead to a social optimum.

viii. Price mechanism cannot work efficiently when consumers behave irrationally. The market economy works on the philosophy that each individual is the best judge of his/her own welfare. Each individual's choices and decisions best serve individual welfare and social welfare. But in reality on many occasions individuals behave in an irrational manner.

4.9 LET US SUM UP

The whole discussion on price mechanism can be summarised as follows:

- The price mechanism refers to the system by which prices of goods and services are determined in a free enterprise economy or capitalist market through the interaction of the forces of demand and supply.
- It is a fundamental concept in economics that plays a crucial role in resource allocation and decision-making of economic agents.
- Adam Smith described the 'invisible hand' of the price mechanism in which the hidden hand of the market allocates scarce resources in society's best interest guided by individual self-interest.

- There are two important elements of price mechanism: price and market.
- Price mechanism helps to solve the three central problems. These are: (a) what to produce, (b) how to produce, and (c) for whom to produce.

? 4.10 MODEL QUESTIONS

Short Questions (Answer each question in about 150 words)

Q.1: Explain the meaning of price mechanism in a capitalist economy.

Q.2: Briefly discuss the role of demand and supply in price determination.

Q.3: State and explain any three advantages of price mechanism.

Q.4: How does price mechanism help in the allocation of resources?

Q.5: Explain the signalling function of price mechanism.

Q.6: What are the conditions necessary for the success of price mechanism?

Q.7: Explain the concept of consumer sovereignty and why it is considered a myth.

Q.8: Write a short note on price mechanism as an incentive system.

Q.9: Distinguish between excess demand and excess supply.

Q.10: Briefly explain the limitation of price mechanism in ensuring social justice.

Long Questions (Answer each question in about 300-500 words)

Q.1: Explain the concept of price mechanism. Discuss its meaning and importance in a capitalist economy.

Q.2: Describe the working of price mechanism with the help of a suitable diagram. Explain how equilibrium price is determined.

Q.3: Discuss the main functions of price mechanism in a free enterprise economy.

Q.4: What conditions are necessary for the successful functioning of price mechanism? Explain each condition in detail.

Q.5: Critically examine the limitations of price mechanism.

Q.6: “Price mechanism promotes efficiency but fails to ensure equity.” Discuss this statement.

Q.7: Explain how price mechanism contributes to economic growth in a capitalist economy.

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UNIT 5: SOCIALISM

UNIT STRUCTURE

5.1 Learning Objectives
5.2 Introduction
5.3 Understanding Socialism
5.4 Evolution of Socialism
5.5 Features of Socialism
5.6 Merits of Socialism
5.7 Demerits of Socialism
5.8 Let Us Sum Up
5.9 Further Reading
5.10 Answers to Check Your Progress
5.11 Model Questions

5.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- understand the meaning of socialism
- explain the evolution of socialism
- discuss the features of socialism
- discuss the merits and demerits of socialism.

5.2 INTRODUCTION

Dear learners, in the previous unit, we have discussed the price mechanism under capitalism. You must have understood what is meant by capitalism, its distinct features.This unit aims to provide a detailed understanding of socialism as an important political and economic ideology. It begins by explaining the meaning of socialism and tracing its historical evolution. The unit then discusses the main features of socialism. In addition, it discusses the advantages and disadvantages of socialism. Through this discussion, you will develop a comprehensive understanding of socialism.

5.3 UNDERSTANDING SOCIALISM

Dear learners, in simple words, Socialism is a social and economic doctrine that advocates public instead of private ownership of property and natural resources. It is a political, economic, and social ideology thatupholds collective or public ownership of the means of production, distribution, and exchange. The Socialist Economy is an exclusively state-controlled

and planned economy where the State entirely controls the means of production. Here, the production and distribution activities are totally regulated by the state. The central idea of socialism is that key industries and resources—such as land, factories, natural resources, and infrastructure—should be owned or regulated by the state or by the community as a whole rather than by private individuals.At its core, socialism seeks to reduce economic inequality and discrimination and ensure that the distribution of wealth and resources are equitably done among the members of the society. Therefore, the socialist model is welfare-oriented and seeks to ensure a fair distribution of economic opportunities and benefits within society. It propagates the belief that individuals should not have to worry about the well-being of their families due to job insecurity, such as the replacement of experienced workers with younger employees. Influenced by Marxist ideas, a socialist economy emphasizes that individuals should be compensated fairly in accordance with the value of their work. They should be paid what they deserve for their work.It advocates the principle that people contribute according to their abilities and receive according to their needs. Furthermore, socialism rejects the concentration of wealth in the hands of a few and promotes a more equitable economic structure.Unlike capitalism, which emphasizes private ownership and profit-making, socialism prioritizes social welfare, cooperation, and the common good.Socialists argue that capitalism leads to exploitation, class divisions, and concentration of wealth in the hands of a few, while the majority struggle to meet basic needs. Socialism aims to eliminate these inequalities by restructuring economic systems to serve human needs rather than private profit.

Socialism therefore –

- Refers to a fully state governed and state controlled economic system.
- Presses on the belief that the effort of an individual which goes behind the production of goods and services will decide the distribution- “From each according to his ability, to each according to his deeds”.
- Welfare oriented in approach.

Thus, Socialism is not a single, uniform doctrine but a broad family of ideas and movements. Different forms of socialism have emerged across history, ranging from democratic socialism and social democracy to revolutionary socialism and communism. Despite these variations, all socialist ideologies share a commitment to social justice, economic equality, and collective responsibility.

In the modern world, socialism continues to influence political debates, public policies, and social movements. Many countries incorporate socialist principles into their economic systems through welfare states, public healthcare, free education, and labor protections. Understanding socialism is therefore essential for comprehending global political and economic structures.

CHECK YOUR PROGRESS

Q 1: What is the primary aim of Socialism?

Q 2: Which principle best represents the socialist belief about distribution of goods and services?

5.4 EVOLUTION OF SOCIALISM

The evolution of socialism can be traced through several historical phases, shaped by changing economic conditions, political struggles, and philosophical ideas.

Early Socialist Thought

The roots of socialism can be found in ancient and medieval societies where thinkers emphasized communal living and shared ownership. Philosophers such as Plato, in his work *The Republic*, proposed collective ownership among the ruling class to promote unity and justice. Similarly, early Christian communities practiced forms of communal ownership based on moral and religious principles.

During the late 18th and early 19th centuries, the Industrial Revolution played a crucial role in the development of socialism. Rapid industrialization led to urbanization, poor working conditions, child labor, low wages, and extreme inequality. These social problems prompted thinkers to question the fairness of capitalist systems.

Utopian Socialism

The earliest modern socialists are often referred to as “utopian socialists.” Thinkers such as Henri de Saint-Simon, Charles Fourier, and Robert Owen believed that society could be transformed through peaceful cooperation and the creation of ideal communities. They emphasized moral reform, cooperation, and social harmony rather than class struggle.

Robert Owen, for example, established model communities where workers enjoyed better wages, education, and living conditions. While utopian socialism was influential, critics argued that it lacked a practical strategy for achieving large-scale social change.

Karl Marx (1818–1883) and Friedrich Engels (1820–1895) strongly criticized this view of socialism. They argued that achieving socialism through moral improvement or social reforms was unscientific and unrealistic. In their pamphlet *The Communist Manifesto* (1848), they presented their theory of socialism, called **scientific socialism**, which later became known as **Marxism**.

Scientific Socialism and Karl Marx

A major turning point in the evolution of socialism came with the ideas of Karl Marx and Friedrich Engels in the mid-19th century. Their theory, known as scientific socialism or Marxism, provided a systematic analysis of capitalism and its inherent contradictions.

Marx argued that history is driven by class struggle between those who own the means of production (the bourgeoisie) and those who sell their labor (the proletariat). According to Marx, capitalism inevitably leads to exploitation, alienation, and economic crises. He predicted that the working class would eventually overthrow capitalism through revolution and establish a socialist society, which would later evolve into communism—a classless society.

Marxism had a profound influence on political movements worldwide and became the

foundation for revolutionary socialism.

Social Democracy and Democratic Socialism

By the late 19th and early 20th centuries, some socialists began to reject violent revolution in favor of gradual reform through democratic institutions. This approach gave rise to social democracy, which seeks to combine capitalist economies with strong social welfare programs, labor rights, and government regulation.

Countries such as Sweden, Norway etc. adopted social democratic policies, creating systems that provide universal healthcare, free education, unemployment benefits, and pensions. Democratic socialism, closely related to social democracy, emphasizes achieving socialism through democratic means rather than authoritarian rule.

Socialism in 20th Century:

The 20th century saw several attempts to implement socialism at the national level. The Russian Revolution of 1917 led to the establishment of the Soviet Union, which adopted a centrally planned socialist economy. Similar systems emerged in China, Cuba, and Eastern Europe.

While these experiments achieved rapid industrialization and improved literacy and healthcare, they also faced significant challenges, including lack of political freedom, economic inefficiency, and authoritarian governance. The collapse of the Soviet Union in 1991 led many to reassess centralized socialist systems.

Contemporary Socialism

In the 21st century, socialism has re-emerged in new forms, often focused on addressing income inequality, climate change, and social justice. Modern socialist movements emphasize democratic participation, environmental sustainability, and human rights. Rather than rejecting markets entirely, many contemporary socialists advocate mixed economies that balance public ownership with regulated private enterprise.

5.5 FEATURES OF SOCIALISM

Socialism is characterized by several key features that distinguish it from other economic and political systems.

- **Collective or Public Ownership:** One of the most fundamental features of socialism is the collective or public ownership of the means of production. By this we mean that major industries, large factories, mines, forests, farms, office, banks, transport systems, media, communications, big shopping chainsand infrastructure are owned by the state, cooperatives, or the community rather than private individuals. The goal is to prevent the concentration of wealth and ensure that economic resources benefit society as a whole.
- **Economic Planning:** Socialist systems often depends on economic planning to allocate

resources and determine production.The economy is planned to serve human needs rather than simply generating profit for the rich. Instead of market forces alone deciding what goods are produced, the state or planning authorities assess social needs and prioritize essential services such as healthcare, education, housing, and transportation.The planning Committee sets the goals for the economy and also the time frame within which these goals are to be realized.Planning aims to avoid economic crises, and ensure that basic needs are met. However, the degree of planning varies across different forms of socialism.

- **Equality and Social Justice:** The chief objective of socialism is to promote economic and social equality. It advocates unbiased and equitable distribution of goods and services. It seeks to reduce income disparities, eliminate poverty, and provide equal opportunities for all citizens. As mentioned above, it upholds the principle of 'from each according to their ability, to each according to their work'. No longer will monopolists, landlords etc, have the choice or the luxury to live on the labour of others or exploit others. Every person will get the opportunity to contribute to society according to his/her ability. Those who work more will receive more income. Those who retired or are unable to work would be supported from the social fund. It promotes progressive taxation, social welfare programs, and equal access to education and healthcare.Socialism also emphasizes social justice by addressing discrimination based on class, gender, race, or ethnicity.
- **Welfare State:** The central concern of a Socialist economy is social welfare and social security. It emphasizes on those production activities and services which ensures highest social benefit to the masses. The economic activities are not stimulated by the dictum of profit but rather by social welfare. The State ought to ensure maximum social security to its people in the form of free education, free or affordable healthcarefacilities, pension, old age benefits and social securitymeans of recreation, so on and so forth.The welfare state aims to protect individuals from economic insecurity and improve overall quality of life.
- **Democratic Control:** In many forms of socialism, there is an emphasis on democratic control over economic and political institutions. This includes worker participation in management, trade unions, and democratic decision-making processes.
- **Reduction of Exploitation:** Socialism seeks to eliminate the exploitation of labor by ensuring fair wages, safe working conditions, and job security. Workers are viewed as contributors to social wealth rather than commodities to be bought and sold in the labor market.

Dear learners, by now, you must have understood what Socialism is, its distinct features, and how it differs from capitalism. In a nutshell, we can say that socialism, unlike capitalism, seeks to reduce the gap between the rich and the poor by enforcing public rather than private ownership of property and resources. It attempts to establish a Classless society where the discrimination between the haves and have-nots is eradicated. Let us now discuss the merits of Socialism.

CHECK YOUR PROGRESS

Q 3: According to socialism, who should own the means of production.

Q 4: What kind of society does socialism aim to establish?

5.6 MERITS OF SOCIALISM

Socialism has several advantages that have contributed to its appeal across different societies and historical periods. Let us discuss them in details.

- **Reduction of Economic Inequality:** One of the greatest merits of socialism is its focus on reducing economic inequality. By redistributing wealth and providing universal access to essential services, socialism helps narrow the gap between rich and poor. This promotes social equality, cohesion and stability.
- **Social Welfare and Human Development:** Socialist systems often prioritize human development over profit. Public investment in healthcare, education, and housing leads to higher literacy rates, better health outcomes, and improved living standards. This ensures overall human wellbeing and development.
- **Economic Security:** Socialism provides greater economic security by protecting individuals from unemployment, illness, and old age through social safety nets. This reduces fear and uncertainty, allowing people to focus on personal growth and community participation.
- **Prevention of Exploitation:** By regulating labor markets and promoting workers' rights, socialism helps prevent exploitation. Trade unions, minimum wage laws, and labor protections ensure fair treatment and dignity for workers.
- **Planned Development:** Economic planning under socialism can help achieve long-term national objectives. Through central or democratic planning, the state can direct resources toward critical sectors such as infrastructure, education, healthcare, and technological innovation, ensuring balanced and inclusive growth. By aligning production and investment with social needs, planned development also promotes economic stability, reduces inequality, and supports sustainable development over time.
- **Promotion of Cooperation:** Socialism encourages cooperation rather than competition. By fostering a sense of collective responsibility, it strengthens community bonds and promotes social harmony.

Thus, we can say that socialism promotes social equity, economic stability, and long-term development by prioritizing collective welfare over individual profit. Its emphasis on planned development, equitable distribution of resources, thereby ensuring an inclusive society.Dear learners, while socialism offers numerous advantages, it also has limitations and criticisms. Let us examine these in details.

5.7 DEMERITS OF SOCIALISM

Lack of Economic Efficiency: Critics argue that centralized planning can lead to inefficiency, bureaucratic hassles, and misallocation of resources. Without market competition, enterprises may lack incentives to innovate or improve productivity.

Reduced Individual Incentives: Socialism is often criticized for reducing individual motivation and entrepreneurship. When income differences are minimized, individuals may feel less incentivized to work harder or take risks, potentially slowing economic growth.

BureaucracaticHassels: State control over economic activities can result in excessive bureaucracy and administrative inefficiency. Decision-making processes may become slow and unresponsive to changing conditions.

Limited Consumer Choice: In some socialist systems, especially centrally planned economies, consumer choice may be limited due to standardized production and shortages of goods. This can affect overall satisfaction and quality of life.

Risk of Authoritarianism: Historically, some socialist states have concentrated power in the hands of the government, leading to authoritarian rule and restrictions on political freedoms. Critics argue that excessive state control can undermine democracy and individual rights.

Financial Burden on the State: Maintaining extensive welfare programs requires high levels of public spending. If not managed properly, this can lead to budget deficits, high taxation, and economic strain.

Conclusion

Socialism is a complex and multifaceted ideology that has significantly shaped modern political and economic thought. It upholds the ideas of equality, social justice, and collective welfare. It emerged as a response to the inequalities and hardships created by industrial capitalism. Over the period of time, it has evolved into various forms, ranging from revolutionary movements to democratic and reform-oriented systems.

Collective ownership, economic planning, welfare provisions, and democratic control are the major features of socialism. It prioritizes serving human needs rather than private profit. Its merits include challenging inequality, improving social welfare, economic security, and protection against exploitation. However, despite its merits, socialism also faces certain challenges regarding efficiency, incentives, bureaucracy, limited consumer choice and the potential concentration of power etc.

5.8 LET US SUM UP

- Socialism is a social and economic doctrine that advocates public instead of private ownership of property and natural resources.
- The socialist economy is an exclusively state-controlled and planned economy where the state entirely controls the means of production
- The central idea of socialism is that key industries and resources—such as land,

factories, natural resources, and infrastructure—should be owned or regulated by the state or by the community as a whole rather than by private individuals

- The socialist model is welfare-oriented and seeks to ensure a fair distribution of economic opportunities and benefits within society
- It advocates the principle that people contribute according to their abilities and receive according to their needs.
- Furthermore, socialism rejects the concentration of wealth in the hands of a few and promotes a more equitable economic structure
- Unlike capitalism, which emphasizes private ownership and profit-making, socialism prioritizes social welfare, cooperation, and the common good.
- Socialism is characterized by collective or public ownership; economic planning; equality and social justice; welfare statedemocratic control; reduction of exploitation so on and so forth.
- Socialism has several advantages such as reduction of economic inequality; social welfare and human development; economic security; prevention of exploitation; planned development; promotion of cooperation etc.
- While socialism offers numerous advantages, it also has limitations and criticisms. Lack of economic efficiency; reduced individual incentives; bureaucratic hassles; limited consumer choice; risk of authoritarianism; greater financial burden on the state etc.

5.9 FURTHER READING

1) Harrington, Michael. *Socialism: Past & Future*. Penguin Publishing, 1989.
2) Huberman, Leo & Paul M. Sweezy. *Introduction to Socialism (Including "The ABC of Socialism")*. Aakar Books, 2010.
3) Newman, Michael. *Socialism: A Very Short Introduction*. Oxford University Press, 2nd ed. 2020.

5.10 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: The primary aim of Socialism is to eliminate inequalities by serving human needs.

Ans. to Q. No. 2: The principle of 'from each according to his ability, to each according to his deeds' best represents the socialist belief about the distribution of goods and services.

Ans. to Q. No. 3: According to Socialism the state or the community should collectively own the means of production.

Ans. to Q. No. 4: Socialism seeks to establish a classless society without rich–poor discrimination.

5.11 MODEL QUESTIONS

Short Questions (Answer in about 150 words)

Q 1: What is meant by Socialism?

Q 2: What is the main principle of Socialism?

Q 3: Briefly explain the role of state in socialism

Long Questions (Answer in about 300-500 words)

Q 1: Explain the features of socialism

Q 2: Discuss the merits and demerits of socialism

Q 3: Discuss the evolution of socialism.

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UNIT 6: RESOURCE ALLOCATION AND INCENTIVES UNDER SOCIALISM

UNIT STRUCTURE

6.1 Learning Objectives
6.2 Introduction
6.3 The Problem of Allocation of Resources Under Socialism
  6.3.1 Methods of Allocation Under Socialism
  6.3.2 Principles of Allocation Under Socialism
6.4 The issue of Incentives Under Socialism
  6.4.1 Different Kinds of Incentives Under Socialism
  6.4.2 Role of Incentives Under Socialism
  6.4.3 Limitations of Incentives Under Socialism
6.5 Let Us Sum Up
6.6 Further Reading
6.7 Answers to Check Your Progress
6.8 Model Questions

6.1 LEARNING OBJECTIVES

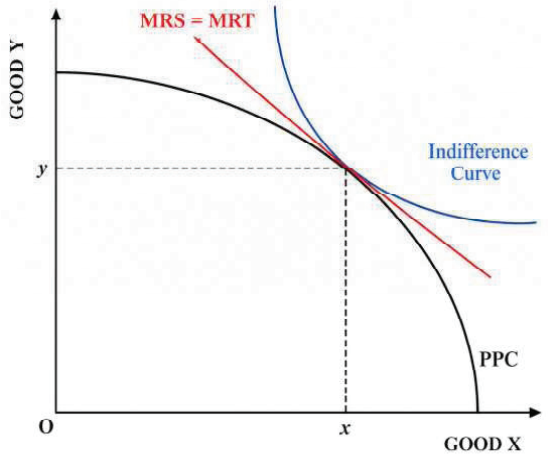
After going through this unit, you will be able to:

- understand and explain the problem of resource allocation under socialism,
- describe the methods and principles of resource allocation under socialism,
- analyse the concept of incentives under socialism by identifying the different types of incentives
- evaluate the role of incentives in socialist economies,
- critically examine the limitations of incentives under socialism.

6.2 INTRODUCTION

The problem of resource allocation lies at the centre of economics. The problem of allocation arises because the resources i.e. land, labour, capital (and organisation) – are scarce while human wants are virtually unlimited. Every society—whether capitalist, socialist, or mixed—must, therefore, decide how best to allocate its limited resources among competing uses. It, thus, gives rise to three fundamental questions viz. *what to produce* (i.e. which goods and services should be produced and in what quantities), *how to produce* (i.e. what combination of resources and technology should be used, for example, whether it should be capital intensive or labour intensive), and *for whom to produce* (i.e. how should the output produced be distributed among members of the producing community or society). These three questions, together, define the core problem of allocation in any economic system.

Notably, the answer to these questions depends on who owns the resources—whether they are owned by individuals, the community, society, or the state. The standard economic theory tries to answer these questions by making some important assumptions regarding this. For simplification, it is commonly assumed that the resources are owned by the individuals with well-defined property rights who try to maximise their self-interests. Further, it is also assumed that at a given point of time the production technology remains unchanged. Under these assumptions the resource owning individuals can gain maximum by allocating the resources to the production of those goods and services which are most demanded by the consumers. Clearly, this situation will maximise the gains for both consumers as well as producers. In technical terms, this condition i.e. the combination of goods produced perfectly matches consumers' preferences – is referred to as the "Efficiency in Product Mix" or simply "Allocative Efficiency" where the Marginal Rate of Substitution (MRS) in consumption equals the Marginal Rate of Transformation (MRT) in production. Evidently, at this point the slopes of the Production Possibility Curve (PPC) and the Indifference Curve (IC) become equal. Evidently, this denotes the point where the Production Possibility Curve (PPC) just touches the highest possible Indifference Curve (IC) as shown in the diagram below:



It may, however, be noted that the assumptions undertaken while arriving at this condition suggests that it holds good in an economic system which is characterised by individual or private ownership of resources where individuals have full information as well as freedom to pursue their respective self-interests through working of the forces of demand and supply within the institution of perfect market. Here the prices of goods and resources play the coordinating role leading to the most efficient allocation of resources; and any short fall or over supply are brought back to the equilibrium via price mechanism which is commonly assumed to be flexible. It may be underlined that such an economic system is broadly termed as *capitalism*.

In socialism, however, this mechanism does not work. This is because the essential assumptions required are not full-filled under socialism. Therefore, the problem of resource allocation under socialism requires altogether a different approach and treatment. In the next section we will discuss this issue in greater detail.

6.3 THE PROBLEM OF ALLOCATION OF RESOURCES UNDER SOCIALISM

Socialism, as an economic system, differs fundamentally from capitalism with regard to the ownership and control of productive resources. Generally speaking, in socialism, the principal means of production are owned and controlled collectively rather than privately. For example, in socialism land is owned by the state or by collective institutions such as communes and cooperatives; private ownership of land may be totally abolished or extremely restricted. Likewise, factories, machinery, mines, transport systems, banks, and other major productive assets are typically owned by the state, worker cooperatives, or society as a whole. Private ownership of large-scale capital is either prohibited or severely limited under socialism.

Unlike land and capital, labour, however, cannot be owned by society because it is inseparable from the individual. In a socialist system, workers retain personal freedom and rights, but the state often plays a major role in allocating jobs, setting wages, and organising production. The common feature of socialism, thus, is the social ownership of major productive resources and the rejection of private ownership as the dominant organising principle. This ownership structure fundamentally alters the conventional assumptions used in economic theories of resource allocation giving rise to a peculiar problem of allocation under socialism.

Noticeably, absence of private property under socialism also implies that there is no private profit which is to be maximised by the individuals. Besides, the role of market and exchange remain highly limited and, consequently, the equilibrium can't be arrived at through the freely operating price mechanism.

Under such a situation, the problem of allocation becomes a problem of social optimisation which is to be resolved through a set of collective actions. The state, in this case, has to play the key coordinating role in achieving the specific social goals. Thus, allocation under socialism becomes linked to social priorities rather than market profitability. It is, however, important to note that question of profit is not necessarily entirely ignored under socialism. Contrarily, many socialist economies often refer to the issue of profitability. Here, the fundamental point is that the socialist economies use profit as an indicator of efficiency and productivity, rather than the ultimate objective of the economy which is to be maximised. In short, the problem of resource allocation under socialism is about how collectively owned resources should be allocated to achieve society's objectives in the most efficient and equitable manner. This is commonly referred to as the "socialist calculation problem" or the "problem of economic coordination" under socialism. Various approaches have been proposed to address this issue, which are discussed below.

CHECK YOUR PROGRESS

Q. 1: Why does the problem of resource allocation arise in economics?

Q. 2: What are the three fundamental questions of resource allocation?

Q. 3: What is allocative efficiency? Why does the market mechanism fail to allocate resources under socialism?

6.3.1 Methods of Allocation under Socialism

In socialist economies, in place of a market, a central planning authority serves as the principal coordinating institution in allocating society's scarce resources for achieving a set of socially desirable goals. The central planning authority first collects all possible information on the availability of natural, physical and financial resources, existing production capacity, supply of labour, technological capabilities, needs of the consumer, and tries to prioritise the country's broader development requirements. Based on the information available, the planning authority prepares a comprehensive economic plan that determines kind and volume of goods and services to be produced, the locations of their production, the allocation of resources across different sectors of the economy, and the distribution of the output produced. As the part of the planning process, enterprises are assigned specific production targets along with corresponding allocations of labour, capital, raw materials, and other essential inputs. In this way, central planning replaces the market mechanism as the primary means of coordinating economic activity. Unlike the spontaneous interactions of demand and supply in case of the market, central planning under socialism seeks to achieve the allocative efficiency through a series of deliberate, systematic, objective and coordinated decision-making in pursuit of society's economic and social objectives.

The central planning, thus, assumes several functions under socialism. It decides the national goals and sectoral targets, allocates resources across sectors and industries, mediates and coordinates the investments, maintains the macro-economic stability and acts towards long term growth and development in the economy. Although central planning can mobilise resources rapidly and is capable of achieving strategic objectives, it may also face some challenges such as information constraints, bureaucratic inefficiencies and bottle-necks, limited incentives, and difficulties in responding quickly to changing consumer preferences.

Notwithstanding, central planning is not a uniform system across the socialist economies; it can assume different forms depending on the institutional and political context. For example the erstwhile Soviet Union practiced a "directive or command planning" where everything was decided by the central planning authority, and the decisions were to be followed up and implemented by the constituent units without having much autonomy. Contrary to this, central planning can be indicative, providing non-binding broad national goals, objectives and strategies; thereby allowing the sectors and units to operate with significant flexibility and autonomy so log their functions remain consistent with the stated national goals, objectives and strategies. France, for example, tried this kind of indicative planning after the Second World War, though the economy was not fully socialist. Under the decentralise planning the planning authority is shared between the central government and individual enterprises or regional governments. Important planning decisions remain flexible; enterprises have greater autonomy in production and investment decisions; while the central planning authority commonly oversee the consistency of the decisions with the national goals and objectives. Yugoslavia, for example, adopted a distinctive model of decentralised planning during 1950s till 1970s. Market socialism is yet another form of socialist planning that combines social ownership of the means of production with the principles of market mechanisms for allocating

most of the goods and services. Here prices continue to play an important role, while the state retains the ownership or control of key industries and most of the economic decisions. China is following this form of socialist planning since the economic reforms initiated in 1978. In short, resource allocation under socialism is fundamentally characterised by collective ownership of means of production coupled with the objectives of social welfare, equality, and mediated by planned coordination.

6.3.2 Principles of Allocation under Socialism

It is also important to recognise that socialist planning is guided by a set of normative principles that shape its objectives and decision-making. For example, socialist planning attempts at allocating the scarce resources according to the social needs. It also intends to maximise the social welfare rather than individual gains. It prioritises the collective interests over personal ones. It aims at achieving the ideals of equity, social and redistributive justice and full employment. It focuses on long term development and sustainability rather than short term regimes of high growth.

Thus, a distinct normative consideration serves as the guiding principle of socialist planning and resource allocation. Normative consideration refers to making economic decisions on the basis of ethical values, social ideals, and moral judgments rather than simply relying on objective criteria like market prices, profitability or efficiency. The objective criteria are, no doubt, important but can't be the sole principles of economic decision making. Economic decisions require certain value judgments regarding justice, equality, fairness, and social welfare if they were to ensure improved quality of life for the people. Consequently, socialism seeks to allocate resources according to ethical principles rather than individual gains and profitability. Decisions about education, healthcare, housing, pensions, environmental protection, and social security are based on what society considers desirable and equitable. Thus, socialist planning for resource allocation is fundamentally guided by normative principles of social goals than private market outcomes. Notwithstanding, several modern socialist economies, now a days, tend to combine both normative planning and market mechanisms, reflecting increasing efforts to balance efficiency with equity and social justice.

CHECK YOUR PROGRESS

Q. 4: What is central planning? Explain its role in resource allocation under socialism.

Q. 5: What is meant by normative consideration in socialist resource allocation?

6.4 THE ISSUE OF INCENTIVES UNDER SOCIALISM

Incentives are factors which encourage (or discourage) people, firm or organisation to work in a particular way. In positive sense, incentives are rewards that motivate the various economic agents and actors to work more and with greater efforts. In negative sense, these

imply penalties that deter the economic agents and actors from doing certain works. Depending on the context, incentives can be of different types such as sense of duty, love for society, religious beliefs, patriotism or nationalism, desire for reputation, sense of sacrifice, job-satisfaction, higher earning, attainment of power so on and so forth. In most of the times, not one but many factors together determine whether more or less work will be performed by the various economic actors.

In a free market economy, most of the economic agents are motivated by their self-interest and private gains. As the free market is assumed to guarantee the maximum private gain for the economic agents, it serves as the most important incentive under such an economy. A capitalist economy, therefore, believes that of all motives, private profit is the most permanent and most powerful incentive that will ultimately bring the very best in individuals as labourer, farmer, investor or industrialist. It will be, however, incorrect to say that the private profit is the only incentive under capitalism. Other incentives like creative joy of innovation, joy of competition, trilling accomplishment in overcoming new challenges etc. can very well motivate individuals in a capitalist economy. But it is commonly understood that the pursuit of private profit is the most important and pervasive incentive among all the possible incentives under capitalism.

In socialism, issue of incentive is one of the most debated issues in economic theory. In absence of private property, there is hardly any private enterprise under socialism, and consequently, there is only limited scope of private profit. This raises an important question: what motivates individuals, enterprises, and institutions to work efficiently, innovate, and improve productivity in a socialist economy? In fact, socialism is heavily criticised on ground of limited incentives for individuals to perform. If there is no individual gain, everyone gets equalised share of the total benefits than there is a possibility of having the problem of free-ridding. A free-rider problem is a situation in which people enjoy the benefits of a good or service without contributing proportionally and fairly. In absence of private gains and personal interests, do socialist economies offer sufficient motivation and enough scope of involvement to the individuals and enterprises? This leads us to the questions whether socialism has any incentive, and if yes, what are the different kinds of incentives.

6.4.1 Different Kinds of Incentives under Socialism

Unlike capitalism, socialist economies usually combine three sets of incentives viz. moral, social and material. Moral incentives are based on the assumption that individuals derive satisfaction from serving society and participating in nation-building. Moral incentives appeal to an individual's sense of social responsibility rather than private gains and rewards. Common moral incentives include recognition for outstanding work, public appreciation and awards, medals and honorary titles, patriotic appeals, pride in contributing to national development, commitment to collective welfare and so on. Moral incentives work best when there is an ideological commitment towards collective good which is the hallmark of socialism.

Social incentives, on the other hand, imply the collective benefits that improve the quality of life and contribute to the welfare of the individuals. For example free education,

free and universal healthcare, common childcare facilities, paid maternity leave, job security, affordable housing, recreational facilities, guarantee of cultural identity, subsidised public transport, guaranteed pensions are some important social incentives which provide a sense of security to all sections of the society and thereby ensures social equity and justice. When most of the day to day needs of life are taken care of individuals can contribute fully to the productive work and this, in turn, assures productivity. Social incentives, thus, enhances the individual quality of life and provides motivation through greater sense of social security and belongingness. They also promote long term goals of improving productivity as well as securing distributive justice.

Material incentives provide tangible economic rewards to individuals for better performance and efforts. Although socialist economies are characterised by absence of private gains or profit in general, it does not mean that material incentives are totally absent under socialism. Under socialism, certain kinds of material incentives prevail; however, their nature is different from those under capitalism. At the same time the degree of material incentives can vary according to the kinds of socialism. The common material incentives under socialism include productivity-linked bonuses, piece-rate payment systems, performance-linked bonuses, profit-sharing schemes within state enterprises, better working conditions and workplace facilities, higher wages for skilled workers etc. Many socialist countries, including the former Soviet Union, Hungary, and China during different periods, increasingly relied on material incentives to improve productivity and efficiency of the individual economic agents.

6.4.2 Role of Incentives under Socialism

Generally speaking, incentives have limited role under socialism. This is because individual economic agents are, more or less, obliged to act according to their given goals and targets decided by the central planning authority whether there is any incentive or not. In command economies, individuals are compelled to following the mandate of the planning authority while in market socialism they have their freedom and autonomy to some extent. Therefore, the role of incentives depends on the kinds of socialism that prevails. But in all forms of socialism moral and social incentives provide both ideological ground and political legitimacy to socialism as an economic system. These incentives encourage workers to put in greater effort, improve efficiency, and reduce absenteeism, thereby increasing overall productivity. Performance-based rewards motivate workers and enterprises to produce greater volume and better quality goods. Likewise, rewards for technological improvements can stimulate innovations. Higher wages, promotions, and career advancement encourage workers to acquire new skills and improve their qualifications. Collective incentives encourage teamwork and cooperation. Essentially, different kinds of incentives encourage individuals and enterprises to achieve or exceed planned targets under socialism. The basic difference between the socialist and capitalist incentives is that socialist incentives are anchored to collective goals and planned targets while the capitalist incentives are more concerned with the maximising the private gains.

CHECK YOUR PROGRESS

Q. 6: What is the free-rider problem in a socialist economy?.

Q. 7: Explain the role of incentives under socialism?

6.4.3 Limitations of Incentives under Socialism

Despite their important role, incentive systems in socialist economies continue to be limited, though they vary widely across different kinds of socialism. This limitation stems from rather weak connection between the individual efforts and motivations derived from the various incentives that prevail under socialism. Since socialist economies, though central planning can compel individuals and enterprises to deliver according to the national goals and target, role of incentives remain in consequential in most cases. Moreover, moral and social incentives alone may not be sufficient to sustain productivity over the long term. Equal rewards and remuneration structures under socialist system may discourage highly skilled and productive workers to put in extra efforts and deliver more. Further, fixed allocation of resources often hinders enterprises ability to innovate and improve efficiency. Excessive pressure to meet the plan target can also result in productive inefficiency. Due to these shortcomings many major socialist economies eventually resorted to series of economic reforms. For example, in the Soviet Union, reforms such as Perestroika, and in China, broader market-oriented reforms, sought to strengthen material incentives, expand enterprise autonomy, and introduce market mechanisms to improve efficiency, productivity, and overall economic performance. It is, thus, evident that the socialist incentives play a supportive rather than a decisive role in influencing economic behaviour of individual economic agents and actors and this limits their role in the functioning of the economy.

6.5 LET US SUM UP

- Resource allocation is the central economic problem in every society and it refers to the process of distributing scarce resources (land, labour, capital and organisation) among competing uses.
- In typical economic analysis allocative efficiency occurs when resources are used to produce the combination of goods and services most preferred by society.
- Under socialism, however, resources are allocated mainly through central planning instead of market forces as social ownership replaces private ownership of the major means of production.
- The main objectives of the socialist planning are social welfare, equality, distributive justice and long-term development.
- Socialist planning is guided by normative principles based on ethical and social values.

- Incentives are factors that encourage or discourage individuals and organisations to work. They may be positive (rewards) as well as negative (penalties). Incentives under socialism are mainly moral, social and material.
- Incentives help improve productivity but play a limited role because economic activities are largely guided by planning.
- Weak motivation, free-rider problems and limited innovation are important limitations of socialist incentive systems.
- Many modern socialist economies, thus, combine planning with market mechanisms to improve both efficiency and social welfare.

6.6 FURTHER READING

1) *Economic Systems* by S S M Desai & Nirmal Bhalerao, Himalaya Publishing House (4th ED), 2015

2) *Fundamentals of Economic Systems* by V G Mankar, Himalaya Publishing House (1st ED), 1992

3) *Comparative Economic Systems* by K K Sen, S Chand & Sons, 2003

4) *Comparative Economic Systems* by W N Loucks & J W Hoot, University of Pennsylvania, 1949

6.7 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: The problem of resource allocation arises because resources such as land, labour, and capital are scarce, whereas human wants are unlimited. Since society cannot produce everything that people desire, it must decide how to use its limited resources efficiently. Consequently, every economic system has to answer three basic questions: what to produce, how to produce, and for whom to produce.

Ans. to Q. No. 2: The three fundamental questions of resource allocation are:

What to produce? – Deciding which goods and services should be produced and in what quantities.

How to produce? – Determining the combination of resources and technology to be used, such as labour-intensive or capital-intensive methods.

For whom to produce?– Deciding how the goods and services produced should be distributed among members of society.

Ans. to Q. No. 3: Allocative efficiency refers to a situation where resources are allocated in such a way that the combination of goods and services produced perfectly matches consumers' preferences. In economic theory, it occurs when the Marginal

Rate of Substitution (MRS) equals the Marginal Rate of Transformation (MRT). At this point, the Production Possibility Curve (PPC) is tangent to the highest attainable Indifference Curve (IC), indicating maximum social welfare under the given assumptions.

Ans. to Q. No. 4: Central planning is a system in which a central planning authority, rather than the market, makes decisions regarding the allocation of scarce resources in the economy. The planning authority collects information on available resources, production capacity, labour, technology, and consumer needs, and prepares a comprehensive economic plan. It determines what goods and services are to be produced, in what quantities, where they should be produced, and how resources and output should be distributed. Thus, central planning coordinates economic activity to achieve social welfare, equity, and long-term development objectives.

Ans. to Q. No. 5: Normative consideration refers to making economic decisions based on ethical values, social ideals, and moral judgments rather than solely on market prices, profitability, or efficiency. In socialism, resource allocation is guided by objectives such as social welfare, equity, justice, full employment, and sustainable development. As a result, decisions relating to education, healthcare, housing, and social security are made according to society's collective needs and values rather than private profit.

Ans. to Q. No. 6: The free-rider problem is a situation in which individuals enjoy the benefits of goods or services without contributing proportionately to their production or cost. In socialism, where private profit is limited and benefits are often shared collectively, some individuals may have less incentive to work harder, expecting to receive the same rewards as others. This can reduce productivity and efficiency.

Ans. to Q. No. 7: Incentives under socialism play a supportive role by motivating individuals and enterprises to improve productivity and achieve planned targets. Moral and social incentives promote commitment to collective welfare, while material incentives encourage better performance, skill development, innovation, teamwork, and higher efficiency. However, their role is generally less significant than in a capitalist economy because production decisions are largely guided by central planning.

? 6.8 MODEL QUESTIONS

Q.1: Why does the market mechanism fail to allocate resources under socialism?

Q.2: Explain the problem of resource allocation in economics and discuss how allocative efficiency is achieved?

Q.3: Discuss the problem of resource allocation under socialism. How does it differ from capitalism?

Q.4: Distinguish between directive planning and indicative planning in socialist economies.

Q.5: Explain the methods of resource allocation under socialism. Discuss the various forms of central planning with suitable examples.

Q.6: Discuss the principles of resource allocation under socialism. How do normative considerations influence economic decision-making in socialist economies?

Q.7: What is meant by incentives? Briefly explain the different types of incentives under socialism.

Q.8: Mention any four limitations of incentives under socialism.

Q.9: Discuss the issue of incentives under socialism. Explain the different kinds of incentives available in a socialist economy.

Q.10: Examine the role of incentives under socialism. How do socialist incentives differ from incentives under capitalism?

Q.11: Critically discuss the limitations of incentives under socialism. Why did many socialist economies introduce reforms to strengthen incentive systems?

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UNIT 7: MIXED ECONOMY

UNIT STRUCTURE

7.1 Learning Objectives
7.2 Introduction
7.3 Mixed Economy
    7.3.1 Meaning
    7.3.2 Rationale behind mixed economy
    7.3.3 Characteristics of mixed economy
    7.3.4 Present status of mixed economic system
7.4 Merits & Demerits of Mixed Economy
7.5 Let Us Sum Up
7.6 Further Reading
7.7 Answers to Check Your Progress
7.8 Model Questions.

7.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- develop an idea about the concept of mixed economy
- analyze the features of mixed economic system
- relate mixed economy with Capitalism and socialism
- trace out the factors responsible for emerging mixed economy
- explore the present status of mixed economy as an economic system
- critically find out the merits and demerits if mixed economy.

7.2 INTRODUCTION

In previous units we already have discussed about various economic systems including capitalism and socialism. This unit focuses on a very realistic economic system, viz. mixed economy which is comparatively a new one. In the classical writings of political economy, the mixed economic system was not familiar like capitalism or socialism. As suggested by the name, it is a combination of two prominent sectors of an economy, i.e., public sector and private sector. The concept of mixed economy has emerged during the second/third decade of the nineteenth century. While implementing one specific type of economic system either capitalism or socialism, countries were experiencing some remarkable shortcomings with their system. That has resulted in the search for a new alternative economic order. In fact, two historical events, viz. the World War –II, the Great Depression and the General Theory of J.M. Keynes – these three are considered as the responsible factors of emerging mixed

economic system. In capitalist countries like England, France, etc. public sector made its way open after the publication of Keynes' General Theory in where he advocated for such policy matters. Basic industries like coal, iron & steel, etc. were nationalized in England and France. India and some other third world countries attained freedom from colonialism and tried to follow a strong-sound but comparatively liberal economic system so that they can address their problems of capital deficiency, lower income, unemployment, mass poverty and backwardness . Thus, a combination of freedom and intervention accepted as a suitable economic system which is called the mixed economic system.

7.3 MIXED ECONOMY

7.3.1 Meaning

The Encyclopedia Britannica defines: "Mixed economy, in Economics, a market system of resource allocation, commerce and trade in which free markets coexist with government intervention". Elaborating a little more the Oxford Dictionary of Economics defines: "Mixed Economy is an economy with a mixture of state and private enterprises. Some economic activities are carried on by individuals or firms taking independent economic decisions, coordinated by markets; others are carried on by organizations under state ownership and control, with some degree of centralized decision-taking". In 'Investopedia', the definition given in the following words: "A mixed economic system is a system that combines aspects of both capitalism and socialism. A mixed economic system protects private property and allows a level of economic freedom in the use of capital, but also allows for governments interfere in economic activities in order to achieve social aims." Thus, "Mixed Economy or Mixed Economic System came to be evolved as an economic system combining some features of capitalism and some of communism that would avoid the defects of both capitalism and communism, while at the same time combining merits of both e.g., combining the efficiency of capitalism on account of the powerful incentive of personal profit motive, ability to the people to take risk to make higher profits, their inventiveness and so on with merits of communism such as systematic and planned use of community's resources with a view to achieve maximum social welfare, avoidance of wastages of resources, avoidance of economic fluctuations with the aid of economic planning, guarantee of employment and minimum standard of living to all, absence of a class of people living on unearned incomes, greater equality in the distribution of income and wealth and so on"(Desai, S.S.M, pg. 45).

7.3.2 Rationale Behind Mixed Economy

As discussed in the earlier units, capitalism was practiced by different countries in Europe as a natural economic system without any alternative for quite a long period of time. There were loopholes in that laissez fair system. As there was absolute freedom of the producers and consumers, resources were not utilized for the betterment of the masses,

rather, there was misdirection and misuse of community resources. There was excessive use of monopoly power, exploitation of the worker class, no government intervention towards curbing income inequality or redistributing the wealth for the sake of welfare in the society which resulted in underutilization of resources and unemployment, cyclical fluctuation, depression and economic crisis. Some of such defects of capitalism were pointed out too by a few socialist economists of the early 19th century, but no other concrete system emerged as an alternative to capitalism for long.

The socialist thoughts of Karl Marx and the October Revolution of 1917 in Soviet Russia which was also influenced by his thoughts created an era of a new economic order, viz., the socialism. This new system said to be a believer of socio-economic equality. There was no market freedom and resources were allocated by the central authority. In other words economic power was concentrated with the central planning authority or in the hands of a few planners-policy makers- bureaucrats as it was concentrated with some powerful industrialists-capitalists in the regime of capitalism. It was also pointed out that socialism could not satisfy the needs and requirements of the people and there was no incentive to work more for improving the living conditions of the people. Over all the system has been criticized to be an inefficient, inflexible and unstable one.

Thus, there were debates and disagreements, conflicts and criticisms amongst the supporters and opponents of these two economic systems. This has led to a middle path in between these two by amalgamating the merits and thereby avoiding the demerits of these two systems. After observing the fatal consequences of the great depression of 1929-33 and experiencing the economic tumble of the World War II, most of the European capitalist countries realized the need for state regulations. In the mean time John Maynard Keynes entered in to the field with his new policy prescription of state intervention. Gradually, the USA, the UK, France, Germany and many others started having public sector, some sort of economic planning, and comprehensive welfare schemes, etc. by bringing drastic changes towards their own capitalistic characteristics. Though, this new change was named as managed capitalism or modern capitalism, it was nothing but a blending of capitalism with some elements of socialism, i.e. the mixed economic system. Russia being the prime mover of socialistic economy remained the same till the last decade of the twentieth century. Now it is a follower of mixed economy. One of the advantages of mixed economy is that it goes hand in hand with political democracy. Therefore, countries with its democratic nature and values find it compatible to work with the framework of mixed economy.

7.3.3 Characteristics of Mixed Economy

As there is co-existence of both capitalism and socialism the mixed economic system combines most of the basic elements of these two systems into its features. However, the degree of coexistence may differ from country to country. Constitutional provisions, legal acts, government's policy resolutions, etc. are means for distinguishing ownerships of resources and operational jurisdictions between public and private sectors. Some of the common characteristics of mixed economy are stated below:

1. Public and Private sectors:

There is co-existence of both the public or government sector and private sector in such an economic system. They do not have any rivalry rather they have mutual understanding and behave like partners in the development process of an economy. It is necessary to have cooperation between these two sectors for sustainability of the mixed economic system. In fact, the basic objective of a mixed economic system is to ensure growth and development from the coordination of these two sectors. Generally, in such a system, areas of ownership and operation in between the public and private sectors are clearly defined by the authority. Public sector's ownership and operational management is rests with the government. On the other hand, in private sectors individual or joint operators may possess the ownership and management rights. However, the private sector is regularly monitored by the government authority. The government issues instructions, gives directions and controls operational activities whenever necessary.

2. Economic Planning:

Economic planning is said to be an integral part of mixed economic system as it includes the features of socialism. However, it is not a totalitarian planning which is commanded from the central authority. The planning is carried out for the public sector. For example, in India, the Planning Commission was constituted in 1950 to conceive and carry forward the five-year planning process throughout the country. Accordingly, all together twelve five- year plans and several annual plans were implemented for the development of the country. In that process of planning private sectors were manipulated to act like a support system for the government sector. Planning under mixed economy aims at eliminating conflicting issues in relates to intentional attitudes of private and public sectors.

3. Exclusive monopoly of the government:

In some follower countries, certain sectors are kept under the exclusive jurisdiction of the state monopoly. The Government of India through its 1948 Industrial Policy Resolution classified the industries into several groups on the basis of ownership rights and operational powers. Accordingly, certain sectors like atomic energy, arms & ammunitions, railways, etc were kept reserve for exclusive monopolies of state. This is done with an objective to safeguard the national security and to exercise the monopoly power for the benefit of the society as a whole.

4. Government's Intervention:

It is the government intervention that makes mixed economy a pro-people economic system. The government uses its monetary and fiscal policies to control private sector. It may also exercise direct controls over some public utilities so that common people can have the accessibilities of their minimum needs. Government intervenes in markets in fixing prices of necessary items. In India, there is Public Distribution System through which goods like rice, sugar, etc. are distributed to the below poverty line people at controlled prices through fair-price shops. The government also provides subsidy to support beneficiary groups like farmers or women or people of the lower income group.

5. Workings of Market Mechanism:

Mixed economy contains the elements of capitalism. Therefore, market has the sovereignty to determine prices of goods and services. Market mechanism acts actively as producers, workers, and consumers, etc. all have freedom of choice and can move accordingly. But, the workings of markets are continuously monitored by the government authority. There are provisions of law to check market actions. Government may categorize goods into several groups, like merit goods, demerit goods and so on and puts rules and regulations in terms of production and consumption of such goods. For example, government controls consumption of cigarettes, alcohol and other such goods by imposing taxes on those goods.

6. Element of Profits and Social Welfare:

Private sectors are always run on the profit motive. On the other hand government's intention is to render services towards the society and public. The policy makers or the government authority intends to curb monopoly profit and therefore enacts law and order rules restricting monopoly practices by the private sectors. Government from time to time defines the areas of production and practices and maintains certain vicinity under the jurisdiction of its own monopoly power. The government strategically uses its power of market intervention so that there remains enough scope to earn profits by the private sector and simultaneously the welfare in the society increases.

7. Possibility of Existence of Joint Sector:

Besides the private and public sectors there may be a joint sector too in a mixed economy. In that case, joint sector may share its ownership and operational management with both the public and private sectors. Generally, in a joint sector, the share of public sector is large than the private sector. India's 1956 Industrial Policy defined the joint sector at 'Schedule B' to be progressively owned by the state. States were to facilitate the private sector industries in the line of second five year plan's objectives so that the private sector would get the opportunity to develop. Authority may define the regulations and amend the same from time to time regarding the existence of joint sector.

There is another model of joint sector, viz., Public-Private Partnership model popularly called the PPP model. This contemporary concept indicates private and public collaboration involving private capitals for financing government projects. Responsibilities at different stages are shared as per the agreed terms and conditions between the two sectors.

8. Existence of Co-operative sector:

Under mixed economy there may exist another unique sector called co-operative sector. This sector exists in almost all countries. It may involve production, procurement, warehousing, and marketing, etc. and may extend to several areas like agriculture, industry, construction, banking and so on. Normally, government provides structural framework, endows with financial helps to this sector and keeps vigilance on workings of the cooperatives. In other words, the cooperative sectors works under the supervision of the government authority. However, this structure may vary from country to country.

CHECK YOUR PROGRESS

Q 1: State whether the following statements are True (T) or False (F):

(a) There is coexistence of market mechanism and government intervention in mixed economy.

(b) Mixed economic system includes totalitarian planning.

(c) In a mixed economic system only the government can practice monopoly power.

Q. 2: Define mixed economy.

Q. 3: Is it possible to increase social welfare under mixed economic sector?

7.3.4 Present Status of Mixed Economic System

At present, mixed economy is visible almost in all countries. The strategy followed by countries may be different from one to another. There may be partial state control where the government plays only a role of regulator and private sectors are allowed to own the factors of production. In most of the Asian countries including India, both the government and private entities share the ownership of resources, production and markets. Government also keeps the regulatory powers of several degrees with itself. Historical factors, political features, environmental elements and socio-cultural perspectives etc all are responsible for shaping the mixed economic character of the countries.

Here is a glimpse how the developed and developing countries of west and east are practicing mixed economy. Despite its capitalistic identity all over the world, the United States of America provides services to people in areas like education, health and so on as per its mixed economic characteristics. It possesses the constitutional provision for mixed economic system which simultaneously encourages the government to adopt measures for promoting social welfare in one side and on the other hand limits government's intervention in market operation. Canada's economy has also a similar pattern with mixed economic system. There is the coexistence of both the private and public sectors, though the scope of the later is less. There is private investment, free trade and government intervention too.

The United Kingdom is a follower of mixed economy where private sector is involved in most activities, but, the government provides essential services like heath care along with many other welfare services. As a follower of mixed economic system, Germany provides market freedom along with central economic planning and government regulation. Not only the U.K. or Germany but almost all European countries have transformed their economies to mixed economy by adopting innovative and strategical measures combining private sectors' freedom and governments' regulatory powers. The European Union allows absolutely free market practices along with social safety nets in its internal market.

The Scandinavian countries, viz., Denmark, Finland, Iceland, Norway and Sweden, being the welfare states provide highly secured essential services in different spheres of

people's life and living. The model adopted by these countries is also known as the 'Nordic Model' is a mixed economic model combining both capitalism and socialism.

In Australia, though there is domination of private sector on production and distribution of goods and services, government performs its role of regulator by using several tools like taxation, economic planning and by making provisions for public goods and so on. New Zealand's economy is an open economy based on free market mechanism, but practically characterized with the features of mixed economic system

Singapore, Japan, Philippines, etc all are the followers of mixed economy with state regulation and market mechanism. With liberal capitalistic market economy, Singapore government keeps provisions for social benefits in the fields of health service, education and public housing, etc. The highly advanced Japan's mixed economic model is slightly different from the western countries' model. There exists a planned system with the government, market system and an informal sector which is known as social sector.

The world famous socialist economies, viz., China and Russia are also now recognized as mixed economy. Russian economy was the first constitutionally recognized socialistic economy where the factors of production were under the ownership of the state authority. There were communism, direct planning and state command till the last decade of the twenty first century. That decade was the transitory period for Russia and gradually transformed to a mixed economy after the break-up of the Soviet Union. Now, it is a combination of free market and command economy. Large -scale industries, banks, foreign trade etc are controlled by the state authority. China's mixed economy model is known as "socialist market model". This model that combines free market resource allocation with state's comprehensive regulation is run simultaneously by the three efficient partners: the central government, the local government and the enterprises. Likewise, another socialist country Vietnam's economy is also called socialist oriented market economy which is a mix of public, private and cooperative sector.

Thus, it is clear now that countries at large are presently experiencing mixed economic system by shaping the same as per its own convenience. India's adoption of mixed economic model came into focus through its first Industrial Policy Resolution of 1948 when it declared the coexistence of private and public sector.

CHECK YOUR PROGRESS

Q.4: State whether the following statements are True (T) or False (F):

(a) The Nordic Model is a mixed economic model.

(b) China has never followed the mixed economic model.

(c) At present, Russia is strong follower of socialism without the existence of free market mechanism.

Q.5: Give an outline of the economic system followed in the USA and Canada.

7.4 MERITS & DEMERITS OF MIXED ECONOMY

A) MERIT

i) Freedom of choice:

Though the system does not include all elements of capitalism, mixed economy allows laissez-fair functioning well as there is freedom of choice. There is free choice for the producers, investors, distributors, and consumers at their respective field of economic activities. Producers are free to start any new industry or expand the existing plants in the stipulated areas fixed by the government. State does not force the industrialists to open industries against their willingness. Likewise, investors are also free to invest in profitable projects. Consumers are free to save or spend at their places of choice. Thus, it creates an environment of freedom where everyone feels comfortable. The significant part of this kind of freedom is that it is enjoyed by everyone under the justified regulations of the state authority.

ii) Proper allocation of resources:

Under mixed economic system, resource ownership is shared between the private and public sector. The private sector allocates resources on the basis of market demand. So, goods and services are distributed as per the need of the people and wherever they are necessary. As maximization of profit is the prime motive of the private sector, it put emphasis on those sectors only that may earn profitable returns. In that case, some socially desirable sectors are overlooked by the private sector. Government accepts the responsibility of such sectors, like infrastructure building, provision of recreational facilities for public, provision of creation of special amenities for the vulnerable group of the society and so on. Within the public sector also as there is the provision of planning, resources are mobilized from various sources and allocated after thorough survey of shortcomings and requirements at several areas of the economy. Therefore, these are managed and placed in proper manner for their optimum use.

iii) Efficiency in production with innovation:

The producers are free to innovate and adopt any technique suitable for their production. Due to this reason, industries become able to meet the requirements of the customers and in return industries earn profits. Thus the mixed economy brings competition among producers and gives due recognition to the efficient producers. That encourages enhancing the productivity of the economy.

iv) Reduction in income disparity:

Through the efficient monetary and fiscal policies the government redistributes the income and wealth in the economy. By using progressive taxation tools, government collects taxes from the high income groups and reallocates those among the poorer section by the means of public expenditures. Regional disparity and sectoral inequalities are also addressed by the government by implementing economic planning.

v) Social welfare through government support:

Government always keeps an eye on the activities of the private sector. Monopoly practices in the private sphere is strictly monitored and controlled by the government. So, there is less scope of such monopoly exploitation. The problems of price rise or any other crisis like unemployment problem, food insecurity, etc. are addressed through government intervention. Government makes it possible to fulfill the minimum needs of the people by adopting several welfare schemes and implements the same with the cooperation of the private sector by making them partner at the stage of implementation.

B) DEMERIT

i) Unwanted nexus between industry and political power:

It is observed that due to very liberal attitude of the government under mixed economic system, a very cordial relationship is developed between the industry and the government authority. Sometimes this kind of relationship goes against the greater interest of the economy. For example, big industrial houses manage to manipulate the decision making process at the government level to fulfill their own interests. Again, if the large houses have to face any crisis, they may seek to influence the government to bail out them at the cost of public interest. Thus, because of this manipulating nature of their relationship they try to take undue advantage of tax relief, subsidy, marketing assistance, waiving of the bank loan etc. which goes against the social justice.

ii) Mismanagement of the public sector:

Mismanagement, lack of proper attention, misuse of fund, inadequate market, lack of innovation, wrong decision, etc may lead the public sector in to losses and even to close down their entities. For example, India's public sector was very strong at the initial stages. Government's intention was to build a huge public sector for the sake of economic growth and development. But over the period, it has been observed that due to mismanagement, inefficiency and negligence, the public sector failed to play its role in right manner. A large number of public sector industries became sick after incurring heavy losses. Some of those industries were compelled to shut down resulting in huge wastage of financial and other resources. Ultimately, government had to sell off some of those to the private sector.

iii) Excessive control hinders growth:

Excessive government control including complicated licensing policies, tax barriers, rigid terms and conditions on trading, etc hinders the expansion of the private sector which ultimately affects the overall growth of the country. The lengthy process of attaining government permissions or certain certificates related to production, distribution, trading or sanction loans as well as other financial grants from government financial institutions often leads to corruption and spoils the whole system of good governance. Under such situations private honest investors find it difficult to invest capital. Thus, the process of capital formation is obstructed. Again, price control may lead to shortage in supply chain; as a result there may be unwanted hoarding and price rise. This may also create instability in the production system. Even the

system is questioned at the point of sustainability as the Austrian school of Economics said that any government intervention will lead to unintended consequences that may require further intervention.

CHECK YOUR PROGRESS

Q.6: State how the income disparity is reduced under mixed economy.

Q.7: State any two reasons of sickness of public sector industries.

Q.8: Briefly explain how resources are allocated under mixed economy.

7.5 LET US SUM UP

- Mixed economic system is closely related with socialism and communism as the system itself is an assortment of these two system. After experiencing the single system of socialism and capitalism for long, the countries traced out their respective loopholes. To avoid such disadvantages, the idea of blending the merits of these two systems worked out and thus the concept of mixed economy came into existence. The Great Depression of Thirties, the Second World War and the policy prescription of J.M. Keynes altogether worked as pushing factors behind the emergence of mixed economic system.
- Mixed economic system is a combination of capitalism and socialism. In this system there is co- existence of private and public sector, free market and government intervention.
- Basic features of both capitalism and socialism are found in a mixed economic system. In private sector the price mechanism helps in decision making, where as in public sector the government adopts economic planning.
- Like Laissez-fair, producers, investors, consumers, etc. all are free to choose their choice. They have sovereignty at their respective fields of economic activities. However, the government monitors the private sector by using several tools of fiscal and monetary policies.
- The government may bring the demarcation line between private sector and public sector with the help of the constitutional provision or by incorporating certain rules-regulations through its policy resolutions. Thus the ownerships of resources are shared between the public and private sectors.
- Though the economic planning may exists in mixed economy, it is not a totalitarian planning in where the government establishes its command over all the economic activities. Through economic planning governments makes outline for resource mobilization and these are allocated through proper mechanism among the needy

areas of the economy.

- As the public sector believes in profit making it may not enter into some areas in where the interest of the public lies down but not the profit. The development of those areas like education, health services, public housing, public parks, etc. are taken care of by the government sector.
- In classical literature of Economics, the concept of mixed economy was almost absent. But, at present, there are huge numbers of follower countries of mixed economic system. The USA, the UK, the EU countries including France, Germany etc., the Nordic countries, Australia, Japan, Singapore and other Asian countries like China and India are the great followers of mixed economic system.
- Mixed economy possesses certain advantages, such as, efficient and skillful allocation of resources, market freedom with government supervision, efficiency in production with better scope for innovation, reduction of economic disparity among regions and people, possibility of increase in social welfare, and so on.
- Despite all advantages the mixed economic system is criticized due to some of its demerits. The system may be unstable as it spares scopes for private enterprises to grab undue advantages from the government. Besides, too much government control may hamper the economy flourishing in its natural way.

7.6 FURTHER READING

1) Desai,S.S.M, 1986, Economic Systems, Bombay, Himalaya Publishing House.

7.7 ANSWERS TO CHECK YOUR PROGRESS

Ans to Q No 1: (a) T (b) F (c) F

Ans to Q No 2: Mixed economy is a market system of resource allocation, commerce and trade in which free markets coexist with government intervention. It is characterized by the coexistence of public and private sector.

Ans to Q No 3: Yes, it is possible. Government can keep an eye on the activities of the private sector. Monopoly practices in the private sector can be monitored and controlled by the government. The problems of price rise or any other crisis like unemployment problem, food insecurity, etc. can be addressed through government intervention. Government can make it possible to fulfill the minimum needs of the people by adopting several welfare schemes and implements the same with the cooperation of the private sector by making them partner at the stage of implementation.

Ans to Q No 4: a) T (b) F (c) F

Ans to Q No 5: The United States of America is famous for its capitalistic identity. But,

in practice, it provides services to people in areas like education, health and so on like a follower of mixed economy. In fact, it possesses the constitutional provision for mixed economic system which simultaneously encourages the government to adopt measures for promoting social welfare in one side and on the other hand limits government's intervention in market operation.

Canada's economy has also a similar pattern with mixed economic system. There is the coexistence of both the private and public sectors, though the scope of the later is less. There is private investment, free trade and government intervention too.

Ans to Q No 6: In a mixed economy, the government may redistribute the income and wealth in the economy through its monetary and fiscal policies. By using progressive taxation tools, government may collect taxes from the high income groups and reallocates those among the poorer section by the means of public expenditures. Regional disparity and inequalities in various sectors of the economy may also be addressed by the government by implementing economic planning. Thus, disparities at different level can be reduced under mixed economy.

Ans to Q No 7: A large number of public sector industries become sick after incurring heavy losses continuously due to mismanagement. The motto of public sector is to render services rather than earning profits. But, industry cannot survive if they incur losses for long time. So, it is necessary to earn the normal profit for each and every industry whether they are in private or public sector.

Sometimes, lack of sufficient amount of capital also makes the industry sick. Sound financial status is must for the survival of any kind of industry, otherwise they become sick.

Ans to Q No 8: Under mixed economic system, the private sector allocates resources on the basis of market demand. So, goods and services are distributed as per the need of the people and wherever they are necessary. As maximization of profit is the prime motive of the private sector, it put emphasis on those sectors only that may earn profitable returns. In that case, some socially desirable sectors are overlooked by the private sector. Government accepts the responsibility of such sectors, like infrastructure building, provision of recreational facilities for public, provision of creation of special amenities for the vulnerable group of the society and so on. Within the public sector also as there is the provision of planning, resources are mobilized from various sources and allocated as per the survey done on the shortcomings and requirements at several areas of the economy. Therefore, these are managed and placed in proper manner for their optimum use.

? 7.8 MODEL QUESTIONS

Very Short Questions (Answer each question in about 50 words)

Q.1: Distinguish between private sector and public sector.

Q.2: Is it suitable to adopt a totalitarian planning under mixed economy? Give reason for your answer.

Q.3: Why is it wrong to call the US economy as a mere capitalist economy?

Q.4: Is Russia a socialist economy? Clarify.

Q.5: With whom the ownership of public sector industry remains under mixed economic system?

Short Questions (Answer each question in about 100-150 words)

Q.1: State the rationale for mixed economic system.

Q.2: Describe how there may be corruption under mixed economic system.

Q.3: What is modern capitalism? Is it the same as mixed economy?

Q.4: State the factors responsible for emerging mixed economic system.

Q.5: How does the mixed economy work?

Essay-type Questions (Answer each question in about 300-500 words)

Q.1: What is mixed economy? Describe the present status of mixed economic system.

Q.2: Explain the advantages and disadvantages of a mixed economic system.

Q.3: Is it correct to say that the mixed economic system is free from any kind of loopholes? Justify your answer.

Q.4: Write an essay on the mixed economic system.

Q.5: Elaborate the basic features of mixed economic system.

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UNIT 8: MIXED ECONOMY IN INDIA

UNIT STRUCTURE

8.1 Learning Objectives
8.2 Introduction
8.3 Evolution of Mixed Economy in India
  8.3.1 The British Regime
  8.3.2 The Public Sector & Private Sector in India
  8.3.3 Economic Planning
8.4 Working of the Mixed Economy
  8.4.1 Working of the Market Mechanism
  8.4.2 State Intervention
  8.4.3 The Changing Pattern of the Econmy
8.5 The Future of Mixed Economy in India
8.6 Let Us Sum Up
8.7 Further Reading
8.8 Answers to Check Your Progress
8.9 Model Questions

8.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- outline the rationale behind India's mixed economic system
- learn about the working strategy of mixed economy in India through private and public sector
- know the role of economic planning in India's mixed economic system
- discuss about the welfare schemes adopted by the government
- be familiar with the challenges of mixed economy in India
- find out some ways to face the challenges successfully.
- trace out a picture of India with this unique economic system of mixed economy.

8.2 INTRODUCTION

India is well known in the world for its mixed economic characteristic. But, in the preamble of India's Constitution, India is declared to be a "…sovereign, socialist, secular and democratic republic…". All these concepts, however, defined and explained in appropriate manner. Accordingly, the word 'socialist' here is not to refer socialism or communism; rather it indicates

equality and social justice without any discrimination. The word 'socialist' included in the preamble of India's Constitution with an amendment in 1976. Being a democracy, sovereignty was bestowed upon the people. Right to own private property was declared as fundamental right as per the Constitution of India. Thus, without mentioning the word, the country implicated the mixed economic system into its administrative mechanism.

Several factors were found to be responsible for India's being a mixed economy. The colonial rule and its exploitations, India's National movement for independence and thereby various goals and objectives to create an independent nation, the vision and mission of the leaders of the freedom movement, contemporary international scenario of political economy, etc. were the background forces to bring mixed economy in India. The British colonial rule for almost 200 years (1757-1947) resulted in a very miserable economic condition with low productivity, lower income, inequality and thereby economic backwardness. The areas of infrastructural growth, industrialization, health-education and other socio-economic development were neglected. Hence, it was the need of the hour to look after those areas by the government with the help of people's participation.

As a follower of mixed economic system, Indian economy is characterized by the coexistence of public and private sectors. However, the government draws the demarcation line between these two with the help of legal as well as administrative rules and regulations. The government also keeps the provision of controlling the private sector. That does not mean the government is not allowing or not encouraging the economic activities at private sector. Rather, gradually, government is becoming liberal towards the private activities. The government has gone through a paradigm shift during the last decade of the twentieth century from planned to a globalised liberal economy. However, the government has kept certain sector consisting of education, health and other areas of community welfare with itself keeping in mind the overall development of the economy. The government invests in these areas and spends huge amount in implementing schemes in these sectors. For example, it has SSA (Sarba Shiksha Abhiyan), mid-day meal, various students' scholarship schemes at various level under education, NHM(National Health Mission), comprehensive health insurance scheme, Swasthya Bima Yojana, etc under Health & Family welfare sector , schemes for pure drinking water-electrification-old age pension, food security schemes, and so on so forth. Almost in every sector, there are innumerable welfare schemes implemented by both the state and central government for the vulnerable groups of the society.

8.3 EVOLUTION OF MIXED ECONOMY IN INDIA

8.3.1 The British Regime

British imperialism was marked by some industries and establishment in the state sector like railways, posts and telegraph, fertilizer factory, shipyard at Visakhapatnam, aircraft factory at Bangalore etc. Simultaneously, a number of industries were established in private initiatives too. Tata, Birla, Godrej, Bajaj, Mahindra, etc were a few names amongst the private industrial houses to initiate their entrepreneurships during the pre-independence era. Thus, in political

arena, there existed the command of the British rulers, but, a legacy of mixed economic system has been carry forwarded in disguise towards the independent India.

8.3.2 The Public Sector & Private Sector in India

After independence India declared its first industrial policy in 1948. It classified the ownerships of large industries on resources and production into four groups, viz., public sector, public-cum-private sector, controlled private sector and private & cooperative sector. Strategic industries like atomic energy, arms and ammunitions, railways etc. were included in the first category. This was kept under the state monopoly. Coal, iron & steel, mineral oils, ship building, aircraft manufacturing, etc. were designated as basic and key industries and grouped as public–cum-private sector. Government was to set up any new industry in those areas; however, existing units of private sector were allowed to remain with them as earlier. The third category included the remaining fields of industries like sugar, paper, cotton textile, cement, machine tools, fertilizers, etc. Though they would be in private sector, the central government kept the provision of intervention in consultation with the state government. The forth category consists all the remaining industries though there were no list of any industry by name. Government may control them whenever it feels the necessity. In this way by allotting the areas for industries, the IPR-1948 laid the foundations for mixed economy for India. It can be observed that the emphasis was put more on the public sector. The objective was to attain social justice through a mixed economic system.

The second IPR of 1956 put further more emphasis on the enlargement of public sector by including 17 industries under the exclusive ownership of the public sector. The IPR also strengthened the controlling power of the government. Even in the designated areas of private sector, provision was kept for attaining government licenses to open a new industry.

India's large public sector has covered the prominent areas associated with the country's defense & security, precious natural resources, economic infrastructure building, education & health services and other fields of community's welfare. India's public sector has been contributing enormously towards the growth and development of the country.

Private sector though was not visible in crucial territories as per government's regulations, it played very significant role activating and expanding several unorganized areas of the economy. This sector has been satisfying the substantial needs of consumer goods of this huge country. India's traditional pride agriculture, small scale industry, handloom-handicraft, small trading etc. are always within the periphery of private sector. This sector generates employment as well as provides scopes for self-employment and thus supports the economy in terms of mobilization of human and physical resources.

8.3.3 Economic Planning

The process of planning India started since 1951 often referred as the socialistic pattern of planning with a democratic set up. Accordingly, strategies were designed and actions

taken through expansion of industrializations and social changes. However, modest efforts of economic planning were made before independence too at individual and group level. In 1934 a book named "Planned Economy of India" was published which was written by M. Visvesvaraya. Even in 1938, "The National Planning Committee" was constituted with Jawaharlal Nehru as the chairman. That committee was appointed by the then president of National Congress, Subhash Basu. In 1944, "Bombay Plan" was formulated by some industries including Tata and Birla. At the same time, another plan called the "People's Plan" was prepared by M. N. Roy. Again, there was "Gandhian Plan" based on decentralization and village growth. On the other hand, the British Government had worked out another plan, viz., "Plan after War". A department of Planning & Development was also set up in 1944.

After independence, in March, 1950 the Planning Commission of India was set up on the basis of the Directive Principles of the Constitution of India. Jawaharlal Nehru, the first Prime Minister of India, was the first chairman of the Planning Commission. The Commission worked through various divisions which were categorized in to three groups, such as General Planning division, Special Planning division and Programme Administration division. The Planning Commission used to assess the resources of the country, formulated the five-year plans for effective uses of those resources, determined the objectives and priorities for various sectors, allocated resources, determined strategies for successful implementation of the plan, monitored periodically the implementation and evaluated the workings. Originally, the nature of India's planning was highly centralized. Gradually, it changed its nature and started working in harmonization with the private sector. The pattern of decentralized planning adopted and the Planning Commission played the role of coordinator of works of various agents, departments and sectors.

When India adopted economic policy reforms with the liberalized principles it was required to redefine the role of the Planning Commission. In fact, the commission's role had fortified with more responsibilities in relates to poverty alleviation, employment generation, balanced regional development, environment preservation and so on. The Commission was entrusted with the crucial tasks of facing the challenges of the New Millennium. On the other hand, question was also raised on the relevance of the Planning Commission in the context of a liberalized economy. The 12th five year plan was on track when the central government decided to dismiss the Planning Commission in 2014. By reconstituting the Planning Commission, the union government announced the formation of the National Institute for Transforming India (NITI Aayog) on 1st January, 2015. Justifying the need for reconstitution of the Planning Commission, Arun Jaitley, the then finance minister commented "The 65 years old Planning Commission had become a redundant organization. It was relevant in a command economy structure, but not any longer." In this way, India's five year planning era came to an end. During the NITI Aayog era, there is no provision for five years plan.

The NITI does not allocate funds for states as it was done by the Planning Commission. Rather, it functions in a different manner. It is also called the 'think tank'. It calls for a shared vision between the centre and the states in the implementation of development plans. It also calls for the cooperation from the local self government. NITI works for the development of

villages and weaker sections. It makes strategies for long term policies. It focuses on innovation and technology up gradation to digitalize the economy.

CHECK YOUR PROGRESS

Q 1: State whether the following statements are True (T) or False (F):

(a) India was declared as a mixed economy by the Constitution of India.

(b) After independence India adopted the totalitarian central planning.

(c) After Economic Reforms of 1991, India has adopted laissez-faire capitalistic pattern of economic system in place of the mixed economy.

(d) The NITI Aayog is a totalitarian planning authority and does not have any association with state governments.

Q.2: Write the relevance of IPR 1948 in the context of India's mixed economic system.

Q 3: Why was the Planning Commission of India dismantled? Write in brief.

8.4 WORKING OF THE MIXED ECONOMY

8.4.1 Working of the Market Mechanism

As a mixed economy, economic activities in the private sector are driven by the incentive of self interest of individuals in India. There is free market where the forces of demand and supply determine prices. The efficiency of the producers helps them to attain highest amount of profits. In the private sectors market has the freedom to choose as what to produce, how to produce and how much and for whom to produce. Except the strategic and key industries exclusively kept under the government monopoly, markets in other industrial areas, manufacturing, small & cottage industries, agriculture, trade and commerce, banking, hotel & restaurant etc. were free to carry on their own activities. The government also provides scope for their establishment and encourages free economic activities though it imposes restrictions as per rules and regulations wherever necessary. It is rightly observed by Desai & Bhalerao " mixed economy while providing scope for private enterprise also stipulates that self-interest should reconcile itself to social welfare; while competition is permitted to some extent, it should not lead to monopoly; while personal freedom is ensured, care is taken to see that it does not degenerate into irresponsible personal license to do what one wishes irrespective of its effects on social welfare (Economic System, SSM Desai & N.D Bhalerao, pg.239)."

8.4.2 State Intervention

While market is free to determine prices, government can also regulate prices of certain factors of production, final goods and services. The government does so to ensure accessibility

of certain goods or services of basic necessities. For example, in 2013, the government of India imposed price control on pharmaceutical products by passing the Drugs (Price Control) Order to set a ceiling price on essential medicines.

The government of India possesses a "price monitoring cell" too in the department of Consumer Affairs to monitor prices of essential commodities. It also checks price variables like wholesale price index, consumer price index, minimum support price, international as well as domestic prices for food and non-food crops, import and export prices of several commodities, etc. on the basis of the monitoring reports after following the due procedures government adopts appropriate actions for market interventions. To take steps against inflationary or other such emergency situations government uses various kind of price control measures as required. The department of Agriculture & cooperative under the Ministry of Agriculture & Farmers Welfare has a "Market Intervention Scheme" to ensure reasonable remunerative price to the farmers in case of emergency situation, such as at the time of fall in prices. In fact, government of India practices a number of devices to intervene in market. Variety of fiscal instruments including tax, subsidy, etc. is used. It also takes help from the Reserve Bank of India's Monetary Policy to stabilize the money and capital market. RBI on behalf of the government of India controls both the domestic and international financial transactions through its monetary instruments. In the tertiary sector too, the policy of nationalization of certain services has been adopted by the government to ensure social welfare. For example, in 1969, 14 commercial banks had been nationalized by the government of India. Before that, in 1955, the Imperial Bank, one of the largest commercial bank of India was nationalized and renamed as the State Bank of India. In the next year, in 1956, the Life Insurance Company was nationalized. In that way, the task of nationalization continued over the time and the role of government had been instituted in the mixed economic set up.

The government adopted acts in relates to licensing, trade practices, etc. such as Monopolies and Restrictive Trade Practices Act (1969), Industries Development and Regulation Act (1981), and so on as per its mixed economic characteristics. Despite the freedom of owning private property, the government immediately after independence enacted laws of land reforms through which ceiling was fixed on landholding for individuals. Besides that, land acquired through land reforms redistributed among the landless farmers.

Government's intervention aims at impacting the economy wherever necessary. The government interferes to control monopoly practices from abusing people's interest, to curb inflationary pressure, to guard the interest of the poor people or to redistribute resources in the economy for the benefit of the society as a whole. Government of India uses its tax policy to bridge the gap between the rich and poor and interferes in the market. Public Distribution System (PDS) has become a part of government of India's policy of managing food security through market intervention. It is involved in procurement, storage, transportation and distribution through fair price shops to the poor people of the country. Subsidies were provided not in case of food only, it was for farms, industries and even for railways which was running at loss for years. Thus, in all these three sectors of the economy, i.e., agriculture, industry &

service, the government of India has been providing direction by imposing rules and regulations and consistently attempting to develop the mixed economic system successful.

8.4.3 The Changing Pattern of the Econmy

The economic growth rate India attained during the period 1950 to 1990 was not up to the expectation. The average growth rate was less than 4 percent per annum and the per capita income growth was less than 2 percent per annum. The rate of gross domestic savings was also very low. One of the purposes of selecting specific strategic economic pattern after independence was to generate more savings so that capital formation could be high for higher level of investment. But, unfortunately that did not happened. On the contrary, fiscal imbalances started growing. The gross fiscal deficit, i.e. the excess of public expenditure over public revenue, continued to be mounted year after year. India's balance of payment position deteriorated and became a causing factor of heavy debt.

Public sector being the vital sector of India's mixed economy played very crucial role over the time. It helped the economy by enlarging India's industrial base. In attaining self sufficiency in the production of both consumer and capital goods, incurring huge investments for infrastructure development, in correcting the disequilibrium in foreign trade, managing strategic areas like arms-ammunition-defense and atomic energy, etc. this sector contributed significantly towards the economy. Despite these grand role, public sector suffered huge losses in many areas. In this way, the strategic pattern of the Indian economy seemed to face failure and the situation became awful for the government. India had to reshape the pattern of its mixed economic façade.

Thus, to overcome the crisis, India initiated a set of measures for economic reforms in 1991. Indicating a shift in the development strategy in June, 1991 the newly constituted government launched a new industrial policy. This new policy has set India for a more open, market-oriented liberal economy from a regulated inward looking economy. The new policy was based on three basic principles: Liberalization, Privatization and Globalization. By following the liberalization rules, the government decided either to abolish the 'license-raj' or to simplify the procedures. However, it was not an agenda for laissez-fair. Rather, it was an agenda for no intervention or less intervention from the part of the government in the field of trade, commerce and industry. By privatization the government meant to expand the private sector in trade and industries, reduce or stop investment in public sector industries in phased manner, sale of shares of public sector enterprises to private buyers, and public-private collaboration, etc. Globalization implies for free flow of trade and foreign capital. It unifies the domestic market with the foreign market at international level. The government plans and prepares foreign investment policies so that it can attract capital from foreign countries directly. India formulated FDI policies for free flow of foreign direct investments in the sectors like telecommunications, power, banking, insurance, media and so on.

Thus, the economic reforms of 1991 aimed at cutting down administrative control from

several fields including foreign trade. Now, the major economic decisions including price policy, investment pattern, production technique, etc are determined mainly by the market forces. The government performs the role of facilitator instead of a controller. Now, the government takes the leadership in those areas that are associated with the interests of the masses and weaker section of the society. As stated above the role of planning has also redefined. In a gradual manner, the government abolished licensing except for certain designated industries, made relaxations in Foreign Exchange Regulation Act, allowed private investment in several sectors like power, oil & gas sector, eased restrictions on banks and allowed more freedom in lending, opened the civil aviation-telecom services etc. for private sector, amended the National Highway Act, built up Free Trade Zone for export trade making them free from government interventions, reformed the taxation policy and so on. In this way the economy becomes more liberalized and globalised.

CHECK YOUR PROGRESS

Q.4: State whether the following statements are True (T) or False (F):

(a) Nationalization of certain services is a part of state intervention.

(b) In India all agricultural activities belong to the public sector.

(c) In a mixed economy, government does not have the power to control inflationary situation.

(d) India's mixed economic system does not allow the consumers to exercise their right to freedom as what to consume.

Q 5: What is price monitoring cell? How is it related to market intervention?

Q 6 : What is PDS?

8.5 THE FUTURE OF MIXED ECONOMY IN INDIA

India is not a closed economy. Under the set up of mixed economic system India has been maintaining trade relations with several countries of the world. India is a member of World Trade Organization (WTO) since 1st January, 1995. India had been a member of GATT (General Agreement on Tariffs and Trade) i.e. the forerunner of WTO, since July, 1948, that is since the next year after independence. India is associated with the International Bank for Reconstruction and Development (World Bank) since its inception in 1944. It had been retaining this association after independence too and over the period of time a number of welfare schemes in the sectors like education, health, agriculture etc are implemented with the financial helps of the World Bank. In the same way India is a founder member of International Monetary Fund (IMF). Therefore, being a member country, India has to abide by the rules & regulations of these international economic and financial institutions.

Despite its loyalty towards those organizations, India from the very beginning adopted the protection policy for the growth and development of domestic industries. The first five

year plan strategically focused on import substitution putting restriction on import and thereby producing such goods within the country. Export promotion has become a recurring objective of India's five year planning. From the very beginning, India maintained a friendly relationship with both the USSR and the USA, the two great leaders of the world economy. In fact, India's mixed economy model was designed by combining the liberal capitalist model of the USA and socialist state-led development model of then USSR under the leadership of Jawaharlal Nehru, the first prime minister of India. India because of its proficient diplomatic bonding was able to attain financial aid from both the super powers. During 1960s India had to face war with two neighboring countries, i.e. Indo-Pak and Indo-China Wars. That led to some financial crisis. That was the government of Prime Minister Indira Gandhi w.e.f. 1966. She became able to attain some financial aids from the USA as well as from the IMF. But, the association with the USSR became much stronger and India's mixed economy molded with the socialistic pattern by including the word 'socialist' in India's Constitution. That pattern continued up to early 1980. During the tenure of Prime Minister Rajiv Gandhi, India started moving out from its socialistic model towards liberalized one. In fact, some of the reforms in foreign trade occurred during Rajiv Gandhi's term. That period was marked with significant political-economic events like final disintegration of United States of Soviet Union (USSR), soaring oil prices, high inflationary trend and so on. Indian economy also shifted to a liberal globalised capitalistic model in the hands of Narasimha Rao (Prime Minister) and Dr Manmohan Singh (Finance Minister). Reforms have been done in the field of trade, industry, capital investment, infrastructure, finance, agriculture, taxation and so on. Thus, the word 'socialist' that was added in the preamble remained hollow in reality.

It has been justified by the policy makers that shifting to liberalization, privatization and globalization was inevitable for India. But they have come with all their positive and negative aspects. In the positive side India received foreign direct investment and foreign technology, new job opportunity for its growing work force. On the other hand, there was loss of jobs in the public sector and job cut in government that created chaos among the common people. The small, medium and other domestic industries have to face massive challenges from multinationals. In other words, the chronic problems of poverty, unemployment, inequality etc remained as they were in pre reform period. That becomes the prime cause concern for the survival of mixed economy in future India. Therefore, the government should ensure the availability and accessibility of resources, goods and services to the needy one. Implementation of welfare measures for the common people, protection of interests and rights of the vulnerable groups of the society should get priority. Mixed economy in India would never going to lose its future if the government, at any shifting pattern, can give assurance for quality education, health care, a decent standard of living along with minimum needs required for the modern people.

The NITI Aayog prepared "Strategy for New India@75' and published it in November, 2018. It is stated in the forward that NITI attempts 'to create an ecosystem which enables every Indian to reach his or her full potential. This will pave the way for inclusive growth, and ensure prosperity to all.' The Preface also states that (NITI'S) "strategy when implemented

will bridge the gap between public and private sector performance. The government has focused on the efficient delivery of public services, rooting out corruption and black economy, formalizing the economy and expanding the tax base, improving the ease of doing business, nursing the stressed commercial banking sector back to healthy state'. This kind of strategy seems to be the government's assurance for a strong and safe future of mixed economy in the country.

CHECK YOUR PROGRESS

Q 7: State whether the following statements are True (T) or False (F):

(a) As a member country of WTO India had to give up its socialist pattern.

(b) It was Jawaharlal Nehru under whose guidance and direction India adopted mixed economy model.

(c) India adopted the good substances from the USA and the USSR to shape its mixed economic model.

(d) During 1960s India had to face war with the USSR.

Q 8: What are the disadvantages of globalization?

Q 9: Is there any challenge for mixed economy in future India?

8.6 LET US SUM UP

- As a follower of mixed economic system, Indian economy is characterized by the coexistence of public and private sectors. Economic activities in the private sector are driven by the incentive of self interest of individuals in India. There is free market where the forces of demand and supply determine prices. Simultaneously, the government controls and intervenes in the private sector by using variety of fiscal and other devices.
- India's mixed economy model was designed by combining the liberal capitalist model of the United States of America and socialist state-led development model of the United States of Soviet Russia under the leadership of Jawaharlal Nehru, the first prime minister of India. Most of the development strategies of the country were based on socialistic pattern of mixed economy.
- India's first industrial policy of 1948 is said to be the first documentary evidence through which India is declared as a mixed economy as the IPR classified the industries in to public and private sector.
- The second IPR of 1956 put more emphasis on the expansion of the public sector by including 17 industries under the exclusive ownership of the public sector. The

IPR also strengthened the controlling power of the government. Even in the designated areas of private sector, provision was kept for attaining government licenses to open a new industry.

- India's public sector has covered the prominent areas associated with the country's defense & security, natural resources, infrastructure building, education & health services and community's welfare. On the other hand, private sector has been found to be visible in industries like production of consumer goods, agriculture, small scale manufacturing, handloom-handicraft, small trading etc.
- After independence, in March, 1950 the Planning Commission of India was set up on the basis of the Directive Principles of the Constitution of India. The process of five year planning started since 1951 which was often referred as the socialistic pattern of planning with a democratic set up. Till 2017, India completed twelve five year plans and several annual plans. The Planning Commission reconstituted in 2015 and renamed as NITI Aayog and the government decided to discontinue the five years plan.
- India's mixed economy is characterized with two distinct features: one a comparatively tight government controlled and public sector dominated economy till 1990 and another liberal-globalised economy with less control and more privatized sector since 1991.
- Even with a capital-oriented globalized system, India's mixed economy has not lost its identity as the government is still active as a balancing coordinator between the public and private sector. It looks after the benefits and loopholes of both the sectors and acts accordingly for bringing sustainable development as a whole.

8.7 FURTHER READING

1) Desai,S.S.M. & Bhalerao D. Nirmal, 2016, Economic Systems, Bombay, Himalaya Publishing House, Girgaon,Mumbai.

8.8 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: (a) F (b) F (c) F (d) F

Ans. to Q. No. 2: India's first industrial policy of 1948 classified the ownerships of large industries on resources and production into four groups. They are public sector, public-cum-private sector, controlled private sector and private & cooperative sector. That one was the first official document to declare the country to be a follower of public and private sector simultaneously. Thus, the economy has been characterized as mixed economy through the IPR 1948.

Ans. to Q. No. 3: In 1991, India adopted new economic policy reforms with the principles of liberalization, privatization and globalization. In that context, it was required to

redefine the role of the Planning Commission. The Commission was acting as commanding authority in terms of resource mobilization and its allocation. Now, the commission's role had set with more responsibilities in relates to poverty alleviation, employment generation, balanced regional development, environment preservation and so on. The Commission was entrusted with the crucial tasks of facing the challenges of the New Millennium. Accordingly, the government dismantled the Planning Commission and reconstituted it as NITI Aayog.

Ans. to Q. No. 4: (a) T (b) F (c) F (d) F

Ans. to Q. No. 5: The government of India constituted a "price monitoring cell" under the department of Consumer Affairs. It monitors prices of essential commodities and checks price variables like wholesale price index, consumer price index, minimum support price, international as well as domestic prices for food and non-food crops, and import- export prices of several commodities.

On the basis of the monitoring reports after following the due procedures government adopts appropriate actions for market interventions. Thus, the government of India with the help of price monitoring cell practices a number of fiscal instruments including Tax, subsidy and so on.

Ans. to Q. No. 6: Public Distribution System (PDS) was introduced in India to distribute food among the poor people at subsidized price. It has become a part of government of India's policy of managing food security through market intervention. It is involved in procurement, storage, transportation and distribution through fair price shops to the poor people of the country.

Ans. to Q. No. 7: (a) F (b) T (c) T (d) F

Ans. to Q. No. 8: Globalization refers to keeping the economy open to all. On political and cultural grounds, it is considered as to be the threat towards national and traditional identity. . It brings unnecessary competition among the big and small companies. There is fear of closure of small traditional industries as big players can enter easily to in the market. In that case there may be unemployment and poverty. It increases the gap between rich and the poor.Thus, it becomes a threat towards own traditional economy.

Ans. to Q. No. 9: Mixed economy is not a capitalistic economy. On the other hand, after the economic reforms of 1991, India has adopted a liberal and more capitalistic pattern in place of its earlier socialistic model. This may sometimes create confusion regarding its own identity of mixed economy. At present, there is liberal trade policy, free flow of foreign capital, many more open sectors in the economy. Therefore, sometimes it seems to be a challenge for the survival of the mixed economy as all these work against the socialistic pattern. But, in reality as long as the government takes care of the interest of the common people, the future of mixed economy will remain safe.

? 8.9 MODEL QUESTIONS

Very Short Questions (Answer each question in about 50 words)

Q. 1: State the meaning of LPG.

Q. 2: What is economic planning?

Q. 3: What is market mechanism?

Q. 4: What is NITI Aayog?

Short Questions (Answer each question in about 100-150 words)

Q. 1: Describe the factors responsible for India's choice for a mixed economic system.

Q. 2: Write a note on India's public sector.

Q. 3: Explain the reasons responsible for India's economic reforms.

Q. 4: Write a note on India's industrial policy resolution of 1948.

Essay-type Questions (Answer each question in about 300-500 words)

Q. 1: Describe the changes occurred to India's economy after 1991.

Q. 2: How is the state intervention helpful to control market mechanism under mixed economic system? Explain.

Q. 3: Explain how do the public and private sectors coexist within mixed economic system.

Q. 4: Explain why India moved from a socialistic-mixed economy to a liberal-globalised economy.

Q. 5: Write an essay on India's mixed economic system.

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UNIT 9: PLANNING: MEANING AND FEATURES

UNIT STRUCTURE

9.1 Learning Objectives
9.2 Introduction
9.3 Definition of Economic Planning
9.4 Need for Economic Planning
9.5 Plan Formulation and Requisite for Successful Planning
9.6 Features of a Planned Economy
9.7 Planning and Development
9.8 Let Us Sum Up
9.9 Further Reading
9.10 Answers to Check Your Progress
9.11 Model Questions

9.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- give the definition of economic planning
- describe the need for economic planning
- analyse plan formulation and requisite for a successful planning
- mention features of a planned economy
- relate planning with development.

9.2 INTRODUCTION

In this unit, we will try to deal with various aspects of economic planning and the related issues.Under this we will study the meaning of planning, its need in an economy and the basic structure. Moreover the unit also tries to through light on the characteristics of a successful planning. It deals with the features of a planned economy and lastly tries to relate planning with development.

You are all well aware of the fact that planning is considered very important and indispensible part of the economy especially in the socialistic and mixed economic systems. It is a popular tool of development in the developing economy like India. In simple sense, economic planning is concerned about various types of resource allocation of an economy and tries to maximize the utility from the given amount of resources. Such resource allocation is done among various sectors and organizations of the economy. Looking back to the historical era, we will find that the first country to adopt such planning is the Soviet Union. Later it has been recognized as Soviet model of planning and from 1930; it remained in its operation till

the breakdown of then greater Soviet Union. Various other socialistic and developing countries followed this model of Soviet planning. It was a centralized planning system. The earliest proponent of such economic planning is the Russian economistsLeon Trotsky.

Now let us look at our own country India. India decided to go for planned economic development. It was decided that India will construct long term planning of 5 years duration starting from the year 1951.So the first five year plan duration was from 1951 to 1956. But it is important to note that, there is currently no active Five Year Plan in India. The last five year plan the 12th five year plan. It was implemented from 2012 to 2017. After the completion of this plan, government of India decided to stop the process of five year planning. It has taken a different development and planning strategy under NITI Aayog.

9.3 ECONOMIC PLANNING: DEFINITION

Economic planning has been defined in a variety of ways by different economists and policy makers. In this regard, we can cite the definition given by Encyclopedia Britannica,According to it;Economic planning isa system in which the central planning authority or the central governments make economic decisions in a systematic way to allocate the resources in its best possible way. An economy primarily based on economic planning is called as planned economy. Economic planning may take various types and forms. By looking at these types, we can say either an economy is centralized or decentralized in nature. If we look at the world economy untill 1960s, it will be clear that almost all of them adopted some form of economic planning for generation of welfare and all round development of their economy. But the decade of 1980s showed a different picture. Significant number of countries who adopted economic planning of different types faced some economic as well as non-economic problems. Among the economic problems, they faced stagnation of the economy and high rate of unemployment. We can aptly remark that as a crisis situation.

9.4 NEED FOR ECONOMIC PLANNING

The need of economic planning is felt on the part of the government to control and regulate the economy in a desired way. We all know that profit maximization is the prime goal of a competitive free market without any government intervention. But simply profit maximization will not do well in a welfare oriented economy.Therefore in the socialistic and developing countries, planning plays a very crucial role.The importance for economic planning can be felt with the help of following points.

1. In building the productive capacity of the economy in a holistic way.
2. Production of goods and services in a sustainable manner so that the need and aspirations of both the present and future generations can be satisfied.
3. Helping in mobilizing resources to the desired channel and increasing the production of goods and services in an efficient way.
4. It helps in reducing economic inequalities of various kinds.

5. Planning is very important to develop the backward region of a country or region in a priority wise manner. This is very crucial for the overall development of the developing economy like India.
6. A proper planning helps the government to regulate and control the economy in a desired way and guide it towards the path of rapid development.

The basic need of economic planning can be illustrated with the following points:

- **To promote economic growth:** The need of economic planning in developing countries like India is felt for promoting economic growth. It can be measured with the help of gross domestic product (GDP)/ gross national product (GNP) etc. With the help of economic planning, production and consumption of desirable goods and services in an economy can by boost up. It will help in the generation of various employment opportunities and will help in reducing poverty.
- **Poverty Reduction:**Widespread poverty is a very crucial problem faced by almost all developing countries. Economic planning tries to give an answer to this burning problem. By increasing productivity and efficiency, providing basic necessities of life and creating viable work opportunities, economic planning aims to reduce poverty.
- **Attaining Self-Sufficiency:** Attaining self-sufficiency is a prime agenda of all the developing countries. Especially in the basic areas of the economy like food, energy needs and defense, economic planning has been considered to be very crucial. So thrust can be given by planning authority to increase the base of domestic production, import substitution and research and development activities fostering new invention and innovation to faster the development process.
- **For the sake of social justice and equity:** Various countries adopt planning to ensure social justice and equity. It is very much essential for the holistic development of all section of people.To ensure this, distribution of resources must be made more equal. The growth must be inclusive for this purpose.
- **Balanced Regional Development:** We know that developments of all the regions are very important for overall development. Merely developing a few regions at the cost of others will not do well for the economy. Therefore, the so called less developed and backward regions of a country should be given more importance while taking development related decisions. It will help to solve the problem of regional imbalance.
- **Employment generation:** India has the second largest country in terms of population. Its labour force is also very huge and each year. A substantial number of young people also join the labour force each year. But the employment opportunities are not sufficient to absorb the rising labour force. It is the reason for widespread unemployment, underemployment and disguised unemployment (in the agricultural sector). So such countries try to generate employment opportunities with the help of proper planning. Such employment opportunities may be in the form of wage employment, salaried job and self-employment in both formal and informal sector.
- **Reducing regional disparities:** Some of the developing countries including India face regional inequality or disparity. It means the fruits of development are not equally shared

by all regions. Income, infrastructure, access to basic facilities like medical facility and education and training etc. are not in the same status in all the regions. Planning helps to gradually reduce such disparities and allocate resources in an efficient way.

- **Increase the Standard of Living:** Economic planning is also very important to maintain and augment the standard of living of the general masses. In the developing countries in particular, significant effort must be made by the policy maker to ensure the basic amenities in adequate quantity for all individuals residing in that country.

9.5 PLAN FORMULATION AND REQUISITES FOR SUCCESSFUL PLANNING

Requisites/Strategy of Economic Planning:

For the developing and underdeveloped countries, the need for proper economic planning is felt without any doubt. But in many developing and underdeveloped countries, planning is not bringing desired results and in many fields, planning strategy has been failed.This is because; the success of economic planning is dependent on some preconditions which must be fulfilled to make the whole planning process effective. These conditions are as follows.

Strong and Efficient Administration:

The administrative system should be strong and efficient to implement the plans. There must be proper inspection and operation mechanism for attaining the objectives of a plan. If the administrative mechanism is weak and inefficient, lack coordination failure then the plan objectives cannot be met within the stipulated period of time. This is the reality of most of the developing countries. Moreover, corrupt government and administrative system also add to this agony.

Political Setup:

To make a plan successful, the central and state governments must be strong and powerful. In a federal democratic setup like that of India, we often notice that there is lack of proper communication, coordination and harmonious relationship among various types of governments between Centre and states. This makes the implementation of the planning process even more difficult. But in socialistic, totalitarian or communist countries, we do not notice such miscommunication due to their strict central tendency.

Creation of a Planning Agency:

Next important step for the success of economic planning is creating a planning commission or planning agency. It is very important for proper formulation of the economic planning. The policymakers or the respective government should construct the planning commission in such a way that it comprises of experts of various fields like economists, statisticians and engineers etc. The planning commission will be made responsible for proper designing and implementation of various economic plans.

Statistical Data:

Another important prerequisite of successful planning is the availability of up to date,

accurate and adequate data about the economy and about various sectors of the economy. If data are not readily available, then planning objectives and strategy will go wrong. It is the realistic problem of most of the developing countries.

Planning Objectives:

Every economic plan should mandatorily contain clear and specific objectives. These objectives should be shared with the people in simple language. Then they can cooperate with the planning authority and among themselves which will increase the probability of success of the specific plan. Moreover, appropriate precautions must be taken by the planners and policy makers so that the objectives do not conflict with each other. Some important and notable objectives and common goals of various plans are increasing the per capita income, enhancing gainful employment opportunities, reduction of poverty and inequality, to reduce disparities faced by states or regions, sectoral development of agriculture, industry and services, promotion of local, regional and international trade etc.

Cooperation of the People:

A plan can be successful if it gets proper assistance and cooperation from the general masses. It is very much important for the successful operation of the plan. People should feel themselves a part of the planning process and they should understand that the success of the plan will bring increase in welfare for them. Peoples' action in this regard should be well informed and disciplined so that their decisions regarding the plan can be efficient and effective.

Achievement of the specific Targets:

You all know that a proper plan consist of various targets to be achieved at a stipulated time frame. The planning authority should take appropriate precautions while framing the targets. The targets should be clear, specific and achievable. It should not be overstatement or understatement and utopian in nature. If the targets are not realistic depending upon the condition of that country, then the plan cannot be successful. General people should be made aware about the working of the planning mechanism. Moreover, the limited resources of the countries should be utilized in an efficient and proper way to visualize the goals of planning.

Balancing the economy in a proper way:

Another precondition for the success of an economic plan is to balance the economy in a proper way. The policymakers and planning authority should give equal importance to all the major sectors of the economy. The resources and capital should be distributed accordingly. If only one or a few sectors develop and other important sectors are lagging far behind, it will create imbalances in the economy. As all the sectors are interrelated in nature, the holistic development of all the sectors will ensure overall welfare and smooth working of the economy besides maintaining a healthy growth rate.

Planning for Financial Resources:

For every economic planning, adequate provision of finance is a must. Such financial requirements can be fulfilled by various sources. Some sources are within the economy and some sources are external to the economy. The respective government or the planning authority should try to manage the funding and allocation of financial resources. In this regard,

both internal and external sources are equally important. We can name some of the important internal sources as savings, tax collection, and internal loan from different domestic agencies or the central bank and deficit financing. The developing and underdeveloped countries also depend on the external sources in need. You know that financial resources are limited in these countries. Those external sources may comprise of loan or grants of the international financial agencies like International Monetary Fund (IMF) and World Bank (WB). Moreover, loan and grant may come from other developed countries of the world.

Sectoral Allocation and Priorities:

It is a well-known fact that the underdeveloped and developing countries are facing lots of structural problems. As these countries are deficient in capital and the resource base is also limited (sometimes not limited but underused/unused or misused).So there arises the problem of choice. The planners and policy makers have to choose the order of project execution in a rational way. They must address some burning issues with topmost priority and some issues may be postponed for future. All projects should be dealt according to their importance and impact on the growth of the economy. But such order or preference should not be very rigid. It should be flexible so that necessary modifications can be made at the need of the hour.

Appropriate Development Policy:

Successful planning demands proper development policy. Prior to policy framing the policy makers should survey the resource base of the economy. Moreover, the suitability of a policy and planning perspective will be highly dependent on research and development activities, invention and innovation of new production techniques, understanding the market, examining demand and supply for any particular good or service, availability of proper education and training facilities, availability of energy and other infrastructural base, government's goodwill towards entrepreneurs and business houses etc.

Determination of the Rate of Growth:

Rate of growth refers to the annual increase in the GNP/GDP of a country. It is a crucial indicator for overall growth and development. Although growth rate as a measure of development has some serious limitations, most of the countries are still sticking to it. In most of the plan objectives, the planners mention about the proposed rate of growth to be achieved during a particular time frame. For example, in India, in each five year plan, there is a tradition to mention some specific growth rate proposed to be achieved.

9.6 FEATURES OF A PLANNED ECONOMY

There are some salient features of a planned economy:

- **Control of price and quantity by the government:** A planned economy is characterized by the control on price and quantity of goods and services. It is done by the respective government of that country.You all know that India is a federal country with the co-existence of both central and state governments. Powers or divided separately for both types of government. So both governments are accountable for control of price and

quantity as per the planning objectives. But the amounts of power enjoyed by both types of governments are different. So the amounts of control exercised are also different in nature and scope.

- **Government policies are used in proper execution of plans:** To visualize the true fruits of planning, various policies are operated by the government. This is a common picture in most of the developing countries. For example, in India, there are numerous welfare oriented policies mainly targeting the priority sector of the economy and the poor and lower middle class people.
- **Most economic plans are created by the Government, except for a few sectors:** It is another feature of a planned economy. Almost all of the plans related to various sectors are crafted by the government. Although there may be a few exceptions.
- **Broader objective of Economic Stability:** one of the major thrust area and characteristic of economic planning is strive for economic stability. Without a stable economy, economic growth and development is a distance dream. It is a compulsory and very important precondition of economic development of such countries. Without achieving proper economic, social and political stability, economic planning will be meaningless.
- **Distribution of Resources:** distribution of resources is another prime goal and characteristics of planning. Generally in a federal setup, the central governments are more powerful. It has been already mentioned in this chapter. So almost all the resources and their distribution authority lies with the central government. It is true for India also. Central government decides how to distribute the resources between Centre and states. They consider several factors based on the planning objectives.
- **Ownership of market sectors:** Another feature of planning is that here different sectors of the markets are owned by the government. The government mechanism also controls those sectors. There are several markets in an economy. So governments own and control them simultaneously. It is done for maintaining balance in the economy.
- **Market factors are restricted from financial bias:** Last but not the least, market factors are restricted by the government from doing any financial bias.

9.7 PLANNING AND DEVELOPMENT

There is a close relationship between planning and development. It is because the prime goal of economic planning is overall development of a region or the concerned country. In this context, we can refer the views of Gandhi ji. He believed in decentralization of economic resources and planning for a holistic development approach. He stated that the ultimate goal of planning should be the development of the last person of the society. Economic planning is a long term tool to develop a developing economy.Through proper planning, an economy can be changed in a positive and desired way. Planning is thus crucial for economic, political and social change especially of a developing country. Planning will mean that there will be some systematic ways and approach to deal with the future course of action for the overall

welfare and development of a country.Here we must keep in mind that all types of social changes are not considered as good for the economy. Some changes may be undesirable and harmful for a particular economy. So we need proper planning to move towards a positive direction and change. Thus, we can see that the three terms are closely inter-linked but have their own specific meaning.

CHECK YOUR PROGRESS

Q.1: What is the meaning of economic planning?

Q.2: Mention the needs for economic planning in a short manner.

Q.3: Discuss a few objectives of economic planning.

Q.4: Mention any five features of a planned economy.

ACTIVITY

Go through various five year plans of India and find out the common objectives and proposed measures for poverty reduction and employment generation and their effectiveness.

9.8 LET US SUM UP

- According to it; Economic planning isa system in which the central planning authority or the central governments make economic decisions in a systematic way to allocate the resources in its best possible way.
- Economic planning is considered better than free market system because it helps in building the productive capacity of the economy, in sustainable production of goods, both for present and future generation, in mobilizing resources to the desired channel and will help in increasing the production of goods and services, in reducing economic inequalities, in developing backward regions of the economy in a preferential basis which is very crucial for the developing countries.

  It also helps the government to control the economy in a desired manner and direct it accordingly for the rapid development
- The basic need of economic planning are for the sake of economic growth, reducing poverty, self-sufficiency, social justice and equity, regional development, employment generation, reducing regional disparities, balanced regional development, increased standard of living
- The successful implementation of the plan requires some pre-requisites. These conditions are strong and efficient administration, political setup, establishment of planning agency, statistical data etc.
- The basic objectives of economic planning are cooperation of the people, achieving the targets, proper balancing, financial resources of the plan, sectoral allocation

and priorities, proper development policy, determining the rate of growth

- The primary features of a centrally planned economy can be stated as control of production limits and prices by the government or the respective authority, various policies to accompany and visualize the planning goals, to attain equality, efficiency and stability, distribution of resources by the central government to various states according to needs and priority, control and regulation of markets etc.
- There is a close relationship between planning and development.

9.9 FURTHER READING

1) Lekhi, R. K., Singh, J. (2015). The Economics of Development and Planning. Kalyani Publishers
2) Mukherjee, D. (2019). Indian Economy since Independence. NCBA Ltd. London
3) Ahuja, H. L. (2016). Development Economics. S. Chand
4) Dhar, P. K. (2014). Indian Economy: Its Growing Dimensions. Kalyani Publishers

9.10 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: According to Encyclopedia Britannica, Economic planning isa system in which the central planning authority or the central governments make economic decisions in a systematic way to allocate the resources in its best possible way.

Ans. to Q. No. 2: The basic need of economic planning can be illustrated with the following points

- To promote economic growth: The need of economic planning in developing countries like India is felt for promoting economic growth.
- Poverty Reduction: Widespread poverty is a very crucial problem faced by almost all developing countries. Economic planning tries to give an answer to this burning problem.
- Attaining Self-Sufficiency: attaining self-sufficiency is a prime agenda of all the developing countries. Especially in the basic areas of the economy like food, energy needs and defense, economic planning has been considered to be very crucial.
- For the sake of social justice and equity: Various countries adopt planning to ensure social justice and equity. It is very much essential for the holistic development of all section of people.
- Balanced Regional Development:Holistic developments of all the regions are very important for overall development. Planning is needed for this purpose.
- Employment generation:Most of the less developed countries try to generate employment opportunities with the help of proper planning. Such employment opportunities may be in the form of wage employment, salaried job and self-

employment in both formal and informal sector.

- Reducing regional disparities: Economic planning aims to reduce various types of regional disparities by allocating resources to underdeveloped regions and promoting balanced regional development.
- Increase the Standard of Living: Economic planning is also very important to maintain and augment the standard of living of the general masses.

Ans. to Q. No. 3: Economic planning takes into account various objectives. They aim at increasing GDP/GNP and per capita income, generating employment opportunities; address the problem of inequality, holistic development of the primary, secondary and tertiary sectors in the economy.

Ans. to Q. No. 4: Five features of a planned economy can be discussed as below

a) The Government controls production limits and prices
b) Government policies are put in place to execute economic plans
c) Most economic plans are created by the Government, except for a few sectors
d) Central authority distributes the resources at its own will
e) Market factors are restricted from financial bias

9.11 MODEL QUESTIONS

Q.1: Give the definition of economic planning.
Q.2: What are the needs of economic planning in a developing country like India?
Q.3: What are the pre requisites of a successful planning?
Q.4: What are the basic features of a planned economy?
Q.5: Discuss the relationship between planning and development.

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UNIT 10: TYPES OF PLANNING I

UNIT STRUCTURE

10.1 Learning Objectives
10.2 Introduction
10.3 Objectives of Economic Planning
10.4 Types of Economic Planning
    10.4.1 Structural Planning
    10.4.2 Functional Planning
    10.4.3 Physical Planning
    10.4.4 Financial Planning
10.5 The importance of Financial Planning in business
    10.5.1 The Benefits of Business Planning are as Follows
    10.5.2 Demerits of Financial Planning
10.6 Perspective Planning
    10.6.1 Merits of Perspective Planning
    10.6.2 Demerits of Perspective Planning
10.7 Annual Planning or Prospective Planning
10.8 Let Us Sum Up
10.9 Further Readings
10.10 Answers to Check Your Progress
10.11 Model Questions

10.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- know the objectives of Economic Planning
- know the different types of Economic Planning
- describe the role played by each type of Planning
- discuss the merits and demerits of each type of Planning in this unit.

10.2 INTRODUCTION

Planning is considered as a panacea for all economic ills. Economic development of a country is closely linked with economic planning. Although the idea of planning is over 2400 years old having its first reference and formulation by Plato in his “Republic” but the same idea attained a systematic shape and support after the end of World War II for the rehabilitation and reconstruction of war divested economies as well as for the rapid economic development of the underdeveloped economies.

Planning consist of totality of arrangement decided upon so as to carry out a project

related to economic activity. Plan is definable by two elements, i.e., (a) a project that is an end which one proposes to achieve and (b) The arrangements put in place to ensure the achievement of this end constitute the determination of the means.

10.3 OBJECTIVES OF ECONOMIC PLANNING

In India economic planning has been an important part of the country's development strategy since its independence in 1947. The main objective of economic planning in India is to achieve rapid economic growth while promoting social justice and reducing poverty. This has been achieved through various Five-Year Plans, which display the country's economic and social goals, and the policies and strategies required to achieve them. Some of the key objectives of economic planning in India include the following:

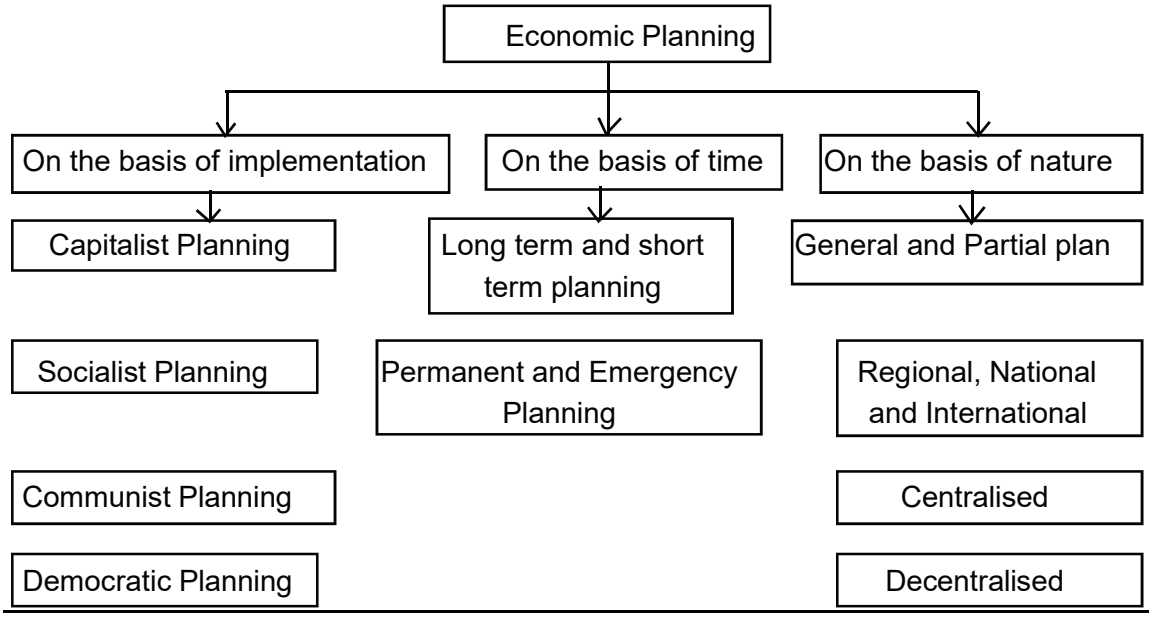
- **Economic growth:** One of the foremost objectives of economic planning in India is to promote economic growth, measured in terms of gross domestic product (GDP). This involves increasing the production and consumption of goods and services in the country, creating jobs, and reducing poverty.
- **Reduction of Poverty:** Economic planning aims to reduce poverty by creating employment opportunities, increasing the productivity of the workforce, and providing basic necessities to the poor.
- **Self-Reliance:** One of the primary objectives of economic planning in India has been to achieve self-sufficiency in key areas such as food, energy, and defence. This is done by promoting domestic production, reducing dependence on imports, and promoting indigenous research and development.
- **Social justice and equity:** Economic planning in India also aims to promote social justice and equity by ensuring that the benefits of economic growth are distributed fairly across all sections of society.
- **Regional Development:** Economic planning in India also aims to promote regional development by reducing regional imbalances and promoting the development of backward regions.
- **Employment generation:** Economic planning aims to create new employment opportunities, especially in the manufacturing and services sectors, and promote entrepreneurship and self-employment.
- **Reducing regional disparities:** India is a vast country with significant regional disparities in terms of income, infrastructure, and access to basic services such as healthcare and education. Economic planning aims to reduce these disparities by allocating resources to underdeveloped regions and promoting balanced regional development.
- **Balanced Regional Development:** Economic planning also aims to promote balanced regional development by ensuring that the benefits of development reach all parts of the country. This is achieved by investing in infrastructure, setting up industries in backward areas, and promoting entrepreneurship.
- **Increased Standard of Living:** Economic planning in India aims to increase the standard of living of the people by promoting economic growth and providing access to basic amenities such as healthcare, education, and housing.

10.4 TYPES OF ECONOMIC PLANNING

There can be plan for production, allotment or distribution, investment which can be considered as a partial plan. But in full sense, the term economic plan is a plan concerned with whole economic life or the entire activity of an economic unit.

Economic planning in India can be categorized into different types based on various factors such as the approach, focus, scope, and level of centralization. The types of economic planning in India aim to promote sustainable economic growth, reduce poverty and inequality, and provide access to basic amenities for all sections of society. Here are the different types of economic planning in India:

- **Planning by Direction and Planning by Inducement:** Planning by direction is a type of planning where the government controls and directs the allocation of resources and the production of goods and services. Planning by inducement, on the other hand, is a type of planning that encourages private investment and entrepreneurship through incentives and market-oriented policies.
- **Financial Planning and Physical Planning:** Financial planning focuses on the allocation of financial resources, while physical planning focuses on the allocation of physical resources such as land, water, and minerals. Both types of planning are important for achieving sustainable economic growth and development.
- **Indicative Planning and Imperative Planning:** Indicative planning provides guidelines and targets for the private sector and market forces to follow, while imperative planning involves mandatory regulations and controls to achieve specific targets.
- **Rolling Plans and Fixed Plans:** Rolling plans are flexible plans that are reviewed and revised annually to reflect changing economic conditions and priorities, while fixed plans have a fixed duration and are not subject to mid-term revisions.
- **Centralized Planning and Decentralized Planning:** Centralized planning involves the central government taking the lead in the planning and implementation process, while decentralized planning involves devolving the planning and implementation responsibilities to lower levels of government such as states, districts, and local bodies.



10.4.1 Structural Planning

It aims to change the existing structures. Under such type of planning the present social and economic structure is changed and a new structure emerges in terms of economic and social changes.

For instance, shift from capitalist to socialist economy can be called a structural change. It can help in enhancing the pace of economic development. The Communist countries like Russia and China followed structural planning.

10.4.1.1 Merits of Structure Planning

The merits of structural planning are

- Structural planning initiates integrated management of complex environmental issues within a defined geographical area (eg, urban growth, inner city redevelopment, open space planning, natural hazards management, improved water quality and quantity management, and protection of natural and cultural heritage values)
- It coordinates the staging of development over time, particularly where large areas are to be developed or redeveloped
- This type of planning ensures co-ordinated and compatible patterns and intensities of development across parcels of land in different ownership, and between existing and proposed areas of development and redevelopment
- It co-ordinate infrastructure provision and other services across land parcels in different ownership, or over different council boundaries
- Assures certainty to developers, the council, key stakeholders and the wider public regarding the layout, character and costs of development in an area earmarked for growth or redevelopment.

➢ **Structure plans are also a good way to:**

- Exhibits a better understanding of the inter-relatedness of issues and proposed management approaches to be used in a particular area (through the use of visual material such as maps, plans and diagrams)
- Ascertains that new development achieves good urban design outcomes by defining the layout, pattern, density and character of new development and transportation networks
- Reveals how economic, social and cultural matters are being provided for and managed alongside environmental considerations, which may be particularly helpful if the structure plan relates to community outcomes described in a Long Term Plan (LTP) under the Local Government Act 2002 (LGA)

Structure plans are often associated with “greenfield” growth areas but can also be utilised to redevelop in and complement other tools such as urban design guides, frameworks and precinct plans.

Some councils also use structure plans as an input to find out the appropriate level of financial contributions or development contributions to be charged in areas subject to development or redevelopment pressures. Structure plans are able to provide a degree of certainty about future levels of development from which the likely cost of infrastructure and services can then be quantified. Structure plans can also manifest and identify who will be responsible for costs of future infrastructure and the intended timeframes to deliver this.

10.4.2 Functional Planning

Under functional planning, there is no necessity to build up new structure, rather the existing structure is corrected and modified. According to Zweig in his "The Planning of Free Societies' has stated "Functional planning will only repair, not build a new, it will improve the wave of the existing order, but not supersede it. It is a conservative, or rather evolutionary type of planning which will not over turn the existing structure and moves only within its narrow border". Thus functional planning brings no change in the economic and social set up.

In business, plans for the future are based on goals and objectives. These goals serve as the framework for the planning that will be used to achieve them in reality. Functional planning is a process to understand what the organization wants to achieve with its available resources. This understanding forms the basis for creating specific plans detailing how the organization will function to achieve its goals.

10.4.2.1 Functional Level Planning

Functional planning is developing and documenting detailed plans to achieve objectives set at higher organisational levels. It includes specifying how resources will be used to support activities in each functional area, such as marketing, production, human resources, finance, and information technology. A well-designed functional plan provides a roadmap for achieving short-term goals that contribute to the success of long-term strategic objectives.

At the operational level of planning, employees' decisions are often described as tactical choices. They are concerned with how various functions of an organisation interact with one another and overall strategy levels.

Functional planning is a detailed plan that focuses on one or more functions. Each function's goals are established in this method. This is because, without functional planning, a company may quickly lose momentum and "get bogged down" while the competition continues to expand.

10.4.2.2 Responsibility for Functional Planning

The functional manager is responsible for the day-to-day running of the department and ensuring that it meets targets set by senior management. They are also in charge of planning for future growth and development and managing budgets and resources.

A functional manager typically has a great deal of experience in their field and is an expert. They use this knowledge to oversee the work of subordinates and ensure that it meets high standards.

Functional managers usually report to a business unit head or director, who gives them broad guidelines for operating. In large organizations, there may be several tiers of management between the functional manager and the CEO.

10.4.2.3 Key Points to Consider in Functional Planning

Functional planning is the most comprehensive type of planning. Each department has its own set of objectives and tools or digital assistance solutions. These are all factors considered during the operational plan. All departments keep track of data regarding performance and team accomplishments in their operations.

- **Progression**

There is a danger of over-tracking data and information to measure progress occurs when we don't have functional planning. It's critical to think carefully about the data that must be tracked to see if the company planning is being supported.

- **Integration**

Functional planning must be integrated from both a horizontal and vertical standpoint. Coordinating purchases/production, stocks, and logistics could be an example of how coordination might work.

- **Resource Allocation**

The various departments and divisions must get the appropriate resources to administer out the functional planning. In another way, if a department lacks financial and human resources, it will be impossible to execute a functional plan.

10.4.2.4 Choice Between Structural and Financial Planning

Indian planning is both structural and financial because under public sector, a new economic structure is built up whereas under private sector, the existing structure is modified. There is not much difference in structural and financial planning. After sometimes structural planning turns into financial planning.

Difference between Functional and Structural Planning

Functional planning	Structural planning
(i) Functional planning refers to that planning which seeks to remove economic difficulties by directing all the planning activities within the existing economic and social structure.	(i) Structural planning refers to a good deal of changes in the socio-economic framework of the country. This type of planning is adopted mostly in underdeveloped countries.
(ii) Functional planning is evolutionary	(ii) Structural planning is revolutionary

10.4.3 Physical Planning

Physical planning refers to those targets or objectives which are fixed in terms of real physical resources. Plans are also formulated on the basis of real resources of the economy, i.e., the availability of natural, human, raw materials and capital resources. Based on these resources, the output targets are fixed. To quote second Five Year Plan, Physical planning, is an attempt to work out the implication of the development effort in terms of factor allocations and product yield so as to maximize incomes and employment. Financial planning is conducted as a mean to achieve physical targets only. But the target under it, should be properly balanced. Further physical planning has to be viewed as an over all long-term planning rather than a short-term planning.

- Physical Planning in its broadest sense refers to a set of actions aimed at improving the Physical, Social and Economic welfare of a place and its dwellers.
- It entails the organization of land uses so that people enjoy the highest achievable degree of efficiency in resource utilization, functionality of places and aesthetic quality.
- The main concerns of Urban Planning therefore include spatial orderliness, aesthetics of the urban places, efficiency of operations in the social, economic and other arena, and most importantly, man's well being.

To attain orderly, progressive, sustainable urban and rural development as a framework for industrialization; provision of social and physical infrastructure, agriculture modernization and therefore poverty eradication.

10.4.3.1 Mission

To ensure adequately planned land utilisation, by developing policy framework, provide technical support, monitor and supervise plan formulation and implementation.

10.4.3.2 Objectives of Physical Planning

1. To enhance economic development.
2. To plan cities and towns.
3. To facilitate the provision of infrastructure, utilities and services
4. To create a conducive environment for all.
5. Conservation of aesthetics.

10.4.3.3 Functions of Physical Planning

1. To initiate, formulate and review the National Land Use Policy.
2. National and regional planning
3. Standard setting.
4. Technical support to local authorities
5. Technical and administrative support to the Town and Country Planning Board

6. Review of the legal framework for physical planning in the country.
7. Inspection and monitoring all land based developments in the country to ensure that they confirm to approve planning schemes, laws and regulation.
8. To monitor the manner of utilization and development of land by various ministries and organizations to ensure compliance with national policies, standards and plans.

10.4.3.4 Merits of Physical Planning

1. Physical Planning is helpful in the fight against urban and rural poverty.
2. It helps to address environmental problems.
3. It helps to maximize the use of land and other resources.
4. It facilitates orderly development.
5. Physical Planning introduces beauty in our settlements.
6. It separates incompatible land uses.
7. It eases service provision.
8. This type of plan can be used as a fund raising tool.
9. It helps to improve property values.
10. It deals with natural selfishness among developers and thus reduces nuisances.
11. It helps conserve/preserve important features/areas.

10.4.3.5 Physical Planning has the Following Demerits

- **Lack of statistics:**

In case of physical planning, statistical data seems to be lacking. The targets without adequate statistics cannot be achieved.

- **Inconsistencies:**

It is difficult to balance different parts of the economy under physical planning. Due to structural difficulties, in the underdeveloped countries internal consistencies seems to be impossible to achieve.

- **Inflationary Pressures:**

Shortages in physical targets lead to inflationary pressures which is really very harmful for developing countries. The rate of savings will be low which leads to low capital formation. Physical planning cannot be successful without financial planning. In case of India, due to lack of, financial resources in the closing year of plan, the size of the plan had to be reduced.

10.4.4 Financial Planning

Removal of disequilibrium between demand and supply to avoid inflation could be done by Financial Planning. It also helps in economic stability. Finance is the basic key to

economic planning. Without financial resources, physical targets cannot be achieved. All objectives are fixed in terms of finance i.e, how much national income, savings and investments are to be increased.

10.4.4.1 What is Business Financial Planning?

Financial plan is essentially just **the financial section of company's overall business plan**. It applies real financial data and projections to put the rest of the business plan in context.

And crucially, it is forward-looking. While we use existing accounting figures and experience to create our plan, it's not simply a copy/paste of our accounting data. Instead, we look at our business goals and define the level of investment we are willing to make to achieve each of these.

The financial section of a business plan is one of the most essential components of the plan, as we will need it if we have any hope of winning over investors or obtaining a bank loan.

10.5 THE IMPORTANCE OF FINANCIAL PLANNING IN BUSINESS

Financial planning is essential to building a successful business. It includes an assessment of the business environment, goals, resources needed to reach these goals, team and resource budgets, and highlights any risks that might be faced.

10.5.1 The Benefits of Business Planning are as Follows

- **Clear company goals**

This is really the starting point for the whole financial plan. What is the company supposed to achieve in the next quarter, year, three years, and so on?

- **Sensible cash flow management**

The financial plan should also set clear expectations for cash flow - the amount coming in and out of the company. By making the plan, challenges can be anticipated both in receiving money and spending it, and identify ways to do both more effectively.

- **Smart budget allocation**

This is closely related to cash flow management and cost reductions. Once we have a clear understanding of the amount of funding we have to spend - whether through sales income or investments - we need to figure out how we will actually spend it.

Budgets give each team their own constraints from within which to build. They know what resources are available to them, and can plan out campaigns and personal or product development accordingly.

- **Necessary cost reductions**

Aside from setting out how much we can afford to spend (and on what), a financial plan also lets us spot savings ahead of time.

- **Risk mitigation**

A crucial aspect of the finance team's role is to help companies avoid and navigate risk - from financial fraud to economic crisis. And while plenty of risks are hard to predict or even avoid, there are plenty that you can see coming.

- **Crisis management**

The first thing that tends to happen in any company crisis is we review and re-build our plans. Which of course means that Otherwise, our crisis response is simply to improvise.

- **A growth roadmap**

Finally, our financial plan helps us analyze our current situation, and project where we want the business to be in the future. Again, our wider business plan will do this on a broad level: the markets we would like to be present in; the number of employees we will have; the products or services we hope to sell.

- **Transparency with staff and investors**

It is n expected that company executives will be open and honest with staff. Some startups go so far as to publicize their salaries for the world to see.

10.5.2 Demerits of Financial Planning

Financial Planning has the following limitations:

- Mobilizing resources through taxation may badly affect the savings.
- There are two sectors in underdeveloped countries i.e barter and monetary system. There is imbalance between the two sectors. It will lead to price-rise due to scarcities of supplies.
- Even if supplies can be raised through imports, it will lead to deficit in balance of payments.
- Financial planning is not beneficial for the developing countries.
- Financial planning can be successful only if there are no bottlenecks. That way, it is necessary to use sectorial planning rather than over all planning.

10.6 PERSPECTIVE PLANNING

Perspective planning means to long term planning where targets are fixed for long period say 15 to 25 years. But it does not refer one plan for the complete period. In a true sense, broader objectives are to be attained in a fixed period by dividing the perspective plan into short-run plans of 4 to 6 years. It is a blueprint highlighting the objectives and targets of long run growth. The long –run objectives are so divided into short-run that one by one all the objectives are achieved in the long long-run. In other words Short-run plans initiate ways for the achievement of long-run motives. For instance in India, under five years plans, the objectives of employment and national income have been ascertained on the basis of short and long-run.

10.6.1 Merits of Perspective Planning

- It helps to guide the other small plans to be prepared and executed.
- This will facilitate integration of spatial and economic policy planning initiatives.
- This plan covers the social, economic, environmental and spatial development goals.

10.6.2 Demerits of Perspective Planning

- The Perspective plan has so many administrative difficulties because of which the achievements of the objectives becomes troublesome.
- Such a plan is of rigid nature because necessary or desirable adjustments to unforeseen changes or corrections of errors may not be known easily**. According to Myrdal**, perspective planning should, therefore, be started during the experimental period.

10.7 ANNUAL PLANNING OR PROSPECTIVE PLANNING

Annual planning or Short term planning is referred to those which are set up for 4 to 6 years plans and are further divided into annual plans so that each annual plan may fit in short-run plan and each short-run plan may ultimately fit in the long-run plan. Plans are further divided into regional and sectional plans. Regional plans are linked with regions, district and localities which are further divided into sectional plans for agriculture, industry, transport, foreign trade etc. Again the sectional plans are divided for different branches like iron and steel, food-grains, exports etc.

➢ **Demerits of Annual Planning**

- Planning becomes expensive.
- Planning may be used to serve individual interest rather than the interest of the enterprise.
- Planning may not work in a dynamic environment and reduces creativity.

CHECK YOUR PROGRESS

Q. 1: What is Economic Planning ?

Q. 2: When was Economic Planning started in India?

Q. 3: When NitiAayog replaced planning Commission?

Q. 4: Who is the chairman of planning Commission

Q. 5: Who is the first chairman of NitiAayog?

Q. 6: What is Business Financial Planning?

Q. 7: How to make choice between Structural and Financial Planning:

Q. 8: What are the objectives of Physical Planning?

Q. 9: Explain how the financial planning is important in business.

Q. 10: Mention the demerits of Annual Planning

10.8 LET US SUM UP

- India has made significant development in infrastructure, education, science and technology and foreign trade.
- Planning consist of totality of arrangement decided upon so as to carry out a project related to economic activity. Plan is definable by two elements, i.e., (a) a project that is an end which one proposes to achieve and (b) the arrangements decided upon in order so that the end may be achieved which indicates the determination of means.
- The main objective of economic planning in India is to achieve rapid economic growth while promoting social justice and reducing poverty. This has been achieved through various Five-Year Plans, which display the country's economic and social goals, and the policies and strategies required to achieve them.
- Economic planning in India can be categorized into different types based on various factors such as the approach, focus, scope, and level of centralization. The types of economic planning in India aim to promote sustainable economic growth, reduce poverty and inequality, and provide access to basic amenities for all sections of society.
- To quote second Five Year Plan, Physical planning, is an attempt to work out the implication of the development effort in terms of factor allocations and product yield so as to maximize incomes and employment. Financial planning is followed as a mean to achieve physical targets only. But the target under it, should be properly balanced. Further physical planning has to be viewed as an over all long-term planning rather than a short-term planning.
- Financial planning helps in removing disequilibrium between demand and supply to avoid inflation and to bring about economic stability. Finance is the basic key to economic planning. Without financial resources, physical targets cannot be achieved.
- The long –run objectives are so divided into short-run that one by one all the objectives are achieved in the long long-run. In other words Short-run plans initiate ways for the achievement of long-run motives. For instance in India, under five years plans, the objectives of employment and national income have been ascertained on the basis of short and long-run

10.9 FURTHER READING

1) Dhar, P.K (2014): *Indian Economy: Its Growing Dimension* (Guwahati : Kalyani)

10.10 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: Economic planning refers to any plans of economic activity which point to achieve specific social and economic outcomes.

Ans. to Q. No. 2: Economic planning started in India in 1951

Ans. to Q. No. 3: NitiAayog replaced Planning Commission in 1st January 2015.

Ans. to Q. No. 4: Prime Minister is the chairman of Planning Commission.

Ans. to Q. No. 5: NarendraModi is the first chairman of NitiAayog.

Ans. to Q. No. 6: Financial plan is essentially just the financial section of company's overall business plan. It applies real financial data and projections to put the rest of the business plan in context.

Ans. to Q. No. 7: Indian planning is both structural and financial because under public sector, a new economic structure is built up where as under private sector, the existing structure is modified. There is not much difference in structural and financial planning. After sometimes structural planning turns into financial planning.

Ans. to Q. No. 8: The objectives of Physical Planning are

(a) To enhance economic development.

(b) To plan cities and towns.

(c) To facilitate the provision of infrastructure, utilities and services

(d) To create a conducive environment for all.

(e) Conservation of aesthetics.

Ans. to Q. No. 9: The importance of financial planning in business are

- **Sensible cash flow management**

  The financial plan should also set clear expectations for cash flow - the amount coming in and out of the company.

- **Smart budget allocation**

  This is closely related to cash flow management and cost reductions. Budgets give each team their own constraints from within which to build.

- **Necessary cost reductions**

  Aside from setting out how much you can afford to spend (and on what), a financial plan also lets you spot savings ahead of time.

Ans. to Q. No. 10: The demerits of Annual Planning are

- Planning becomes expensive.
- Planning may be used to serve individual interest rather than the interest of the enterprise.
- Planning may not work in a dynamic environment and reduces creativity.

? 10.11 MODEL QUESTIONS

Short Questions (Answer each question in about 150 words)

Q 1: Explain any threeObjectives of Economic Planning in India.

Q 2: Explain the important points to be considered in Functional Planning.

Q 3: Write short notes on a) Rolling Plans and b) Fixed Plans and

c) Indicative Planning

Long Questions (Answer each question in about 300-500 words)

Q 1: What is Structural Planning? Explain the merits of Structural Planning.

Q 2: What is Functional Level Planning? Distinguish between Structural Planning and Functional Planning.

Q 3: What is Perspective Planning? Explain the merits and demerits of Perspective Planning.

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UNIT 11: TYPES OF PLANNING II

UNIT STRUCTURE

11.1 Learning Objectives
11.2 Introduction
11.3 Features of Economic Planning
11.4 Types of Economic Planning
  11.4.1 Planning by Direction
  11.4.2 Planning by Inducement
  11.4.3 Centralised Planning
  11.4.4 Decentralised Planning
  11.4.5 Democratic Planning
  11.4.6 Totalitarian Planning
  11.4.7 Physical Planning
  11.4.8 Financial Planning
11.5 Let us Sum Up
11.6 Further Readings
11.7 Answers to Check Your Progress
11.8 Model Questions

11.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- know the features of Economic Planning.
- know the different types of Economic Planning.
- describe the role played by each type of Planning.
- discuss the merits and demerits of each type of Planning.

11.2 INTRODUCTION

Economic planning is considered as the most systematic technique for redressing all economic ills. Various countries of the world have already experienced the successful implementation of economic planning in the mean time.

In India the first systematic attempt of economic planning was made in 1934 when M. Visvesyaryya published his book “Planned Economy for India”.

The Government of India set up a Department of Planning and Development in 1944 and it introduced short term and long term plan for restoration of normalcy after second world war for economic reconstruction and development.

But in India the real beginning of planning was made on March 1950 when the Indian Planning Commission was established. In July, 1951 the commission submitted its draft outline of the First Five Year Plan to be effective from 1951-52 to 1955-56.

The rationale for planning arises in underdeveloped countries to improve and strengthen the market mechanism. The market mechanism works imperfectly in underdeveloped countries because of the ignorance and unfamiliarity with it. To remove market imperfections, to mobilise and utilise efficiently the available resources, to determine the amount and composition of investment, and to overcome structural rigidities, the market mechanism is required to be perfected through planning.

11.3 FEATURES OF ECONOMIC PLANNING IN INDIA

- **Democratic:**The first important feature of Indian planning is that it is totally democratic. In India, every basic issue related to its Five Year Plan is determined by a democratically elected Government.
- **Regulatory Mechanism:** Another important feature of Indian planning is that it is being directed by a central planning authority, i.e., the Planning Commission of India. The Planning Commission of India is also having adequate regulatory mechanism over the successful implementation of planning..
- **Existence of Central Plan and State Plan:** Another important feature of Indian Planning is that there is the co-existence of both the Central Plan and State Plan. In every Five Year Plan of the country, separate outlay is earmarked both for the Central Plan and also for the State Plan.
- **Public Sector and Private Sector Plan:** In each plan, a separate outlay is earmarked both for public sector and the private sector. In each five year plan of the country, public sector investment and private sector investment amount is separately fixed, which comprises the total investment in each plan.
- **Balanced Regional Development:** It constantly attaches much importance on balanced regional development. Development of backward region is one of the important objective of Indian planning.
- **Unchanging Priorities:** The planning in India is determining its priorities considering the needs of the country. It has been giving too many importance on the development of industry, power and agriculture with minor modifications.

11.4 TYPES OF ECONOMIC PLANNING

Economic planning in India can be categorized into different types based on various factors such as the approach, focus, scope, and level of centralization. The types of economic planning in India aim to promote sustainable economic growth, reduce poverty and inequality, and provide access to basic amenities for all sections of society. Here are the different types of economic planning in India:

- **Planning by Direction and Planning by Inducement:** Planning by direction is a type of planning where the government controls and directs the allocation of resources and the production of goods and services. Planning by inducement, on the other hand, is a type of planning that encourages private investment and entrepreneurship through incentives and market-oriented policies.
- **Financial Planning and Physical Planning:** Financial planning focuses on the allocation of financial resources, while physical planning focuses on the allocation of physical resources such as land, water, and minerals. Both types of planning are important for achieving sustainable economic growth and development.
- **Indicative Planning and Imperative Planning:** Indicative planning provides guidelines and targets for the private sector and market forces to follow, while imperative planning involves mandatory regulations and controls to achieve specific targets.
- **Rolling Plans and Fixed Plans:** Rolling plans are flexible plans that are reviewed and revised annually to reflect changing economic conditions and priorities, while fixed plans have a fixed duration and are not subject to mid-term revisions.
- **Centralized Planning and Decentralized Planning:** Centralized planning involves the central government taking the lead in the planning and implementation process, while decentralized planning involves devolving the planning and implementation responsibilities to lower levels of government such as states, districts, and local bodies.

11.4.1 Planning by Direction and Planning by Inducement

Professor Lewis draws a distinction between planning by direction and planning by inducement for the purpose of mobilizing resources of the plan.

➢ **Planning by Direction**

Planning by direction is an integral part of a socialist society like that of the Soviet Union. It entails complete absence of laissez-faire. There is one central authority which plans, directs, and orders the execution of the plan in accordance with pre-determined targets and priorities. Such planning is comprehensive and encompasses the entire economy. As Lange has stated: “With regard to the socialist sector the national plan represents a binding directive. The targets of the national plan and its financial provision represent orders to be carried out of the various ministries and the enterprises subject to him. They are duty bound to carry out the directives of the plan.” The State holds the “commanding posts” in its hands by taking over the entire private industrial and agricultural sectors, and banking and transport. “Without such concentration the State would lack the means to carry out the tasks of the plan. Provisions in the plan would be mere “pious wishes” without any guarantee of realization attached to them.”

➢ **Drawbacks of planning by direction**

Planning by direction has got some drawbacks:

First, planning by direction is associated with a bureaucratic and totalitarian regime.

There is complete absence of consumers' sovereignty. People are not allowed to spend and consume according to their choice. Even the right to choose one's occupation does not exist. Both the consumer and labour markets are determined by the planning authority. Rationing and price controls are the main props of planning by direction which will lead to corruption and nepotism. Thus there is no economic freedom.

Secondly, planning by direction is always unsatisfactory because the present economic system is exceedingly complex. In order to increase the output of a commodity, planning requires the increase in the output of all complementaries or a reduction in the output of substitutes. And when such decisions are to be taken in the case of innumerable commodities, it becomes an extremely difficult task and targets are never fulfilled.

Thirdly, planning by direction is always inflexible. Once a plan has been drawn, it becomes impossible to revise any part of it, necessitated by circumstances. For, it is an extremely difficult task to alart a part of the plan without altering the whole of it. So the plan has to be carried through as an integrated whole despite the various pitfalls.

Fourthly. as a corollary to the above, as the plan proceeds the fulfilment of targets under planning by direction becomes a difficult task. The more one tries to overcome the difficulties of planning by direction, the more costly the fulfilment of targets become in terms of resources.

Fifthly, planning by direction develops what Lewis calls the tendency to procrustean." It leads to excessive standardization because it makes production process easy. A standardized product is manufactured without any varieties. Lewis maintains that "standardization is frequently an engine of progress, but it is also frequently the enemy of happiness, and in foreign trade it is in many lines fatal to success" Moreover, production of only one type of standard good in each line of production is inimical to the growth of initiative and enterprise. There is no urge to innovate

Lastly, planning by direction is a costly affair. It requires an army of clerks, statisticians, economists, and other trained personnel. Large funds are spent on conducting innumerable surveys and censuses.

Despite all these defects in planning by direction, the experience of the Soviet Union is a clear testimony to the fact that this type of planning is the most effective technique for accelerating the growth rate of the economy.

11.4.2 Planning by Inducement

Planning by inducement is a democratic planning. It means planning by manipulating the market. There is no compulsion but persuasion. There is freedom of enterprise, freedom of consumption and freedom of production. But these 'freedoms' are subject to state control and regulation. People are induced to act in a certain way through various monetary and fiscal measures. If the planning authority wishes to encourage the production of a commodity,

it can give subsidy to the firms. And if it finds scarcity of goods in the market, it can introduce price control and rationing. In order to increase the rate of capital formation, the planning authority can then undertake public investment and/or encourage private investment. It can adopt a suitable monetary policy and anddiscourage a taxation policy which encourages investment and discourages consumptition

Thus planning by inducement is able to achieve the same results as are likely to be achieved in planning by direction but with less sacrifice of individual liberty.

➢ **Difficulties of Planning by inducement**

Planning by inducement is beset with a number of difficulties which may make it less successful as compared to planning by direction.

- It is maintained that the incentives offered may not be adequate for the producers and consumers to act the way the state desires them to behave. It may upset the government plans.
- Since the actual working of the plan is left to the market forces, surpluses or shortages are bound to arise. Proper adjustment between demand and supply is difficult to achieve. Shortages are frequent and they necessitate price control and rationing which are the forms of direction. In such a situation, planning by inducement merges into planning by direction.
- Similarly, monetary and fiscal measures alone are inadequate to induce planned development of the economy by raising the rate of capital formation. It is very difficult to raise the rate of capital formation in an underdeveloped country because of the low levels of income and saving. People have a tendency to utilize their savings in unproductive channels. On the other hand, planning by direction is more useful for this purpose.

Whether a country should adopt the method of planning by direction or planning by inducement depends entirely on the system of government. A full-fledged socialist country will adopt planning by direction On the other hand, a capitalist economy will adhere to the technique of the planning by inducement

But both these planning techniques are complementary. They cannot be placed into water-tight compartments. Both of them are indispensable and at the same time practicable in underdeveloped countries. The state alone is incapable of developing the economy in such countries. It lacks not only in financial but also in administrative resources. So it leads the private sector to work and expand under its direction and control. For this, inducements can be given in the form of subsidies and tax exemptions. Savings, investment, consumption and productions can be directed into right directions. The state can obtain resources through deficit financing, borrowing and taxation. It can also set up basic and heavy industries and undertake social and economic overheads. Thusthe best course for an underdeveloped country is to have a judicious blending of the two.

India has adopted a middle course of action in her development plans, a mixed economy in which both planning by direction and planning by inducement are playing their respective roles.

11.4.3 Centralised Planning

The framing, adopting, executing supervising and controlling the plan is done by central planning authority. Planning authority determines targets and priorities. It is the duty of the planning authority to bring harmony in the planning process. This type of planning comes from the top to the bottom. This plan determines the equality and cohesion. The central planning authority determines the basic policies in view of the regional and local needs.

All investment decisions are taken in accordance with goals and targets fixed by the central planning authority. All economic decisions like what to produce, how to produce, where to produce and to whom it is to be allocated are exclusively decided by the central authority. All aspects of the economy are controlled by the central authority. Again the prices and wages are also fixed by the planning authority.

Oscar Lange criticized centralized planning as it is not democratic in nature and character. The complete process of planning is regulated and controlled by authority. This planning is inflexible due to which it has less adaptability. There is no economic freedom at all. Further, the disequilibrium arising on account of centralized planning cannot be easily corrected.

11.4.4 Decentralised Planning

Under this planning, responsibility lies with local and regional officials who take economic decisions about the plan. This planning starts from the grass roots. In other words, this type of planning is from bottom to top. Under this, plan is framed by the central planning authority by consulting different administrative units of the country.

The plan incorporates plans under central, state and local schemes. Also plans are prepared for different industries too. But individual firms are free to take their own decisions about investment and output. Prices are determined by market mechanism even though there are government controls.

There is complete economic freedom in consumption, production and exchange. The main defect of decentralized planning is that there is no uniformity and coordination among different sectors of the economy. This plan has been adopted in England and France.

- **Importance of Decentralized Planning in India:**
  - **Better linkages between the villages and small towns:** Considering the huge size and proportion of rural population in India, it is felt that proper linkages must be established between dispersed small villages and also between such villages and adjacent small towns by developing appropriate infrastructural facilities such as feeder roads, improved transport facilities, marketing and storage facilities, health and sanitation facilities and other welfare centres.
  - **Planning becomes realistic and flexible:** Decentralised planning is considered as more realistic as it maintains a close coordination between locally available resources, local skills, local manpower and local requirements.

- **Development of Agriculture:** Decentralised planning is suitable for the development of agricultural and allied activities such as animal husbandry. Horticulture fisheries, forestry along with development of village and cottage industries.
- **Promote people's participation:** Decentralised planning can promote active participation of local people in implementing various local plans and programmes. Thus it can enhance the involvement of local communities in such development activities.
- **Minimising wastage of resources:** Under decentralised planning wastage of resources can be reduced to a minimum level as the people participating in these developmental activities keep a close watch over the utilisation of fund as well also on the implementation of plan project.

➢ **Objectives of Decentralized Planning in India:**

Following are some important objectives of decentralised planning

(a) Effective implementation of poverty eradication programme

(b) Ensuring balanced regional development for meeting minimum needs of the people

(c) Ensuring active public participation in the development process of different sectors

➢ **Causes of dismal Performance of Decentralized Planning in India:**

- **Unsuccessful Land Reform:** The success of decentralised planning depends much on the implementation of land reform measures viz., imposition of land ceiling and the redistribution of surplus lands, tenancy reform, consolidation of holdings etc.
- **Lack of proper administrative bodies:** In India, decentralised planning could not achieve much success due to lack of adequate administrative bodies at the local level for the implementation of its various programmes.
- **Absence of effective organisation:** In the absence of effective organisation of marginal and small farmers, agricultural labourers, artisans, scheduled castes, scheduled tribes and other backward sections, there is no proper representation of these sections for serving their economic interests.
- **Lack of adequate resource transfer:** The government machinery has also failed to develop adequate managerial structures to finalise the modalities of decentralised planning in detailed form.

➢ **Measures for Improving Performance of Decentralised Planning in India**

(a) Panchayati Raj Institutions of the country should be strengthened for the effective implementation of Decentralised Planning

(b) Land reform and other institutional reforms must be introduced for the successful implementation of decentralised planning in India.

(c) State government should make necessary arrangements for devaluation of funds in adequate quantity for Panchayati Raj Institutions along with mobilisation of local private capital.

(d) In order to have successful implementation of decentralised planning, modalities of its implementation have to be sorted out systematically.

➢ **Choice between Centralized and Decentralized Planning**:

Decentralized planning is superior to centralized planning. It provides economic freedom and flexibility in the economy. Dependence on market mechanism results into shortages or surpluses in the production of goods and services. The adjustment can be made only through government. If there are shortages of goods, it will lead to inflationary pressures.

These inflationary pressures can be controlled through price controls and rationing. But these create more problems than what they solve. Also it is not possible to coordinate the decision of the planned and unplanned activities. This may lead to disequilibrium in the demand for and supply of goods and services. Again decentralized planning provides economic freedom and incentives to the market economy while centralized planning provides cohesiveness to the economy.

11.4.5 Democratic Planning

Democratic Planning implies a system of economic order in which the authority that vests in the state is based on the support of common masses. The economists like Hayek and Lippman have pointed out that planning is incompatible with democracy. Hayek says that "What was promised to us as the road to freedom was in fact the high road to selfdom." Therefore, in democratic planning, the state does not control all the means of production and does not regulate economic operations of the private economy directly.

➢ **Features of Democratic Planning**

The main characteristics of democratic planning are as follows:

- It is due to the direct result of democratic planning, mixed economy comes into being. Public and Private Sectors operate side by side.
- Central Planning Authority has direct control over Public Sector.
- Through fiscal and monetary measures, private sector is indirectly controlled by the Central Planning Authority in the national interest.
- People enjoy economic, social and religious freedom. People have freedom to conduct such economic activities as consumption, production, exchange, investments etc. in the national interest and social welfare of the community as a whole.
- People's co-operation is desired strongly in the preparation of the plan. There is close relationship between welfare of the people and economic activities.
- One of the aims of planning is to co-operate with the activities of public and private sectors.
- People's co-operation is mainly to achieve the targets of the plan by giving them proper incentives.
- Economic activities are conducted both to earn profit and promote social welfare.
- Under democratic planning, significance is given both to price mechanism and government-decisions.

- Objectives of public sector and private sector are co-ordinated
- It is quite a flexible planning because scope is given to modify-the targets of private sector. Targets of Public Sector could be changed according to changed circumstances.
- It has a tendency of decentralization.
- Its main objective is to higher the standard of living of the people quickly. As such, consumer goods industries are given as much importance as heavy industries.

In democratic planning, the philosophy of democratic government is regarded as the ideological basis. Under this type of planning, the decisions of the private sector are influenced by incentives and partial controls through monetary and fiscal policies. People are involved at every step in the formation and implementation of the plan. In fact, democratic planning reconciles capitalism with government interference.

Since democratic planning is a planning by the people, for the people and of the people, the stateact as a representative of the people but not as a separate identity. The state government gives wide publicity to know the opinion of the people and tries its best to gain the cooperation and active support of the people in the country. It tries to avoid all clashes and tries to harmonies different opinions for the sake or welfare of the poor lots.

Therefore, different agencies, voluntary groups and other associations are closely linked and play pioneer role in its execution. Furthermore, the plan is fully debated in the Parliament, state legislature and in the private forums. The plan prepared by the planning commission is not fully accepted but it can also be rejected or modified. Thus, it acts systematically and is not forced to the people from the higher authority.

11.4.6 Totalitarian Planning

When planning is adopted under a planning, it is called totalitarian dictator. Under this planning, state fully takes over the economic affairs, productive resources and economic decisions. The state is the final authority in allocating the productive resources and it determines in accordance with the directions of the central authority.

The profits or production instead of being pocketed by the private capitalists go to the state for ameliorating the problems of the poor. Totalitarian planning shows the complete socialization of entire national economy. Under such planning, plans are formulated, controlled, financed and executed by the state and people have to do nothing in it. This type of authoritarian planning has found in the writing of Maurice Dobb.

➢ **Features of Totalitarian Planning**

Totalitarian Planning has the following features:

- Public sector alone functions in this type of planning. Government has full and direct control.
- Central Planning Authority formulates a comprehensive plan for the entire economy.
- There is no economic freedom and all economic decisions are taken by the government.
- People's welfare can be sacrificed at the altar of rapid economic development of the country. Minimum needs of the people alone are catered to.

- Means of production are controlled by the government that functions as an entrepreneur. Private enterprise has no place in it.
- Economic decisions are not taken by the market forces or price mechanism but by the government.
- There is no economic freedom. Government alone controls all economic activities.
- All economic activities like foreign trade, foreign capital, investment and loan etc. are controlled by the government.
- It is a rigid planning. People can be pressurized by the government for the achievements of the plan-targets.
- It is more comprehensive and efficient.

Regarding choice between democratic and totalitarian planning, some regard democratic planning as better because it gives complete freedom to consumers and producers. But this planning accelerates the pace of economic development slowly. Others regard democratic planning as imaginary since the interference by the government is indispensable. On the other hand, under totalitarian planning, there are big sacrifices by the public. But the pace of economic development is very fast. Prof. Myrdal has observed that 'planning in any way has affected democracy'.

11.4.7 Physical and Financial Planning

Financial planning refers to the technique of planning in which resources are allocated in terms of money while physical planning pertains to the allocation of resources in terms of men, materials and machinery

➢ **Physical Planning**

Physical planning "is an attempt to work out the implications of the development effort in terms of factor allocations and product yields so as to maximize incomes and employment." The physical balance consists in a proper evaluation of the relations between investment and output. Investment coefficients are computed. These coefficients indicate the amount of investment and also the composition of that investment in terms of various kinds of goods needed in order to obtain an increase of output of a product by a given amount. For example, how much iron, how much coal, how much electric power is needed in order to produce an additional ton of steel. On this basis, the planned increase in output of various products is balanced with the amounts and types of investment. It is also necessary to balance the outputs of the various sections of the economy because the output of one branch of the economy serves as an input for producing the output of another branch." Financial planning is only a means to achieve this end. Lack of financing to carry out an investment project in an underdeveloped country ordinarily does not reflect the lack of physical resources but In physical planning, an overall assessment is made of the available real resources such as raw materials, manpower, etc., and how they have to be obtained so that bottlenecks may not appear during the working of the plan. Physical planning requires the fixation of physical targets with regard to agricultural and industrial production, socio cultural and transportation services, consumption levels and in respect of employment, income and investment levels of the economy. There

must be proper balances in the various targets set in the plan. Moreover, physical planning has to be viewed as an overall long-term planning rather than a short-term piecemeal planning. Professor Balogh stresses the importance of physical planning in these words, "The only politically sound and morally responsible strategy involves steady pressure up to the limits of physical resources. It involves hair-sharp sectoral balance and concentration of attention on the widening of supply bottlenecks as they arise. The soundness of a plan from a national point of view can be tested only by the strain it causes. A lessening of strain, the accumulation, for instance, of foreign reserves. means that the system is not being driven to the utmost of its physical capacity.

- **Limitations of Physical Planning**

But physical planning has certain limitations in an underdeveloped country.

First, the most formidable problem in such economies is the lack of statistical data and information with regard to the available physical resources. If physical targets are fixed beyond the availability of resources on the basis of inaccurate data, planning will end in a fiasco

Secondly, another problem is that of balancing the different segments of the economy. It is not possible to attain internal consistency of a high order in an underdeveloped country due to its inherent structural difficulties. The country may not have reached that state of technology needed for achieving the targets laid down. There may be unexpected failure of harvests thus restricting the supply of agricultural commodities. Or, industrial production itself may fall due to the shortage of power supply. Dr. Lange suggests that in order to provide for such contingencies, the input-output and consumption balances must provide for certain reserve stocks.

Thirdly, such shortages in physical targets are bound to lead to inflationary pressures through an increase in prices. An inflationary process is extremely harmful for an underdeveloped economy where levels of income and saving are already very low. In such a situation, the Indian Planning Commission recommends physical controls and allocation.

11.4.8 Financial Planning

Financial planning refers to the technique of planning in which resources are allocated in terms of money while physical planning pertains to the allocation of resources in terms of men, materials and machinery

Finance is the main key to economic planning. If sufficient finances are available, it is not difficult to achieve physical targets. But without the stipulated financial resources, it is not possible to carry the plan to its successful culmination. Financial planning is essential in order to remove maladjustments between supplies and demand and for calculating costs and benefits of the various projects. The Indian Planning Commission points out that: "The essence of financial planning is to ensure that demands and supplies are matched in a manner which exploits physical potentialities as fully as possible without major and unplanned changes in the price structure"

In the case of financial planning "the outlay is fixed in terms of money and the estimates

are made on the basis of various hypotheses regarding the growth of the national income, consumption, imports, etc., to cover this outlay by taxation, savings and the increase in the cash holding." "This consists in establishing an equilibrium between the incomes of the population-wages, incomes of peasants and others and the amount of consumers goods which will be available to the population. Further it must establish equilibrium between that part of incomes of the population which will be used for private investment and the amount of investment goods made available to private investors. Finally, in the public sector a balance must be established between the financial funds made available for investment purposes and the amount of investment goods which will be produced or imported. In addition to these balances, it is necessary to establish the balances of foreign payments and receipts." Financial planning is thus thought to secure a balance between demands and supplies, avoid inflation and bring about economic stability.

- **Limitations of Financial Planning**

But this appears to be an exaggerated view, for financial planning has its limitations in an underdeveloped country

First, measures to mobilize financial resources through taxation may adversely affect the propensity to save

Secondly, in an underdeveloped country there is a vast subsistence non-monetized sector and a small organized money sector. Thus there is bound to be an imbalance between the two sectors. This will lead to shortages in supplies and to an inflationary rise in prices. As a result, physical targets are likely to be upset.

Thirdly, it is possible that supplies can be increased through imports, but they will lead to balance of payments difficulties from which underdeveloped countries already suffer.

Fourthly, to be successful, financial planning must be free from all bottlenecks, especially inflationary rise in prices. It is more appropriate to use it in sectoral planning rather than in overall planning

Lastly, financial planning is unsuited to an underdeveloped economy where this "means not merely loss of potential income but also a threat to the character of balanced social development because it results in an insufficient provision of employment at average wages relative to the increase in the population and thus increases inequality between those who are privileged to obtain employment and those whose needs both for work and income necessarily remain unmet."

CHECK YOUR PROGRESS

Q. 1: What is Economic Planning ?

Q. 2: When was Economic Planning started in India?

Q. 3: When NitiAayog replaced planning Commission?

Q. 4: Who is the chairman of planning Commission

Q. 5: Who is the first chairman of NitiAayog?

Q. 6: What is Democratic Planning?

Q. 7: How to make choice between Centralised and Decentralised Planning?

Q. 8: What are the objectives of Decentralised Planning?

Q. 9: Mention the features ofTotalitarian Planning

Q. 10: How to make choice between democratic and totalitarian planning?

11.5 LET US SUM UP

- The rationale for planning arises in underdeveloped countries to improve and strengthen the market mechanism. The market mechanism works imperfectly in underdeveloped countries because of the ignorance and unfamiliarity with it. To remove market imperfections, to mobilise and utilise efficiently the available resources, to determine the amount and composition of investment, and to overcome structural rigidities, the market mechanism is required to be perfected through planning.
- India has adopted a middle course of action in her development plans, a mixed economy in which both planning by direction and planning by inducement are playing their respective roles.
- Economic planning in India can be categorized into different types based on various factors such as the approach, focus, scope, and level of centralization. The types of economic planning in India aim to promote sustainable economic growth, reduce poverty and inequality, and provide access to basic amenities for all sections of society.
- Decentralized planning is superior to centralized planning. It provides economic freedom and flexibility in the economy. Dependence on market mechanism results into shortages or surpluses in the production of goods and services. The adjustment can be made only through government.
- In democratic planning, the philosophy of democratic government is regarded as the ideological basis. Under this type of planning, the decisions of the private sector are influenced by incentives and partial controls through monetary and fiscal policies. People are involved at every step in the formation and implementation of the plan. In fact, democratic planning reconciles capitalism with government interference.
- To quote second Five Year Plan, Physical planning, is an attempt to work out the implication of the development effort in terms of factor allocations and product yield so as to maximize incomes and employment. Financial planning is followed as a mean to achieve physical targets only. But the target under it, should be properly balanced. Further physical planning has to be viewed as an over all long-term planning rather than a short-term planning.
- Financial planning helps in removing disequilibrium between demand and supply

to avoid inflation and to bring about economic stability. Finance is the basic key to economic planning. Without financial resources, physical targets cannot be achieved.

- The long –run objectives are so divided into short-run that one by one all the objectives are achieved in the long long-run. In other words Short-run plans initiate ways for the achievement of long-run motives. For instance in India, under five years plans, the objectives of employment and national income have been ascertained on the basis of short and long-run

11.6 FURTHER READING

1) Dhar, P. K (2014) : *Indian Economy : Its Growing Dimension* (Guwahati: Kalyani)

11.7 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: Economic planning refers to any plans of economic activity which point to achieve specific social and economic outcomes.

Ans. to Q. No. 2: Economic planning started in India in 1951

Ans. to Q. No. 3: NitiAayog replaced Planning Commission in 1st January 2015.

Ans. to Q. No. 4: Prime Minister is the chairman of Planning Commission.

Ans. to Q. No. 5: Narendra Modi is the first chairman of NitiAayog.

Ans. to Q. No. 6: Democratic Planning implies a system of economic order in which the authority that vests in the state is based on the support of common masses

Ans. to Q. No. 7: Decentralized planning is superior to centralized planning. It provides economic freedom and flexibility in the economy. Dependence on market mechanism results into shortages or surpluses in the production of goods and services. The adjustment can be made only through government. If there are shortages of goods, it will lead to inflationary pressures.

These inflationary pressures can be controlled through price controls and rationing. But these create more problems than what they solve. Also it is not possible to coordinate the decision of the planned and unplanned activities. This may lead to disequilibrium in the demand for and supply of goods and services. Again decentralized planning provides economic freedom and incentives to the market economy while centralized planning provides cohesiveness to the economy.

Ans. to Q. No. 8: The objectives of Decentralised Planning are

(a) Effective implementation of poverty eradication programme

(b) Ensuring balanced regional development for meeting minimum needs of the people

(d) Ensuring active public participation in the development process of different sectors

Ans. to Q. No. 9: The importantfeatures of Totalitarian Planning are

- Public sector alone functions in this type of planning. Government has full and direct control.
- Central Planning Authority formulates a comprehensive plan for the entire economy.
- There is no economic freedom and all economic decisions are taken by the government.
- People's welfare can be sacrificed at the altar of rapid economic development of the country. Minimum needs of the people alone are catered to.
- Means of production are controlled by the government that functions as an entrepreneur. Private enterprise has no place in it.

Ans. to Q. No. 10: Regarding choice between democratic and totalitarian planning, some regard democratic planning as better because it gives complete freedom to consumers and producers. But this planning accelerates the pace of economic development slowly. Others regard democratic planning as imaginary since the interference by the government is indispensable. On the other hand, under totalitarian planning, there are big sacrifices by the public. But the pace of economic development is very fast. Prof. Myrdal has observed that 'planning in any way has affected democracy'

? 11.8 MODEL QUESTIONS

Short Questions (Answer each question in about 150 words)

Q 1: Explain any three features of Economic Planning in India.

Q 2: Explain the important points to be considered in Physical Planning.

Q 3: Write short notes on a) Rolling Plans and b) Fixed Plans and c) Indicative Planning

Long Questions (Answer each question in about 300-500 words)

Q 1: What is Decentralised Planning? Explain the importance of Decentralised Planning.

Q 2: What is Physical Planning? Distinguish between Physical Planning and Financial Planning.

Q 3: What is Planning by Direction? Explain the demerits of Planning by Direction

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UNIT 12: PLANNING IN UNDERDEVELOPED COUNTRIES

UNIT STRUCTURE

12.1 Learning Objective
12.2 Introduction
12.3 Meaning of Under Developed or Developing Country
12.4 Need for Planning in Under Developed Country
12.5 Prerequisites for the Successful Planning
12.6 Let Us Sum Up
12.7 Further Reading
12.8 Answers to Check Your Progress
12.9 Model Questions

12.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- give the meaning of underdeveloped or developing country
- analyse the need for planning in underdeveloped country
- explain the prerequisite for the successful planning.

12.2 INTRODUCTION

In unit 9, you have come across the system of economic planning. It comprises of the definition of planning, its features, needs of economic planning, the structure of planning etc. In this unit, we will discuss economic planning in the context of developing or underdeveloped country. At first, we will discuss the meaning of underdeveloped or developing countries as given by United Nations.Then we will analyse the need for planning in underdeveloped country. There are some prerequisite of a successful planning in each country. We have already discussed some of the conditions to make an economic plan successful. In this unit, we will discuss it in the developing country's perspective. We already know that economic planning is an indispensable part of most of the developing countries. The need of planning in these countries will also be discussed in a detailed manner.

12.3 UNDERDEVELOPED OR DEVELOPING COUNTRY: MEANING

Underdeveloped countries or least developed countries (LDC's) or developing countries are the countries listed by the United Nations. The listing is on the basis that these countries show the lowest indicators of socioeconomic development. The concept originated in the 1960s and the first list was coined by United Nations in 1971. Whether a country will be

considered as LDC or not will be decided on the basis of three factors. Firstly poverty to be measured in some stipulated units, secondly human resource weakness based on nutrition, health, education and literacy and thirdly economic vulnerability which is based on instability of agricultural production, instability of exports of goods and services, economic importance of non-traditional activities, merchandise export concentration, handicap of economic smallness, and the percentage of population displaced by natural disasters. As of December 2023, 45 numbers of countries are still considered as LDCs or underdeveloped countries. We are combining both the term underdeveloped and developing countries but some literature shows a few differences between them. According to those studies, underdeveloped countries are at the lowest level of development while developing countries' condition is a bit better than them. However, we will confine our discussion on planning while considering both the term as interchangeable.

12.4 NEED FOR PLANNING IN UNDERDEVELOPED COUNTRY

You have got the idea of economic planning and its related concepts in a detailed manner in our previous chapters. Here we will discuss the need for planning in underdeveloped or developing countries. Most of the developing countries of the world were under British colonial rule until 1950. In this period, they were significantly exploited by the British colonial rulers. For instance we can cite the example of our own country India.Prior to the colonial rule, India was quite prosperous but in the colonial rule it became underdeveloped and poor. Its handicrafts could not compete with the cheap imported industrial products, and as a result the artisans and workers employed in them were rendered unemployed. To meet their day to day living needs they tried to engage in agriculture. With this too many people came to be employed in agriculture than required resulting in disguised unemployment on a large scale.On attaining freedom from colonial rule, they adopted economic planning as a means of developing their economies.

You can consider the following points to know the needs of planning in the underdeveloped or developing countries.

1. **To correct market imperfections**: We all know that the markets in developing countries are characterized by widespread imperfections. For instance, the product markets in such countries are characterized by monopolies, oligopoly and other forms of imperfect market. Moreover, imperfect factor markets prevail in developing countries due to which factor prices determined do not reflect the social opportunity cost.Imperfection in product, factor and foreign exchange markets of developing countries would lead to economic inefficiency or Pareto non-optimality and would therefore be unable to achieve maximum social value. Exchange market is also imperfect in such countries. The national currency's exchange rate may be overvalued, discouraging exports and encouraging imports, resulting in balance of payments difficulties.There is therefore a case for the role of State and planning by it to remove these factors of price distortions if the goal of economic efficiency is to be achieved.

2. **To ensure benefits of positive externalities on resource allocation and economic growth:** Welfare oriented countries are concerned with generating positive externalities while resource allocation. It is important to know that most of the developing countries are welfare countries. You know that private sectors are guided by profit motive. So positive externality creating assets like healthcare and education will not be provided below than its production cost or on free basis by the private provider. Therefore, planning is very essential for such countries to provide education and health.

3. **To correct market failure**: Market failure means inefficient price mechanism resulting in undersupply or oversupply of resources. Due to lack of proper information and presence of uncertainty that are faced by both producers and consumers, developing countries often face this situation. In many developing countries, producers are unaware and unsure about the size of the market, the presence of competitors and availability of inputs etc. Such market failure can be corrected by government intervention in the form of proper economic planning. Through planning, government may provide required information of the market and intervene to guide the consumers and producers.

4. **To accelerate capital formation and economic growth**: We all know that the developing or underdeveloped countries are capital deficient. Due to this deficiency of capital, overall capital formation is low. This is mostly due to the low income of most of the workers in such countries and resultant low savings. It hampers the industrialization and modernization and technology upliftment in such countries.Therefore, proper economic planning is felt utmost necessary to accelerate capital formation and economic growth.

5. **Accelerating industrial growth**: There were two main features of economic policy of the developing countries, especially India that emphasized the role of planning and intervention by the State in the development process of the economy until 1980. First, to accelerate economic and industrial growth, economists and planners recognised that raising the rate of saving and investment was essential to accelerate the rate of economic growth.The State had to intervene to raise resources through its fiscal and monetary policy and thus increase the rate of saving and investment. This made the planning and the expansion of the public sector essential to accelerate economic growth.

6. **Promoting agricultural growth**: Economic planning is very much essential for promoting agricultural growth of the underdeveloped countries. These countries are mostly seen as agrarian with major portion of workforce depending on traditional agricultural practices. The productivity of such agricultural sector is low and hence income is also low. Agricultural modernization and growth is one of the prime prerequisite for overall development of an economy. Hence systematic planning in this regard is very necessary. Rapid growth of agriculture requires various forms of state intervention and planning. The land reforms in agriculture, supply of adequate credit to farmers, development of infrastructure such as irrigation, power, and roads were necessary where planning and the State could play an important role.

7. **State regulation of private sector and market**: There is another important aspect of the role of State and planning in the developing and underdeveloped countries. Though the private sector was given an important role to play in the framework of mixed economy like that of India, to achieve optimal allocation of resources among different industries, economic activities in the private sector were required to be regulated by the State. Here comes the essence of economic planning.

8. **Dealing with the problem of poverty and unemployment**: All the developing countries are facing the problem of poverty and unemployment. You all know that poverty is a situation where people are deprived of basic necessities of life namely food, shelter and clothing. And unemployment is a situation where job seeking people fail to get job opportunities at the prevailing wage rate. The problem of unemployment augments the problem of poverty. Both the problems are hence interrelated in nature.

The underdeveloped or developing countries prime agenda in the long term planning is therefore, reducing the problem of poverty and unemployment. For example in India also, significant effort has been given in various five year plans to reduce poverty and unemployment.

12.5 PREREQUISITE FOR SUCCESSFUL PLANNING

There are some conditions and prerequisites for an economic planning to be successful. Some of these prerequisite can be discussed as below:

1. **Central-Planning Authority:** The most important conditions for the success of an economic planning are the existence and operation of a central planning authority. For instance, in India, there was a central planning authority to visualize the long term goals of various five year plans namely Planning Commission and in Russia, there is Gosplan, a central authority to make and exercise the economic plans. This body carries a group of experts, economists, statisticians, and engineers etc. who deal with the different aspects of the economy. They suggest measures for the proper implementation of the plan.

2. **Reliable Statistical Data:** A pre-requisite for the sound and successful planning is the availability of reliable, adequate and accurate statistical data relating to various fields of the economy. For obtaining necessary statistical information, a survey of the existing and potential resources has to be undertaken like raw-material, capital, human and natural resources of the country. It is to be noted that due to absence of adequate and reliable data, many a time, planning in the developing country cannot meet up desired level of success.

3. **Specific Objective:** Another imperative condition for the success of economic planning is the presence of specific objective. The prescribed objectives should be definite and laid down in an order of priority keeping in view the urgency of economy's problems. Moreover, objectives should not be too many in number but should be realistic, mutually

compatible, flexible and feasible within means.

4. **Fixation of Targets and Priorities:** A successful economic planning should mention their targets, priorities and capabilities in a clear way. Moreover, various projectshavedifferent level of importance in the national and regional economy. So the plan executers should prioritize the plans according to their respective importance.However, the priorities should not be much rigid: rather it may be changed according to the requirements of the economy. These targets should be mutually consistent for attaining a particular growth rate for the economy.

5. **Suitable Economic Organization:** For the success of planning there must be suitable economic organization which promotes and faster the progress of the country. In other words, a strong central socialistic economic organization in which means of production are socialized is a basic condition for the realistic planning in a country. That's why socialistic countries like China and then Soviet Russia were famous for their strong and elaborative economic planning. But on the contrary, the experience of capitalistic countries show that private enterprise never promotes planning. It is because planning is basically a welfare oriented affair. But capitalistic economic system strives for profit motive only.

6. **Strong and Stable Government:** The success of economic planning also depends on the strong and stable government with a high degree of authority. Political stability is very essential for the overall success of economic planning. Planning process does not achieve desired level of success in many underdeveloped countries due to frequent change in their governments. In this matter, India is fortunate enough as it enjoyed considerate political stability during the period of its planning process.

7. **Fair and Efficient Administration:** The administrative machinery with a high degree of honesty and efficiency plays very pioneer role in the formulation and implementation of plans. Our country has a bitter experience in this regard. Even the best plans fail due to corrupt, inefficient, inactive and lethargic administration.

   In most of the poor and backward countries, there is a great paucity of trained and competent administration and technical personnel which is chief constraint in the development of the country. Prof. W.A. Lewis considers a strong competent and transperant administration as the first condition for the success of the plan.

8. **Mobilization of Resources:** The success of planningis based on the proper mobilization and utilization of financial resources of the country. In an underdeveloped country, resources are inadequate and irregular, ineffectively developed and mobilized to the required extent. Some of the underdeveloped countries are in fact rich in natural resources. But due to poor mobilization and inefficient utilization of resources, these countries remained poverty stricken. In this case, we can cite the example of our country India also. Despite having various valuable mineral and natural resources in a significant quantity, the development scenario of India is not very inspiring.

CHECK YOUR PROGRESS

Q.1: Who coined the first list of underdeveloped countries?

Q.2: What are the factors that determine the underdeveloped nature of a country?

Q.3: How many countries are still considered as underdeveloped countries?

Q.4: Mention three specific needs of economic planning in an underdeveloped economy?

Q.5: Give three prerequisite of a successful economic planning.

12.6 LET US SUM UP

The concept of underdeveloped countries originated in the 1960s and the first list was coined by United Nations in 1971.

- Whether a country will be considered as LDC or underdeveloped country or not will be decided on the basis of three factors-poverty, human resource weakness and economic vulnerability.
- As of December 2023, 45 numbers of countries are still considered as LDCs or underdeveloped countries.
- Most of the developing countries of the world were under British colonial rule until 1950.
- In this period they are significantly exploited by the British rulers for their own interest. In this case, we can cite the example of India also.
- We need proper economic planning in the underdeveloped or developing countries due to the following reasons
  a) to correct market imperfections and market failure
  b) to accelerate capital formation, industrial growth and overall economic growth of a specific country
  c) to provide the benefits of positive externalities in different sections of the economy
  d) to augment and modernize agricultural growth
  e) to reduce the problem of poverty and unemployment
- There are some prerequisite of a successful economic planning. They are-
  a) Existence and operation of a powerful central authority like that of Soviet Russia, China and India.
  b) Availability of adequate and reliable statistical data.
  c) Presence of specific and realistic objectives in the plan document in a detailed manner
  d) Fixation of targets and priorities to be achieved positively in a specific period of time.

e) For the success of planning there must be suitable economic organization which promotes and faster the progress of the country.

f) Existence of a strong and stable government is needed for the overall success of an economic planning.

g) The administration mechanism should be active, fair and efficient.

h) Moreover the success of planningis based on the proper mobilization and utilization of financial resources of the country.

12.7 FURTHER READING

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3) Ahuja, H. L. (2016). Development Economics. S. Chand.

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12.8 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: United Nations Coined the first list of underdeveloped countries in 1970.

Ans. to Q. No. 2: Whether a country will be considered as LDC or underdeveloped country or not will be decided on the basis of three factors-poverty, human resource weakness and economic vulnerability.

Ans. to Q. No. 3: As of December 2023, 45 numbers of countries are still considered as LDCs or underdeveloped countries.

Ans. to Q. No. 4: The need of economic planning is felt in the underdeveloped or developing countries due to various reasons. Three among them are-

a) To correct market imperfections

b) To correct market failure

c) To accelerate capital formation and economic growth

Ans. to Q. No. 5: There are some specific prerequisite for a successful planning in an underdeveloped country. Three among them can be stated as below:

a) Existence and operation of a powerful central authority like that of Soviet Russia, China and India.

b) Availability of adequate and reliable statistical data.

c) Presence of specific and realistic objectives in the plan document in a detailed manner.

12.9 MODEL QUESTIONS

Q.1: Give the definition of underdeveloped or developing countries.

Q.2: Discuss the needs of economic planning in an underdeveloped country.

Q.3: State the prerequisite for the success of economic planning in an underdeveloped country.

Q.4: Analyse the success and failure of economic planning in the context of developing country like India.

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UNIT 13: ECONOMIC PLANNINGIN INDIA

UNIT STRUCTURE

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13.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- understand the historical background, rationale, and institutional framework of economic planning in India, including the role of the Planning Commission.
- outline the objectives, priorities, and strategies adopted in the various Five-Year Plans implemented in India, from the First Five-Year Plan to the Twelfth Five-Year Plan.
- critically analyse the achievements and failures of the different Five-Year Plans across various sectors, and evaluate the challenges faced during their implementation.
- explain the reasons behind the abolition of the Planning Commission and its replacement with the NITI Aayog, and appreciate the ongoing debates surrounding the appropriate approach to economic policy-making in India.

13.2 INTRODUCTION

As mentioned previous chapters, economic planning has played a significant role in shaping India's development trajectory since gaining independence. After colonial rule, India

faced significant challenges such as widespread poverty, low industrial growth, and economic stagnation. To address these issues and achieve rapid socio-economic development, the newly formed government adopted a planned approach to economic development.

In India, economic planning was embraced as a means to transform the country's agrarian-based economy into a modern, industrialised nation. The establishment of the Planning Commission in 1950 marked the beginning of a comprehensive planning process, with the formulation and implementation of Five-Year Plans as the primary instrument for guiding the country's economic and social development.

The Five-Year Plans, which spanned from 1951 to 2014[1], were designed to address a wide range of issues, including industrial growth, agricultural productivity, employment generation, poverty alleviation, and the development of infrastructure and social services. Each plan had specific objectives, priorities, and strategies, reflecting the changing economic and political landscape of the country.

Throughout its journey of economic planning, India has witnessed both successes and failures. While notable achievements have been made in areas such as industrialization, infrastructure development, and poverty reduction, challenges persisted, including regional imbalances, inefficiencies in resource allocation, and the inability to fully address socio-economic disparities.

The Planning Commission was abolished by the government in 2014[2], and its position was taken by the NITI Aayog (National Institution for Transforming India) on 1st of January 2015, by indicating a change in the direction of a more decentralised and cooperative approach to economic planning and policymaking.

In this unit,we will delve into the meaning, types, history, rationale, Planning Commission and its framework of economic planning in India, thus developing a comprehensive understanding of the Five-Year Plans, their objectives, achievements, and failures. We will also explore the transition from the Planning Commission to the NITI Aayog and the ongoing debates surrounding the appropriate approach to economic policy-making in the country.

13.2.1 Meaning of Economic Planning

Economic planning involves the process of efficiently managing and utilizing the economic resources available in a country to meet specific socio-economic goals. The main goal of economic planning is to create a long-term vision and strategy for a country's economic development.

Hermann Levy, a German economist, defined economic planning as "a conscious and thoughtful control over production or distribution to secure a better balance between demand and supply".To achieve economic goals, economic planning involves developing strategies and policies. This is done by identifying objectives, prioritizing them, allocating resources, and implementing measures. Economic planning can be carried out at different levels, such as national, regional, or local levels. After the identification of goals and priorities, it becomes necessary to develop policies and strategies. These policies and strategies are crucial in

achieving the desired outcomes. They may include a focus on infrastructure development, export promotion, or improving access to education and healthcare. Once developed, these policies are implemented through a range of programs and schemes. The successful implementation of these programs and schemes is of paramount importance for achieving the desired outcomes.

For economic planning to be successful, several factors need to be taken into account. These include having enough resources, policies that work, and institutions that can put them into action.In many countries, economic planning is guided by a series of Five-Year Plans, which are periodically updated to reflect changes in economic priorities and conditions.

In essence, economic planning is when a government or an organisation determines what is important and how to allocate resources to achieve specific goals. They create plans based on predictions and establish rules to control the economy. The main aim of economic planning is to promote economic growth and development sustainably.

In 1951, India commenced economic planning with the coexistence of both public and private sectors. For four decades, the public sector was considered the engine of economic growth. However, with the beginning of the new economic policies i.e. liberalization, privatization and globalization(LPG), the government has started withdrawing direct involvement in productive activities, leaving most of the space to the private sector. Consequently, the private sector has now become the dominant sector, while the public sector is merely an adjunct to the former. In such an institutional arrangement of the Indian economy, there are two key components of economic planning:

1. The government mobilizes financial resources, both domestically and internationally, to undertake projects that, due to high linkages with the private sector, encourage productive activities in the latter.
2. The government implements monetary and fiscal policies that are expected to stimulate private economic activity and ultimately promote overall economic growth.

Economic planning in India follows a systematic approach that involves the following steps:

1. Firstly, all the prevalent economic problems are listed and prioritized based on their urgency. The problems that require immediate resolution are placed at the top of the list.
2. The problems that need to be addressed in the short run and the ones that require a long-term plan are identified and segregated accordingly.
3. A target is set either in terms of time or quantity to achieve the desired goal. Based on this, the amount of resources required to achieve the target is estimated and mobilized.
4. Finally, after arranging all the necessary resources such as human resources, financial resources, physical and material resources etc., the proposed plan is implemented. Periodic reviews are done to ensure that everything is on track. If not, appropriate changes are made to the plan and execution process.

13.2.2 Types of Economic Planning

There are several types of economic planning that countries follow to achieve sustainable economic growth and development. Some of the significant types are listed below:

- **Democratic planning:** In this type of planning, representatives of the people control the country's economy. They implement economic planning in the country. India follows the democratic form of government, and thus democratic planning is employed.
- **Decentralized planning:** In this type, the Central government sets overall targets of production and investment, and the State and local governments are given the freedom to achieve their targets. This type of planning is more efficient and productive in attaining the result and is more prevalent in countries such as France and Great Britain.
- **Planning by inducement:** In this type, the government uses persuasion to implement certain schemes of projects and tries to influence investment decisions by offering incentives to entrepreneurs through fiscal and monetary policies. However, this method is not time-efficient.
- **Financial planning:** It focuses on the allocation of financial resources, whereas physical planning focuses on the allocation of physical resources such as land, water, and minerals. Both types of planning are essential for achieving sustainable economic growth and development.
- **Indicative planning:** It is a planning approach that offers guidance and objectives for the private sector and market forces to adhere to. Imperative planning involves mandatory regulations and controls to achieve specific targets.
- **Rolling plans:** Rolling plans are flexible and are reviewed annually to reflect changing economic conditions, while fixed plans have a fixed duration and are not subject to mid-term revisions.

13.3 HISTORY OF ECONOMIC PLANNING IN INDIA

As we know, India was economically drained by the British for over two centuries, resulting in the exploitation of the country's resources for their own benefit. When the British left India in 1947, the country was faced with several problems such as poverty, inflation, food shortages, and lack of healthcare. In order to combat these issues, leaders believed that economic planning was necessary. Before India's independence, various plans were devised to promote economic development, including the Bombay Plan and the Gandhian Plan. However, these plans remained only on paper and were never implemented. Now let us understand why is it so.

The roots of economic planning in India can be traced back to the pre-independence era when the country was under British colonial rule. The concept of "economic planning" was not entirely new in India at that time. In 1934, Sir M. Visvesvaraya published a book called "Planned Economy for India", becoming the first person in the country to advocate for

economic planning and that is why he is known as the 'Father of the Planning Commission'. The idea of planned economic development was further developed during the 20th century, as India faced various economic and social challenges.

One of the earliest attempts of economic planning in India was the establishment of the National Planning Committee (NPC) in 1938, led by Pandit Jawaharlal Nehru. In 1944, the then eight leading Indian industrialists published a plan for the economic development of the country, which came to be known as the 'Bombay Plan'. The committee consisted of prominent industrialists, economists, and politicians, who drafted a comprehensive plan for the future development of India. The reportproposed a broad framework for industrialization, employment generation, and social welfare measures.The plan's objective was to double both the national income and per capita income during that time. It called for a five-fold rise in industrial production and a two-fold increase in agricultural output over 15 years. The plan proposed expenditures of Rs. 10,000 crores spread over 15 years.

The 'People's Plan' was a substitute for the Bombay Plan developed by the Indian Federation of Labour. M.N. Roy created this plan back in 1944. This plan aimed to provide basic needs to all the people in the country within a period of 10 years. The plan was worth Rs. 15000 crores. To achieve this aim, the plan laid a special emphasis on the development of agriculture through the nationalisation of land. This is justified by the fact that agriculture is the main industry and the foundation of the nation.

Another important plan known as 'The Gandhian Plan' was written in 1944 by S.N. Agarwal, the then-principal of Wardha Commercial College. It was constructed with Gandhian values in mind. This plan's primary objective was to create a decentralized, self-sufficient agrarian community with a focus on the growth of cottage enterprises. An estimated Rs. 3500 crores were needed to carry out this proposal.

The renowned socialist leader Jayaprakash Narayan created the 'Sarvodaya Plan', which was released in January 1950, as a single blueprint for the planned development of India following the publication of the NPC findings and the government's decision to proceed with the five-year plans. The Gandhian methods of constructive work by the community and trusteeship, along with the Sarvodaya concept of the renowned Gandhian constructive worker Acharya Vinoba Bhave, served as the main sources of inspiration for the plan. The plan's main concepts were very similar to those of the Gandhian Plan, including the emphasis on agriculture, small and cottage industries based on agriculture, land reforms, self-sufficient villages, decentralized participatory planning, and economic progress, among other things. Some of the acceptable ideas of the plan got their due importance when the Government of India promoted the five-year plans.

Lastly, the Colombo Plan for India was a 6-year plan which proposed to spend Rs.1,839 crores on development projects during the period 1951 to 1956. The plan aimed to increase the production of food grains, industrial raw materials and finished goods to improve the living conditions of the people of South and South-East Asia.

However, after India gained independence in 1947, the newly formed government, led by Pandit Jawaharlal Nehru, recognized the importance of economic planning in addressing

the country's developmental challenges. On 15th March 1950, the Planning Commission was established as an advisory body to the government, with the primary objective of formulating and implementing Five-Year Plans.With that regard, the "National Development Council" (NDC) was founded on August 6, 1952, to consolidate and mobilise national resources and efforts in support of the Planning Commission's Five-Year Plans. It served as a platform for cooperation and coordination between the central and state governments and is crucial in India's policy-making framework. The NDC formulates policies for various sectors, such as agriculture, industry, and infrastructure. It aims to promote balanced economic development in the country. The Prime Minister of India chairs the Council.

It was in 1951 that India started planned economic development by establishing the National Planning Commission. However, in 2015, the five-year plan was replaced by the three-year action agenda of NITI Ayog.

Now let us understand very briefly what the key objectives of these plans were.

The First Five-Year Plan (1951-1956) aimed to develop the agricultural sector and establish a strong industrial base. This plan focused on promoting agriculture and irrigation facilities.

Subsequent Five-Year Plans built upon the foundation laid by the First Plan and had their respective priorities and objectives. The Second Plan (1956-1961) prioritized heavy industrialization, while the Third Plan (1961-1966) aimed to achieve a self-reliant and self-generating economy, especially in food production through the Green Revolution.

The Fourth Plan (1969-1974) shifted its focus towards the growth of stability and progressive achievement of self-reliance. The Fifth Plan (1974-1979) emphasized on poverty alleviation and employment justice, agricultural production and defence.

The Sixth Plan (1980-1985) marked a shift towards economic liberalization, by eradicating poverty, generating employment opportunities and promoting technological advancement. The Seventh Plan (1985-1990) continued this trajectory, emphasizing economic productivity and employment through social justice.

Subsequent plans, including the Eighth (1992-1997), Ninth (1997-2002), Tenth (2002-2007), Eleventh (2007-2012), and Twelfth Five-Year Plans (2012-2017), focused on various aspects of economic development such as infrastructure, education, healthcare, and environmental sustainability while also addressing issues of fiscal discipline and economic reforms.

13.4 RATIONALE FOR ECONOMIC PLANNING IN INDIA

Now let us understand the main objectives of economic planning in India.

Economic growth - It is the first and foremost objective of economic planning in India. Economists argue that the economic growth of a country can be attained by increasing both the real national income and per capita income. When both of these factors grow, it results in a higher standard of living, not just for individuals but for society as a whole.

Poverty reduction - At the time of independence more than fifty percent of India's

population was poor. Lack of employment is a major cause of poverty. Many people in the country do not have access to even one square meal a day. As a result, the Planning Commission has decided to create an appropriate plan to eradicate povertyfrom the country.

Modernization of the economy - Since the inception of economic planning, modernization of the Indian economy has been the key objective of the planners. The introduction of structural and institutional changes in the three major sectors of the economy - agriculture, industry, and services - will lead to a modern and progressive economy. It is also crucial to develop a diversified economy that produces a wide variety of goods.

Increase in employment - The role of employment is of utmost importance in the production of goods and services. It is a critical factor that contributes to the overall growth and development of an economy. The availability of a skilled workforce is essential for the successful functioning of any business or industry. Unemployment is the cause of various social problems such as poverty, crime etc. So, the planners of the Indian economy put the creation of employment as one of the major objectives of economic planning.

Reduction in income inequality - India has a diverse population with varying economic standards, but income disparity is a major concern in the country. A large portion of the population falls under the lower-income category, while a few are in the high-income category. The main reason for this disparity is the unequal distribution of assets, such as per capita land holding and possession of movable and immovable property, which is often inherited. Therefore, planners aim to reduce this inequality while planning the country's economy.

Self-sufficiency - Self-sufficiencyhas been one of the main goals of economic planning in India, particularly in areas such as food, energy, and defence. The government has achieved this by promoting domestic production, decreasing reliance on imports, and encouraging indigenous research and development.

Social justice and equity - The economic planning in India endeavours to foster social justice and equity by ensuring that the benefits of economic growth are equitably distributed across all sections of society. The principal objective of this approach is to establish a more inclusive and fairer economic framework that promotes the welfare of all citizens. In light of this, Government is committed to implementing policies and programs that focus on reducing disparities in income and wealth, especially among marginalized and disadvantaged communities. By doing so, the Indian economy can achieve sustainable and equitable growth, which is essential for promoting long-term prosperity and social stability.

Reducing regional disparities - India is a vast country that experiences significant regional disparities in terms of income, infrastructure, and access to basic services such as healthcare and education. To address these disparities, economic planning is undertaken to allocate resources to underdeveloped regions and promote balanced regional development.

Balanced Regional Development - Economic planning aims to promote balanced regional development by investing in infrastructure, setting up industries in backward areas, and promoting entrepreneurship to ensure the benefits of development reach all parts of the country.

Increased Standard of Living - Economic planning in India aims to increase the standard of living of the people by promoting economic growth and providing access to basic amenities such as healthcare, education, and housing.

Social Welfare and Provision of Efficient Social Services - The objective of all five-year plans, including those suggested by NITI Aayog, is to enhance labour and social welfare for all sections of society. Development of social services in India, such as education, healthcare and emergency services have been part of planning in India.

13.5 PLANNING COMMISSION IN INDIA:OBJECTIVES& FUNCTIONS

Objectives:

- In 1950, the Indian Government established the Planning Commission under the Chairmanship of Pandit Jawaharlal Nehru, the first Prime Minister of independent India.
- The Planning Commission was a non-constitutional body. It operated under the guidance of the National Development Council (NDC), which served as the primary policy-making body in the country.
- The commission was set up to formulate economic plans keeping in view the resources of the country and suggesting the best methods to utilize them effectively and in a balanced manner.
- To address various socio-economic problems, the Indian government adopted the five-year planning system.
- In July 1951, the Planning Commission presented the draft outline of the first five-year plan which lasted from 1951 to 1956.
- From 1951 to 2017, the Government of India implemented 12 five-year plans in total.

Functions:

- The functions of the Indian Planning Commission, as outlined by the government's 1950 resolution, are as follows:
- To make an assessment of the material, capital and human resources of India, including technical personnel, and investigate the possibilities of augmenting those related resources which are found to be deficient in the nation's requirement.
- To formulate a plan for the most effective and balanced utilisation of the country's resources.
- To define the stages, based on priority, in which the plan should be carried out and propose the allocation of resources for the due completion of each stage.
- To indicate the factors that tend to retard economic development.
- To determine the conditions which need to be established for the successful execution of the plan within the incumbent socio-political situation of the country.
- To determine the nature of the machinery required for securing the successful implementation of each stage of the plan in all its aspects.
- To appraise from time to time the progress achieved in the execution of each stage of the plan and also recommend the adjustments of policy and measures which are deemed important vis-a-vis a successful implementation of the plan.

- To make necessary recommendations from time to time regarding those things which are deemed necessary for facilitating the execution of these functions. Such recommendations can be related to the prevailing economic conditions, current policies, measures or development programmes. They can even be given out in response to some specific problems referred to the commission by the central or the state governments.

CHECK YOUR PROGRESS

Q. 1: What were the main challenges faced by India after gaining independence?

Q. 2: What is the goal of economic planning in India?

Q. 3: When did economic planning begin in India and what was the role of the Planning Commission?

13.6 ACHIEVEMENTS AND FAILURES OF DIFFERENT FIVE-YEAR PLANS IN INDIA

We shall discuss the achievements and failures of all the 12 five-year plans one by one:

First Five-Year Plan (1951 to 1956):

- The targeted growth was 2.1% and actual growth was 3.6%.
- The first plan was made based on the Harrod-Domar model which was developed independently by R.F. Harrod and E. Domar.
- The main objective of this plan was to increase agricultural production and thereby increase the growth of the sector. The focus was on achieving full employment, eliminating economic disparities, and improving power and transportation infrastructure.
- Some objectives, including food self-sufficiency, refugee rehabilitation, and price stability, were partially achieved.
- During the initial five-year plan, the government established five Indian Institutes of Technology (IITs).

Second Five-Year Plan (1956 to 1961):

- The targeted growth was 4.5% and actual growth was 4.3%.
- Simple aggregative Harrod Domar Growth Model was again used for overall projections and the strategy of resource allocation to broad sectors such as agriculture & Industry was based on a two &four-sector Model prepared by Prof. P C Mahalanobis(Plan is also called Mahalanobis Plan).
- The second plan was created during a period of economic stability, leading to the belief that agriculture could be given a lower priority.
- The plan was centred on speedy industrialization, with a focus on the development of heavy and basic industries. This plan advocated for huge imports through foreign loans.
- The Industrial Policy of 1956 was based on the establishment of a socialistic pattern of society as the goal of economic policy.

- Due to an acute shortage of forex, development targets were trimmed and prices rose about 30% compared to the previous plan, resulting in moderate success for the 2nd FYP.

Third Five-Year Plan (1961-66):

- The targeted growth was 5.6% and actual growth was 2.8%.
- India's economy aimed to become self-reliant and self-generating during its take-off stage.
- This plan laid the foundation for the growth of small and medium-sized industries as well as cottage industries.
- Based on the experience of the first two plans (agricultural production was seen as a limiting factor in India's economic development), agriculture was given top priority to support exports and industry.
- It was during this plan period, that India resorted to borrowing from the International Monetary Fund (IMF) for the first time.
- The Plan was a thorough failure in reaching the targets due to unforeseen events - Chinese aggression (1962), Indo-Pak war (1965), and severe drought 1965-66. Due to conflicts the approach during the later phase was shifted from development to defence & development.

Three Annual Plan- Plan Holidays (1966-69):

- Failure of the Third Plan of the devaluation of the rupee (to boost exports) along with inflationary recession led to the postponement of the Fourth FYP. Three Annual Plans were introduced instead. Due to a severe food shortage, the Annual Plans emphasizedthe agricultural sector.
- A new agricultural strategy was implemented during these plans. It involves wide-spread distribution of high-yielding varieties of seeds, extensive use of fertilizers, exploitation of irrigation potential and soil conservation.
- During the Third Plan, the economy successfully absorbed shocks as part of the Annual Plans.
- It paved the path for the planned growth ahead.

Fourth Five-Year Plan (1969-1974):

- The targeted growth was 5.6% and actual growth was 3.3%.
- The fourth plan aimed to achieve self-reliance and stability, specifically in the defence sector, while promoting growth.
- The family planning programs were introduced during this plan.
- Special emphasis was laid on improving the conditions of poor and underprivileged sections of society by providing education and employment.
- The main focus was on increasing the growth rate of agriculture, which would help other sectors progress. The first two years of the plan were successful, as they saw a record production. However, the last three years did not meet expectations due to a poor monsoon season.

- Post Indo-Pak war of 1971, there was a huge influx of Bangladeshi refugees into the country which created a scarcity of resources. This led to the failure of the plan.

Fifth Five-Year Plan (1974-79):

- The targeted growth was 4.4% and actual growth was 4.8%.
- The final draft of the fifth plan was prepared and launched by D.P. Dhar during a time of economic crisis. This crisis was caused by runaway inflation, which was fueled by an increase in oil prices. Additionally, the government takeover of the wholesale trade in wheat had failed.
- The proposal aimed to accomplish two primary goals: the eradication of poverty (Garibi Hatao) and the attainment of self-sufficiency.
- Promotion of a high rate of growth, better distribution of income and significant growth in the domestic rate of savings were seen as key instruments
- The original cost calculations for the Plan turned out to be incorrect due to high inflation, leading to an increase in the public sector outlay. Following the declaration of the emergency in 1975, the focus shifted to implementing the Prime Minister's 20-Point Programme, causing the FYP to be given less priority. The Plan was eventually terminated when the Janta Party came to power in 1978.

Rolling Plan (1978-80):

Two Sixth Plans were implemented, with the Janta Government proposing a plan for 1978-1983 that emphasized employment as opposed to the Nehru Model. The government criticized the Nehru Model for its concentration of power, widening inequality, and mounting poverty. However, the Janta Government lasted for only two years. When Congress Government returned to power in 1980, it launched a different plan that aimed to directly address the problem of poverty by creating conditions for an expanding economy.

Sixth Five-Year Plan (1980 - 85):

- The targeted growth was 5.2% and actual growth was 5.7%.
- The Plan focused on an Increase in national income, modernization of technology, ensuring a continuous decrease in poverty and unemployment through schemes for transferring skills (TRYSEM) and assets creation (IRDP) and providing slack season employment (NREP), controlling population explosion etc. Broadly, the sixth Plan could be taken as a success as most of the targets were realised even though during the last year (1984-85) many parts of the country faced severe famine conditions and agricultural output was less than the record output of the previous year.
- It marked the start of economic liberation by removing price controls.
- It was considered as the end of Nehruvian Socialism.
- Family planning was introduced to prevent overpopulation.
- The National Bank for Agriculture and Rural Development was established based on the recommendation of the Shivaraman Committee.

Seventh Five-Year Plan (1985-90):

- The targeted growth was 5.0% and the actual growth was 6.0%.
- The plan was initiated under the leadership of Rajiv Gandhi's Prime Ministership.
- It aimed to enhance industrial productivity levels by utilizing technology. Additionally, it sought to boost economic productivity, increase food grain production, and create employment opportunities through social justice initiatives.
- The success of the Sixth Five-Year Plan provided a solid platform for the Seventh Five-Year Plan.
- Emphasis was placed on combating poverty, employing modern technology, and transforming India into a self-sufficient economy.
- The goal was to attain the necessary conditions for self-sustained growth by the year 2000.
- The Plan focused on accelerating food grain production, increasing employment opportunities, and raising productivity with an emphasis on "food, work, and productivity."
- The plan was highly effective, as the economy recorded a 6% growth rate, surpassing the targeted 5% for the 1980s, which marked a departure from the "Hindu Rate of Growth.".
- Following this plan, there was a Plan Holiday from 1990 to 1992 due to the political instability and economic crisis that existed then in India.

Annual Plans- Plan Holidays (1990-92):

In 1990, the Indian government did not introduce the Eighth Five-Year Plan due to economic instability. Instead, the years 1990-91 and 1991-92 were treated as Annual Plans. During this time, India faced a foreign exchange reserve crisis. To address this issue, Prime Minister P.V Narasimha Rao introduced Liberalization, Privatization, and Globalization (LPG) policies.

Eight Five-Year Plan (1992-97):

- The targeted growth was 5.6% but the actual growth was 6.8%.
- The eighth plan's implementation was delayed by two years due to political instability at the central government level.
- During the launch of the plan, the main economic issues included a worsening balance of payment position, rising debt burden, growing budget deficits, industrial recession, and inflation.
- To address these challenges and achieve an annual average growth rate of 5.6% through fiscal and economic reforms, including liberalization, the plan implemented drastic policy measures under the leadership of Prime Minister Shri P V Narasimha Rao.
- During the eighth plan period, there were several key economic outcomes, including rapid economic growth (the highest annual growth rate to that point at 6.8%), significant growth in the agriculture and allied sectors, as well as the manufacturing sector, growth in exports and imports, and improvements in the trade and current account deficits. Despite a considerable decline in the public sector's share of total investment to about 34%, a high growth rate was still achieved.

Ninth Five-Year Plan (1997- 2002)

- This plan was an extension of the eighth plan, with a focus on growth and social justice. Priority was given to agriculture and rural development for generating adequate productive employment and eradication of poverty.
- Provisions to provide safe drinking water, PHC facilities, UPE, shelter and connectivity to all in a time-bound manner were made under this plan.
- It also aimed to ensure food and nutritional security to all, particularly to the weaker sections of society.
- The government aimed to support social welfare programs to completely eradicate poverty and collaborated with both the public and private sectors to ensure economic growth.
- The government also strived to balance between rapid growth and the quality of life of the citizens.
- The objectives included empowering socially disadvantaged communities, promoting self-reliance, and ensuring primary education for all children.
- The strategies implemented included increasing the rate of exports to achieve self-reliance and leveraging scarce resources for rapid growth, among others. The target growth rate was estimated at 6.5% but its actual growth rate fell shorter to 5.4%.

Tenth Five-Year Plan (2002-07)

- This plan aimed to promote inclusive growth and equitable development.
- It is intended for an 8% GDP growth per year.
- It aimed at reducing poverty by half and creating employment for 80 million people.Furthermore, the objective was to lessen the disparities between different regions.
- By 2007, it was emphasised to reduce gender gaps in education and wage rates.
- The target growth rate was 8.1% while the actual growth was 7.6%.
- The Tenth Plan recognized that economic growth alone could not be the sole objective of the national plan. As a result, the plan established “monitorable targets” for several critical development indicators, in addition to the 8% growth target. These targets included a reduction in gender gaps in literacy and wage rates, the reduction of infant and maternal mortality rates, improvements in literacy, access to potable drinking water, cleaning of major polluted rivers, and more. Governance was considered a factor of development, and agriculture was designated as the primary driving force of the economy. The plan aimed to increase the role of states in planning, with greater involvement of Panchayati Raj Institutions. The plan sought to achieve balanced development of all states through state-wise breakdowns of growth and social development targets.

The following were the main objectives of the tenth plan:

- Providing access to basic services such as education, health, drinking water and sanitation.
- Substantial allocation of resources to the social sector and major improvement in governance for effective use of resources.

- Reduction in poverty to 5% by 2007 and 15% by 2012.
- To reduce the gender gap in literacy and wage rate to 50% by 2007 and population growth to 16.2% during 2001-2011.
- To provide sustained access to drinking water for all villages in the country by 2007.

Eleventh Five-Year Plan (2007–2012)

- The theme of the 11th plan was "towards faster and more inclusive growth".
- Though the Indian economy witnessed growth, it was not perceived as sufficiently inclusive by various vulnerable sections of the society. Thus, the concept of inclusive growth was introduced in this plan.
- Agriculture, infrastructure and education were the key areas of concern during this plan period.
- Around 27 detailed national targets, ranging from enhancing production and incomes to literacy, health, child development, poverty reduction etc., were set under the 11thplan.
- The Eleventh Five Year Plan aimed to increase agricultural, industrial, and service growth rates to 4%, 10%, and 9% respectively. Additionally, it aimed to provide safe drinking water to every individual by 2009.
- This plan prioritized higher education and focused on distance education as well as IT institutes. For example, the Right to Education Act was introduced in 2009 and made education free and compulsory for children aged between 6-14 years.
- The Eleventh Plan also aimed at environmental sustainability and reducing gender inequality.
- C. Rangarajan was the person who prepared the Eleventh Five Year Plan.
- Even though the target rate was 9%, the actual growth rate achieved was 8%.

Twelfth Five-Year Plan (2012-17)

- The last Five-Year Plan had "Faster, More Inclusive and Sustainable Growth" as its theme.
- The objective of the plan was to strengthen infrastructure development and guarantee electricity supply to all villages.
- Additionally, it aimed to eliminate gender and social disparities in school admissions and expand access to higher education.
- The plan also sought to increase the green cover by one million hectares annually and generate new opportunities in the non-farm sector.
- The target growth rate was set at 9%, but in 2012, the National Development Council approved a growth rate of 8% for the twelfth plan.But the actual growth for the five years were 5.1% (2012-13), 6.9% (2013-14), 7.2% (2014-15), 7.6% (2015-16), 7.1% (2016-17) respectively.
- The Twelfth Five Year Plan 25 core indicators reflect its commitment to promoting economic growth, reducing poverty and unemployment, expanding access to education, health, and infrastructure, protecting the environment, and improving the delivery of public services.

1. Economic Growth

- A GDP growth rate of 8.0% and an agricultural growth rate of 4.0% are targeted.
- A manufacturing growth rate of 10.0% is aimed for, with each state ideally exceeding the Eleventh Plan's growth rate.

2. Poverty and Employment

- Head-count ratio of consumption poverty to be reduced by 10% points over the preceding estimates by the end of the Twelfth FYP.
- To generate 50 million new employment opportunities in the non-farm sector and provide skill certification to equivalent numbers during the Twelfth FYP.

3. Education

- Mean Years of Schooling to increase to seven years by the end of the Twelfth FYP.
- To enhance access to higher education by creating two million additional seats for each age cohort aligned to the skill needs of the economy.
- To eliminate gender and social gap in school enrolment (that is, between girls and boys, and between SCs, STs, Muslims and the rest of the population) by the end of the Twelfth FYP.

4. Health

- To reduce IMR to 25 and MMR to 1 per 1,000 live births, and improve Child Sex Ratio (0–6 years) to 950 by the end of the Twelfth FYP.
- To reduce the Total Fertility Rate to 2.1 by the end of the Twelfth FYP.
- To reduce under-nutrition among children aged 0–3 years to half of the NFHS-3 levels by the end of the Twelfth FYP.

5. Infrastructure, Including Rural Infrastructure

- To increase investment in infrastructure as a percentage of GDP to 9% by the end of the Twelfth FYP.
- To increase the Gross Irrigated Area from 90 million hectares to 103 million hectares by the end of the Twelfth FYP.
- To provide electricity to all villages and reduce AT&C losses to 20% by the end of the Twelfth FYP.
- Connecting all villages with all-weather roads by the end of the Twelfth FYP.
- Upgrading national and state highways to the minimum two-lane standard by the end of the Twelfth FYP.
- To complete Eastern and Western Dedicated Freight Corridors by the end of the Twelfth FYP.
- Increase rural tele density to 70% by the end of the Twelfth FYP.
- Ensuring 50% of the rural population has access to 40 LPCD piped drinking water supply, and 50%-gram panchayats achieve Nirmal Gram Status by the end of the Twelfth FYP.

6. Environment and Sustainability

- To increase green cover (as measured by satellite imagery) by 1 million hectares every year during the Twelfth FYP.
- Adding 30,000 MW of renewable energy capacity in the Twelfth Plan
- Reducing emission intensity of GDP in line with the target of 20% to 25% reduction over 2005 levels by 2020.

7. Service Delivery

- To provide access to banking services to 90% of Indian households by the end of the Twelfth FYP.
- Major subsidies and welfare-related beneficiary payments are to be shifted to a direct cash transfer by the end of the Twelfth Plan, using the Aadhar platform with linked bank accounts.

CHECK YOUR PROGRESS

Q. 4: What were the objectives of the Five-Year Plans in India?

Q. 5: What were the successes and failures of India's economic planning journey?

Q. 6: What factors contribute to the success of economic planning in a country?

Q. 7: How does economic planning in India aim to reduce income inequality?

Q. 8: Which model was adopted in the first five-year plan?

13.7 REASONS FOR THE ABOLITION OF THE PLANNING COMMISSION

The erstwhile Planning Commission was originally established with an advisory role but over time it had emerged as a powerful and directive authority. After the liberalization era began in 1991, there was a shift in emphasis from indicative planning to detailed planning in some keyareas such as poverty alleviation, rural and agricultural development, drinking water, education, and other social services. Furthermore, in several sectors of the economy, the private sector was given a greater role and responsibility to stimulate growth. These domains typically pertain to commerce, trade and industry. In adopting an indicative planning strategy for such growth regions, the Planning Commission acknowledged the significant role of the private sector as well as Public Private Participation (PPP) in a few key development areas. Thus, two approaches to planning co-existed side by side, traditional detailed planning and indicative planning.

There has also been a contention that, in the federal system, the Planning Commission has infringed upon state autonomy. The intrusion was perceived as pertaining to the Planning Commission's decision to approve, alter, or reject the state proposals for the development plans, which required a central financial assessment that could only be approved on the Planning Commission's suggestion.

Nonetheless, the Planning Commission has been criticized for generally going beyond its stated responsibilities and expected authority and taking on some administrative powers.

Recall that the Planning Commission should limit its role to developing perspectives, five-year and annual plans, as well as resource assessments and evaluations. It should not become involved in the actual implementation of the plans, as that was the sole purview of the executive agencies. This was emphasized by the First Administrative Reforms Commission in its Report on the Machinery of Planning. Additionally, the commission emphasized that the Planning Commission should not be engaged in activities that are solely administrative in nature.

As previously stated, the Planning Commission was not established by statute and was not included in the Indian Constitution. With planning's range of influence growing over time, its functions have grown significantly and now encompass nearly every aspect of administration, except foreign affairs and defence. Not surprisingly, some referred to it as the "economic cabinet of the country as a whole." It has been said that it even infringed upon the powers of constitutional authorities like the Finance Commission due to its strong position under the Prime Minister's supervision, although not being answerable to the Parliament. It built up a heavy bureaucratic organization which led even Jawaharlal Nehru, the commission's first Chairman, to observe: "The Commission which was a small body of serious thinkers, had turned into a government department complete with a crowd of secretaries, directors and, of course, a big building."

Some of the major criticisms of planning in India are:

(i) Lack of Perspective in Planning
(ii) Failure in Promoting Balanced Growth and Development
(iii) Highly centralized nature of Planning
(iv) Lop-sided employment strategy
(v) Excessive emphasis on PSUs
(vi) Agriculture overshadowed by the industry
(vii) Faulty industrial location policy
(viii) Wrong Financial strategy
(ix) Politicization of the Planning Process

13.8 NITI AAYOG

In 2015, National Institution for Transforming India (NITI Aayog) replaced Planning Commission of India.The term "NITI" comes from the Sanskrit word for "moral guidance" and "policy making." NITI Aayog is an executive body and not a statutory or constitutional body. It aims to boost the country's economic growth and help India emerge as a strong economy worldwide.

NITI Aayog serves as a policy think tank of the Indian government, providing policy-related and directional input to the government of India. It also offers technical advice to states and centre in addition to assisting the central government. Compared to previous planning commission approaches, NITI Aayog takes a collaborative approach by providing diversified points of view rather than being confrontational.

- Chairman of NITI Aayog – PM Narendra Modi
- Vice-Chairman of NITI Aayog – Dr. Rajiv Kumar (September 2017 – present)

13.8.1 Composition of NITI Aayog

The composition of NITI Aayog is as follows:

- The Chairperson, who is also the Prime Minister of India
- The Chief Ministers of all states and Union Territories, as well as the Lieutenant Governors of Union Territories
- Regional Councils: These are constituted to address the contingencies which impact more than one state. The Regional Council is convened by the Prime Minister and consists of the Chief Ministers of states and Lieutenant Governors of Union Territories, all with fixed tenures.
- Special Invitees: They are nominated by the Prime Minister and are expert practitioners and specialists in a particular domain.
- Full-term organizational framework: It consists of the vice-chairpersons, the members, part-time members, ex-officio members, the chief executive officer, and the secretariat.

13.8.2 Seven Pillars of NITI Aayog

The 7 pillars of NITI Aayog are based on good governance and they form the theme of the think tank.

1. Pro-people
2. Pro-activity
3. Participation
4. Empowering
5. Inclusion of all
6. Equality
7. Transparency

13.8.3 Objectives of NITI Aayog

- The primary objective of NITI Aayog is to establish a shared vision among all states and prioritize national development with their active participation.
- To prepare and formulate the plans at the grassroots level in the villages and work on them seriously and progressively at the higher levels of government.
- It aims to ensure that all sections of society are financially benefited and none are left behind.
- NITI Aayog formulates long-term plans, policies, and frameworks and monitors program efficiency.

- NITI Aayog is a watchdog that ensures the implementation of technology in government programs and initiatives in India.
- NITI Aayog implements government programs and identifies resources to improve livelihoods.

13.8.4 Indexes released by NITI Aayog:

Apart from the Reports published by NITI Aayog, there are several indices and index released by NITI Aayog:

- Composite Water Management Index
- District Hospital Index
- Export Preparedness Index
- Global Innovation Index
- India Innovation Index
- Multidimensional Poverty Index
- School Education Quality Index
- SDG India Index
- State Energy Index
- State Health Index

13.9 LET US SUM UP

- Economic planning played a significant role in shaping India's development trajectory since independence.The Planning Commission was established in 1950 to formulate and implement Five-Year Plans.
- Economic planning in India started in 1951, focusing on the public sector and transitioning to the dominance of the private sector with liberalization. It follows a systematic approach that involves listing and prioritizing economic problems and implementing them in the Five-Year Plans.
- It involves the conscious allocation of resources and formulation of policies to achieve specific economic and social objectives.
- India adopted economic planning to transform its agrarian-based economy into a modern, industrialized nation. The government mobilizes resources and implements policies to stimulate private economic activity and promote growth in India.
- Five-Year Plans addressed issues like industrial growth, agricultural productivity, poverty alleviation, and infrastructure development.
- India witnessed successes in areas like industrialization and poverty reduction, but challenges like regional imbalances persisted.
- The Planning Commission was replaced by the NITI Aayog in 2014, signalling a more decentralized approach to economic planning.

- Economic planning involves listing and prioritizing economic problems, setting targets, and mobilizing resources.
- Types of economic planning in India include democratic planning, decentralized planning, and planning by inducement.
- The NITI Aayog aims to boost India's economic growth and position the country as a strong global economy.

13.10 FURTHER READING

1) Singh, Ramesh Singh. (2020-21).*Indian Economy.* McGraw Hill.

2) Kapila, Uma Kapila (2023-24). *Indian Economy: Performance And Policies.* 24th Edition. Academic Foundation

13.11 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: India faced challenges such as widespread poverty, low industrial growth, and economic stagnation after gaining independence.

Ans. to Q. No. 2: The goal of economic planning in India is to promote balanced and sustainable growth, reduce regional disparities, and ensure an equitable distribution of resources and opportunities.

Ans. to Q. No. 3: Economic planning began in India in the pre-independence era, with the establishment of the National Planning Committee in 1938, which drafted a comprehensive plan for the future development of the country. However, it was after India gained independence in 1947 that the government recognized the importance of economic planning in addressing the country's developmental challenges. In 1950, the Planning Commission was established as an advisory body to the government, with the primary objective of formulating and implementing Five-Year Plans. The Planning Commission played a significant role in India's economic planning process, with the formulation and implementation of Five-Year Plans as the primary instrument for guiding the country's economic and social development.

Ans. to Q. No. 4: The objectives of the Five-Year Plans in India included industrial growth, agricultural productivity, employment generation, poverty alleviation, and the development of infrastructure and social services.

Ans. to Q. No. 5: India's economic planning journey has witnessed both successes and failures, with notable achievements in areas such as industrialization, infrastructure development, and poverty reduction, but challenges persist in regional imbalances, inefficiencies in resource allocation, and socio-economic disparities.

Ans. to Q. No. 6: The success of economic planning depends on factors such as the availability of resources, the effectiveness of policies and strategies, and the capacity

of institutions to implement them.

Ans. to Q. No. 7: Economic planning in India aims to reduce income inequality by addressing the unequal distribution of asset holdings and implementing policies that promote a more equitable distribution of resources and opportunities

Ans. to Q. No. 8: he First Five-Year Plan (1951-1956) in India adopted the Harrod-Domar model for its economic planning.

? 13.12 MODEL QUESTIONS

Short Questions(Answer each question in about 150 words)

Q. 1: What is indicative planning and when was it adopted in India?

Q. 2: How is economic planning carried out in India and what factors contribute to its success?

Q. 3: What are the different types of economic planning followed in countries?

Q. 4: In which plan did the Planning Commission adoptthe Mahalanobis model?

Q. 5: What is the significance of achieving self-sufficiency in key areas like food, energy, and defence?

Q. 6: Discuss briefly the role of NITI Aayog in India.

Long Questions (Answer each question in about 300-500 words)

Q. 1: What isthe rationale for economic planning in India?

Q. 2: What are some of the successes and failures of India's economic planning?

Q. 3: What replaced the Planning Commission in 2014 and what does it signify?

Q. 4: What is NITI Aayog and how does it differ from the Planning Commission?

Q. 5: What were the objectives and achievements of the Five-Year Plans in India's economic development? Discuss in detail.

Q. 6: Explain the transition from the Planning Commission to the NITI Aayog and its implications for economic planning in India.

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UNIT 14: NITI AAYOG

UNIT STRUCTURE

14.1 Learning Objectives

14.2 Introduction

14.2.1 The mandate of the institution incorporated as below

14.3 The NITI Ayog has the following Aims and Objectives

14.4 Functions of NITI Ayog

14.5 NITI Ayog constitution

14.6 NITI Ayog flagship initiative

14.6.1 Competitive Federalism

14.7 The significant programs of NITI Ayog are:

14.8 Let Us Sum Up

14.9 Answers to Check Your Progress

14.10 Further Reading

14.11 Model Questions

14.1 LEARNING OBJECTIVES

After going through this unit, you will be able to:

- explain the origin, mandate and institutional structure of NITI Aayog.
- distinguish NITI Aayog from the erstwhile Planning Commission in terms of role and approach to planning.
- analyse how NITI Aayog advances cooperative and competitive federalism, inclusive growth and SDGs.
- trace the major functions, plans and flagship programmes of NITI Aayog in India's development process.

14.2 INTRODUCTION

In 2014, the Planning Commission, which had been one of the main pillars of the development of the Indian economy in the last 60 years, was dissolved. The Planning Commission was also accused of being top-down and bureaucratic. It dwelled heavily on centralized planning and the distribution of resources, and was often in touch with the wide range of needs and ambitions of states and regions of India. The government of India realized these shortcomings, and thus embarked on a process of reform to make it more responsive and effective.

Its successor, the National Institution of Transforming India (NITI Aayog), was set up with the purpose of adopting a cooperative federalism, inclusive growth, and a proper realization

of policies. This chapter will explore the origin of NITI Aayog, the reasons why it was created, and how it has transformed to be a key institution in the development process of India.

On 29 May 2014, the Independent Evaluation Office wrote an assessment report to Prime Minister Narendra Modi, and suggested that the Planning Commission be replaced with a control commission. In 13th August 2014, the Union Cabinet dissolved the Planning Commission (India), and replaced it with a watered down version of the National Advisory Council (NAC) of India that was instituted by the UPA government. A resolution of the Cabinet dated 1 January 2015, replaced the Planning Commission with the newly constituted NITI Aayog (National Institution of transforming India). NITI Aayog was built by the Union Government of India on 1 January 2015. NITI Aayog was introduced on 8 February 2015 under the chairmanship of Narendra Modi.

The NITI Aayog was conceived as a more liberal and interrelated platform and would facilitate cooperative federalism and would foster active involvement of states in business and implementation of policies. It was formed as a think tank, a hub of knowledge and a catalyst of transformational change.

LET US KNOW

NITI Aayog was created in 2015 to replace the Planning Commission and address its limitations of centralized, top-down planning. It acts as a national think tank to promote cooperative federalism, inclusive growth and transformational development through long-term plans, policy advice and coordination between Union and states for better implementation and outcomes.

CHECK YOUR PROGRESS

Q.1: What is NITI Ayog ? (Answer in about 50 words)

14.2.1 The Mandate of the Institution Incorporated as Below

Policy Formulation: NITI Aayog has the role of formulating and prescribing national development policies. It is important in providing advice to the government on various matters such as agriculture, education, healthcare, infrastructure and more.

Cooperative Federalism: The NITI Aayog encourages cooperative federalism where dialogue and collaboration are enhanced between the central government and the states. It can be used as a venue of sharing best practices, mitigating the geographical inequalities and ensuring that policies are in tandem with demands of various regions of the country.

Knowledge Hub: NITI Aayog is a knowledge hub, which researches and analyzes the development issues. It gives evidence-based policy recommendations and assists in the development of innovative solutions.

Transformation Change: NITI Aayog will be committed to causing transformational change in India. It is geared towards inclusive growth, poverty alleviation and sustainable development.

NITI Aayog has done a lot in realizing its mandate. It has been instrumental in shaping some of the major policies such as the National Health Mission, National Education Policy, and National Infrastructure Pipeline. Another approach that has helped the Aayog to enhance cooperative federalism is the Atal Innovation Mission and the National Institutional Ranking Framework.

NITI Aayog is mainly concerned with long term planning though it does short term planning occasionally. The three most important plans created by NITI Aayog are the following:

15-Year Road Map: This is the most ambitious proposal, which describes a long-term vision of development of India. It addresses a great spectrum of areas and has high ambitions of the nation.

7-Year Vision: This plan is a narrowed down variant of the 15-year road map, detailing goals, strategies, and action plans of a timeframe of seven years.

Short-Term Plans: NITI Aayog also makes short-term plans according to the necessity, to overcome the particular challenge or opportunity. Such plans can concentrate on a specific sector or region and they can last a few months or years.

Along with these three primary types of plans, NITI Aayog is also involved in the plan of reviewing and evaluation of government policies and programs. This goes in order to make sure that these initiatives are in line with the long-term vision and strategy which are outlined in the 15-year road map and 7-year plan.Although these projects of NITI Aayog may vary over the years, the following are some of the prominent ones that have been linked to its numerous plans:

Under the 15-Year Road Map:

Atal Innovation Mission (AIM): Promotes innovation and entrepreneurship in the youth.

National Health Mission (NHM): The objective is to enhance the access to and outcome of healthcare in India.

National Education Policy (NEP): sets out an extensive education policy in India.

National Infrastructure Pipeline (NIP): Selects infrastructure projects to be developed in India.

Based on the 7-Year Vision, Strategy and Action Plan:

Jal Jeevan Mission: The objective of the mission is to supply piped water to the rural households.

PM Awas Yojana (PMAY): Aims at affordable housing to everyone by the year 2022.

Swachh Bharat Mission: Objective of the swachhbharat mission is to ensure the country is open defecitation-free.

Pradhan Mantri Jan Dhan Yojana (PMJDY): This is an initiative that encourages all individuals to have bank accounts.

Under Short-Term Plans:

COVID-19 pandemic response: NITI Aayog was also instrumental in organizing the response to the pandemic in India.

Economic recovery plans: NITI Aayog has come up with strategies to ensure that India is out of the economic depressions.

Regional development initiatives: NITI Aayog has developed plans to promote development in specific regions of India.

LET US KNOW

NITI Aayog prepares a 15-year Road Map, 7-year Vision, and short-term plans that guide India's long-term development priorities. It is involved in designing, reviewing and supporting major initiatives like the National Health Mission, National Education Policy, National Infrastructure Pipeline and COVID-19 response, ensuring alignment with broader development goals.

CHECK YOUR PROGRESS

Q. 2: What are the three major types of plans prepared by NITI Aayog? (Answer in about 50 words)

14.3 THE NITI AYOG HAS THE FOLLOWING AIMS AND OBJECTIVES

- **Promote Cooperation in Federalism:**

NITI Aayog is intended to provide a collaborative situation in which there is a joint effort of the central and the state governments towards achieving the same development objectives. Through cooperation, NITI Aayog aims at making sure that national policies are directed with regional needs and priorities resulting in a greater impact in implementation as well as outcomes.

- **Establish Processes of coming up with Believable Plans at Village Level:**

NITI Aayog seeks to establish an environment in which development strategies will be developed on the ground, including the particular needs and the hopes of the communities. Bottom-up planning also makes development projects more pertinent and sustainable because the projects are informed by local knowledge and priorities.

- **Ensure Economic Strategy and Policy National Security:**

NITI Aayog aims at balancing between the economic development factors and the national security, which must not affect the economic policies at the expense of the national security of India. The national security is a significant aspect of the general development of a country. NITI Aayog tries to create a sustainable and resilient economy by ensuring that security is incorporated in economic policies.

- **Give Special attention to the Neglected parts of the Society:**

NITI Aayog understands that not all sectors of society may have equal advantages of economic growth like the poor, marginalized communities and women. It tries to fill such discrepancies and to have a unanimous development. Social justice and well being can only be promoted through inclusive development. NITI Aayog wants to make the society more balanced and fair by targeting the areas marginalized.

- **Design Strategic and Long-term Policy and Program Frameworks:**

NITI Aayog is intended to create long-term and multi-faceted strategies of developing India, covering a number of spheres and issues. Long-term planning gives a clear focus of the developmental effort and that policies are championed towards the national goals.

- **Advise and Promote Partnerships**:

NITI Aayog also seeks to engage stakeholders, think tanks, and research institutions in order to share experience and build collaborations. Teamwork and exchange of knowledge may result in new solutions and improved policy development.

- **Develop an Innovation, Knowledge, and Entrepreneurial Support System:**

NITI Aayog will be establishing a conducive atmosphere to facilitate innovation, entrepreneurship and knowledge development. Economic growth and creation of jobs majorly depend on innovation and entrepreneurship. NITI Aayog will encourage self-sufficiency and economic growth through the creation of a favorable atmosphere.

- **Provide a Fora of Inter-Sectoral and Inter-Departmental Problems Resolution:**

NITI Aayog is meant to promote synergy and relations among various departments and sectors in the government to promote speed in development. In order to implement the development programs effectively and efficiently, it requires proper coordination and collaboration.

- **Have a State-of-the-Art Resource Center:**

NITI Aayog strives to create a knowledge and research base on good governance and best practices in sustainable and equitable development. A resource center can also be an important part of the policymakers and researchers as it will give them information and knowledge on how to develop effectively.

- **Constructively oversee and assess Program Implementation:**

NITI Aayog will help in monitoring the development programs and measurement of its effectiveness. Monitoring and evaluation enable pointing out areas where improvement is required and also make sure that the programs are delivering the desired results.

- **Emphasis Technology upgradation and Capacity Building:**

NITI Aayog will also seek to invest in technology and capacity development to make the development programs more effective. Development interventions require technology and capacity building to enhance efficiency, productivity, and quality of the interventions.

- **Conduct Other Businesses as Necessary:**

NITI Aayog is not afraid to engage more activities where necessary to help in the development agenda of India. This flexibility will enable NITI Aayog to conform to new situations and meet new demands.

LET US KNOW

The institution aims to foster cooperative federalism, village-level participatory planning, and balance economic policy with national security. It seeks inclusive development by focusing on neglected groups, building innovation and entrepreneurial ecosystems, promoting inter-sectoral coordination, strengthening monitoring and evaluation, and upgrading technology and capacity for effective and equitable development.

CHECK YOUR PROGRESS

Q. 3: What is the main aim of NITI Aayog in terms of Centre–state relations? (Answer in about 50 words)

14.4 FUNCTIONS OF NITI AYOG

The dual responsibility of NITI Aayog is to monitor and implement the SDGs in the country, and facilitate the emergence of competitive and cooperative federalism between States and UTs.

NITI Aayog does not only have to routinely gather data on SDGs but actively achieve the goals and targets. A parallel exercise of interaction with the Ministries has already been done by the ministry of statistics and programme implementation (MoSPI) with the aim of developing indicators that capture the SDG goals and targets.

As a preliminary stage, NITI Aayog with the consultation of MoSPI has drawn up a draft mapping of the goals and targets. Also, the centrally sponsored schemes such as the core of the core, the core and the optional and some of the recent schemes undertaken by the Central Government have also been mapped. In addition, States and Ministries are instituting central sector schemes and state schemes respectively which are in tandem with one or more SDGs. The detail functions are:

1. Formulation and Implementation of Policies.

- **Strategic Planning:** NITI Aayog constitutes long-term strategic plans of socio-economic development of India in accordance with the national purposes and world tendencies.
- **Policy Recommendations:** It also offers evidence-based policy suggestions to the government and it encompasses a broad area of sectors including agriculture, healthcare, education, and infrastructure.

- **Monitoring of policies**: NITI Aayog is the body that keeps the policies of the government in check, ensuring they are effective and taking corresponding corrections.

2. Cooperative Federalism

- **State Engagement**: NITI Aayog creates partnership between the central and state governments, which facilitates a federal system that allows the states to be ahead in any development efforts.
- **Inter-State Coordination**: It promotes coordination and exchange of knowledge between states, assists in filling existing regional gaps and learning through experience.
- Knowledge and Innovation
- **Research and Analysis**: NITI Aayog undertakes research and analysis of different development issues, which are valuable to the policymakers.
- **Innovation Hubs:** It creates and encourages the use of innovation hubs and incubators in order to stimulate entrepreneurship and technological developments.
- **International Cooperation:** NITI Aayog is also involved in the provision of such foreign organization and international think tanks to hear the international best practices and to voice the Indian interests.

3. Sustainable Development

- **SDG Monitoring**: The institution will be important in tracking the Indian development towards the realization of the Sustainable Development Goals (SDGs).
- **Green Growth**: NITI Aayog advocates the idea of sustainable and green growth, the emphasis of which is on environmental protection and resource efficiency.
- Development Monitoring and Evaluation.
- **Performance Tracking**: It monitors the performance of government programs and initiatives where there are improvements to be made and accountability is guaranteed.
- **Impact Assessment:** NITI Aayog is an institution that performs impact assessment to assess the efficiency of the policies and programs.

LET US KNOW

NITI Aayog performs strategic planning, policy formulation, monitoring and evaluation across sectors. It leads India's Sustainable Development Goals (SDG) agenda by mapping schemes to SDG targets, tracking progress, promoting green growth, facilitating inter-state coordination, stimulating innovation, and conducting impact assessments to improve government programs and ensure accountability.

CHECK YOUR PROGRESS

Q. 4: How does NITI Aayog use monitoring and evaluation in its functions?
(Answer in about 50 words)

14.5 NITI AYOG CONSTITUTION

NITI Aayog (roughly translated: National Institution of Transforming India) is a leading policy think tank that was set up in 2015, to replace the Planning Commission. It is also in its own unique structure which supports a collaborative and federal model of policymaking.

Composition: The Prime Minister is the head of the institution, and he acts as the Chairperson. The Vice-Chairperson which is presently occupied by Shri Suman K Bery is a leading personality who is well versed in economics, public policy or administration.

Full-Time Members: it has 4 full time members. The Prime Minister appoints these and they are involved in the Aayog policy making and research.

Ex-Officio Members: The senior-most Chief Ministers of States are usually ex-officio members of the Aayog who offer a regional point of view to the deliberations of Aayog. The ex-officio members are: as of 16 th July 2024, they are:

- Minister of Defense Shri Raj Nath Singh.
- Minister of Cooperation Shri Amit Shah, Minister of Home Affairs.
- Shri Shivraj Singh Chouhan, Minister of Agriculture and Farmers Welfare as well as the Minister of Rural Development.
- Minister of Finance and Minister of Corporate Affairs: Smt. Nirmala Sitharaman.

Special Invitees: These are persons, who are knowledged of having expertise in certain areas, and who are welcomed to assist the Aayog in working part time. It has 11 special invitees.

Chief Executive Officer (CEO): The CEO deals with the operations of the Aayog on a day to day basis and coordinates its operations.

Noteworthiness of this Composition.

This composition indicates that NITI Aayog believes in:

- Cooperative Federalism: This is through integration of Chief Ministers as ex-officio members so that the policies of Aayog are balanced to the needs and priorities of the states.
- Varying Experience: Full-time members, special invitees and a CEO who has diverse backgrounds bring in a lot of experience and opinions to the deliberations of the Aayog.
- Well-established Leadership: The Prime Minister as the Chairman offers the Aayog high political support and makes sure that its suggestions are taken seriously by the government.

This organization will make NITI Aayog able to bridge the gap between the central government and the states, foster innovation, and the overall development of India.

LET US KNOW

NITI Aayog is chaired by the Prime Minister, with a Vice-Chairperson, full-time members, Union ministers as ex-officio members, special invitees and a CEO handling day-to-day operations. This structure embodies cooperative federalism, diverse expertise and strong political backing, enabling closer Centre–state coordination and more responsive policy design and implementation.

CHECK YOUR PROGRESS

Q. 5: Who are the key members in the constitution of NITI Aayog?
(Answer in about 50 words)

14.6 NITI AYOG FLAGSHIP INITIATIVE

NITI Aayog, the National Institution of transforming India has promoted two principles of governance, that is, competitive federalism and cooperative federalism. These ideas are expected to bring about an efficient, fair and responsive system of governance in India.

14.6.1 Competitive Federalism

Competitive federalism is premised on the notion that inter-state rivalry is capable of delivering superior governance and results. In this model, the states are motivated to compete among themselves in many aspects including economic development, education and health care. This competition would be able to motivate states to use best practices, become more efficient, and draw investment.

The major features of competitive federalism:

- State autonomy: More autonomy is granted to the state to come up with decisions and policies in their jurisdictions.
- Performance benchmarking: The states are compared to one another according to the key performance indicators to determine the areas of improvement.
- Bonuses and penalties: Rewards and penalties are provided to those states who perform better and those that do not.
- Cooperative Federalism: In contrast, cooperative federalism focuses on cooperation and coordination between the central and the states. It understands that numerous issues, including poverty, climate change, and national security demand collaborative actions with all levels of governments.

The main points about cooperative federalism:

- Sharing of responsibility: Sharing of responsibility is seen in the central government and the states taking responsibility in solving common challenges.
- International coordination: It is about the mechanisms that are put in place to support

communication and cooperation among the various levels of government.

- Joint programs: Joint programmes and initiatives are the programs which the central government and the states do to meet a common objective.

NITI Aayog is significant in enhancing competitive federalism as well as cooperative federalism. It acts as a point of discussion and cooperation between the central government and the states, as well as promoting the competition between states. NITI Aayog seeks to develop a more effective, fair, and responsive system of governance in India by developing a balance between competition and cooperation.

Simply, competitive federalism is geared towards establishing healthy competition between states in order to push greater results, whereas cooperative federalism is geared towards cooperation and coordination to tackle common problems. The approach by NITI Aayog aims at combining the advantages of the two models in order to establish a better and responsive government in India.

LET US KNOW

NITI Aayog promotes competitive federalism by ranking states and encouraging performance-based competition, while also deepening cooperative federalism through dialogue, joint programs and shared responsibilities. This dual approach seeks efficient, innovative governance as well as coordinated action on common challenges like poverty, climate change and national security

CHECK YOUR PROGRESS

Q. 6: How does cooperative federalism differ from competitive federalism?
(Answer in about 50 words)

14.7 THE SIGNIFICANT PROGRAMS OF NITI AYOG ARE

- **Lifestyle for Environment (LIFE) Mission (LIFE Mission).**
  The objective is to lead lifestyles that are sustainable to the environment and lessening the use of single-use plastics. The mission key objectives under this mission include, Awareness campaigns and educational programs, Business and personal partnerships to help in encouraging sustainable practices, Policy interventions to deter the use of single-use plastics.
- **National Data Analytics Platform (NDAP).**
  This is aimed at establishing a common platform on which data can be analyzed and decision made across the government departments. The important points under this mission include, Data sources integration, Advanced tools and techniques of analytics and Secure and scalable infrastructure.

- **Shoonya (Shoonya Mission to Clean Air)**

  This aims at curbing air pollution in India by different means. Some of the important missions objectives under this mission are Promotion of electric vehicles and clean fuels, Implementation of stricter emission standards and Awareness campaigns on air pollution and its effects.

- **E-Amit (E-Amrit Mission of Water Conservation)**

  The objective is to encourage water conservation and effective management of water. Development of water conservation technologies, Awareness campaigns on water conservation, Policy interventions to promote water- efficient practices are the key objectives under this mission.

- **Women Entrepreneurship Site.**

  This will empower women entrepreneurs and help them gain economic empowerment. Access to finance and mentorship, Skill development programs and Networking opportunities are some of the important objectives of this mission.

- **Methanol Economy**

  This is aimed at encouraging the use of methanol as a clean fuel and chemical feedstock. Some of the major objectives that will be achieved under this mission include, Research and development of methanol-based technologies, policy interventions to support the methanol economy and Partnership with industry players.

- **India Policy Insights**

  This is aimed at offering evidence-based policy suggestions to the government. Research and analysis on matters relating to different policy issues, Publication of policy briefs and reports and Engagement with policymakers and stakeholders are under this mission key objectives.

- **Reinventing the Gold Market in India.**

  The is to liberalize and control gold market in India. . The under this mission key objectives include Promotion of electronic gold trading, Strengthening of regulatory oversight and Development of gold exchange and depository.

- **NITI Lectures**

  This is aimed at establishing a conversation and exchange of knowledge between policymakers, experts, and scholars. This mission has the following key objectives; Organization of lectures and seminars on different topics and Publication of lecture series.

- **Mahatma Gandhi National Rural Employment Guarantee Scheme (MGNREGS)**

  This seeks to guarantee at least 100 days of wage labour each year to the rural families. The role of NITI Aayog in MGNREGS is mainly aimed at increasing the convergence of this sector to the agricultural sector. By doing this, the Aayog encourages MGNREGS labour and resources to be used to produce long term assets such as water conservation structures, farm ponds, and irrigation channels to enhance agricultural output and sustainability of rural livelihoods.

- **Centrally Sponsored Schemes (CSS)**:
  Where the States carry out the implementation of the scheme but the Central Government plays the major role in funding them. It frequently audits such schemes in order to remove overlaps and provides effective use of funds and makes efforts to provide greater flexibility to States to adjust the schemes according to the local requirements. The Aayog also makes sure that the CSS initiatives are in National development goals and Sustainable Development Goals (SDGs).
- **The Ministry of Skill Development and entrepreneurship (MSDE)**
  Operates in collaboration with the Ministry of Skill Development and entrepreneurship and is known as the Skill India mission. It is aimed at preparing the Indian workforce with skills that are employable and enabling them to suit the demands of the new economy. The Aayog focuses on the training, entrepreneurship development, and technological skills based on the industry to equip the young generation with the opportunities coming in both country-side and urban regions.
- **Swachh Bharat Mission :**
  Which was initiated in 2014 and monitors the progress made towards the goal of a clean and open-defecation-free India. It can contribute through the implementation of behavioral change programs, community involvement and long term sustainability of sanitation systems. The SDG 6, which seeks to provide clean water and sanitation to everyone, is also closely related to the mission.
- **Agricultural Development:**
  To address agricultural stagnation in growth. It looks at questions involving irrigation, land reforms, market efficiency and the adoption of technology. The task force also gives recommendations on how to raise income of farmers and enhance resilience of agricultural sector by diversifying and improving innovations.
- **NITI Forum of the North-East:**
  This forum is used as a platform to determine the areas of the priority development in the states of the northeast region. It enables the coordination of the central ministries, state governments, and other concerned parties in a bid to enhance development, tourism, as well as enhance connectivity within the region.
- **Sustainable Development of the Indian Himalayan Region**:
  This is situated on the ecological conservation, sustainable livelihood development, and disaster resilience within the vulnerable Himalayan ecosystem. NITI Aayog promotes regional planning that is sensitive of the environment besides ensuring social and economic progress.
- **Financial Advise** :
  NITI Aayog offers policy and technical assistance to the states that have financial or administrative difficulties through the Development Assistance to States programme. This initiative puts more stress on cooperative federalism, in which the Centre and the States collaborate to generate equal development results.

- **SATH-E (Sustainable Action for Transforming Human Capital in Education):**
  Another programme by NITI Aayog that tries to enhance the quality of school education is the SATH-E (Sustainable Action for Transforming Human Capital in Education). It offers model structures and handholding assistance to the states to enhance learning results, teaching ability, and management effectiveness.
- **Aspirational DistrictProgramme** :
  The most effective programs are the Aspirational **District** Programme (ADP) and the Aspirational Blocks Programme (ABP). These programmes aim at bringing the socio-economic status of the most underdeveloped parts of India at the same pace by addressing the most important spheres of life such as health, education, agriculture and infrastructure. NITI Aayog is an organization that monitors progress and ensures accountability through real time monitoring and data driven governance.
- **State Ranking**:
  Further, State Rankings developed by NITI Aayog (including the School Education Index, the Health Index and the Innovation Index) can contribute to the creation of competitive federalism, as they motivate states to improve their performance, due to its transparent evaluation and benchmarking.
- **Sustainable DevelopmentGoals (SDGs):**
  NITI Aayog is at the center of efforts to coordinate the Indian development towards the achievement of the Sustainable Development Goals (SDGs). It is the national nodal agency in SDG monitoring, policy alignment, and reporting with attention to the fact that all the governmental programmes are aimed at making the country develop in exclusive, sustainable, and equitable ways.

LET US KNOW

The Aayog anchors diverse initiatives such as LIFE Mission, NDAP, Shoonya, E-Amrit, Women Entrepreneurship Platform and Methanol Economy to advance sustainability, innovation and inclusion. It also supports schemes like MGNREGS, CSS, Skill India, Swachh Bharat, NITI Forum for North East, Aspirational District Programme and SDG coordination.

CHECK YOUR PROGRESS

Q. 7: Mention any three keyinitiatives of NITI Aayog.
(Answer in about 50 words)

14.8 LET US SUM UP

- NITI Aayog was established in 2015 as a policy think tank to replace the Planning Commission and promote cooperative and competitive federalism.

- It formulates long-term, medium-term and short-term plans and offers evidence-based policy advice across key sectors.
- The institution's aims include inclusive development, village-level planning, innovation promotion and balancing economic policy with national security.
- NITI Aayog leads SDG coordination, green growth advocacy, monitoring and evaluation of programmes, and inter-state knowledge sharing.
- Its composition, led by the Prime Minister with ministers, experts and a CEO, strengthens Centre–state collaboration and policy responsiveness.
- The Aayog advances both competitive and cooperative federalism through rankings, incentives, dialogues and joint initiatives.
- Major programmes span environmental missions, data platforms, entrepreneurship, labour schemes, education, regional forums and the Aspirational District and Blocks Programmes.

14.9 FURTHER READING

1) https://niti.gov.in/
2) https://india.gov.in/

14.10 ANSWERS TO CHECK YOUR PROGRESS

Ans. to Q. No. 1: NITI Aayog is the National Institution for Transforming India, established in 2015 to replace the Planning Commission. It serves as the government's policy think tank, promoting cooperative and competitive federalism, long-term strategic planning and evidence-based advice to accelerate inclusive, sustainable development across sectors and regions.

Ans. to Q. No. 2: NITI Aayog prepares a 15-year Road Map outlining long-term national vision, a 7-year Vision and Strategy document detailing medium-term goals, and short-term plans focused on specific sectors or emerging challenges to ensure responsive and phased development planning.

Ans. to Q. No. 3: NITI Aayog creates platforms for regular dialogue between the Centre and states, involves chief ministers in decision-making bodies, and aligns national policies with regional priorities, thereby building shared ownership of development strategies and improving implementation.

Ans. to Q. No. 4: It tracks performance of government policies and programs, undertakes impact assessments and uses data-driven analysis to identify gaps and suggest corrective measures, thereby improving effectiveness and accountability in public policy.

Ans. to Q. No. 5: Key members include the Prime Minister as Chairperson, a Vice-Chairperson, full-time members, Union ministers as ex-officio members, special

invitees with domain expertise and a Chief Executive Officer responsible for day-to-day administration.

Ans. to Q. No. 6: Cooperative federalism emphasizes collaboration, joint programmes and shared responsibility between Centre and states to address common challenges, whereas competitive federalism stresses performance-based competition and innovation among states.

Ans. to Q. No. 7: Key initiatives include LIFE Mission promoting sustainable lifestyles, the National Data Analytics Platform for integrated data-driven governance, and Shoonya Mission aimed at reducing air pollution through promotion of electric vehicles and cleaner technologies.

14.11 MODEL QUESTIONS

Short Questions (Answer each question in about 150 words)

Q. 1: Explain the evolution from the Planning Commission to NITI Aayog, highlighting the limitations of the former and the conceptual foundations of the latter.

Q. 2: Discuss the main aims and objectives of NITI Aayog with special reference to cooperative federalism, inclusive development and innovation.

Q. 3: Examine the role of NITI Aayog in formulating and implementing India's Sustainable Development Goals (SDG) agenda.

Q. 4: Analyse how the composition and structure of NITI Aayog enable it to function as an effective policy think tank and coordination platform.

Essay-type (Answer each question in about 500 words**)**

Q. 1: Critically evaluate the role of NITI Aayog in promoting competitive and cooperative federalism in India, giving suitable examples of its initiatives and state-level impacts.

Q. 2: Assess the contribution of NITI Aayog's flagship programmes and missions (such as LIFE Mission, NDAP, Aspirational District Programme and Skill India) towards inclusive and sustainable development in contemporary India.

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