

**B.A. 3<sup>rd</sup> Year  
ECONOMICS**

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DSE (CBCS)**

# **ECONOMIC SYSTEM**

**Lessons - 1 to 9**

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**Course Title:** Economic Systems  
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### **Course Description**

This course seeks to enrich the knowledge of the students regarding working of various economic systems. The course does not require any prior knowledge of economics.

### **Course Outline**

Unit	Title	Credits	
		L	T
I.	<b>Introduction to Economic Systems</b> Nature, Scope and Importance of the study of Economic Systems: The economy as a system. Definitions of an Economic system. Functions of an economic system. Kinds of Economic systems (Broad features of Primitive Communism, Feudalism, Mercantilism, Capitalism, Socialism, Communism and Mixed Economy. Mode of Production.	12	4
II.	<b>Capitalism</b> Evolution of Capitalism: Laissez-faire capitalism, Welfare capitalism, Regulated capitalism, Industrial capitalism, Capitalism and Technological Progress, Achievements and failures of capitalism.	11	4
III.	<b>Socialism</b> Evolution of Socialism: Types of Socialism: Utopian Socialism, Marxian Socialism (Theory of Social Change), Market Socialism and Decentralisation.	10	4
IV.	<b>Mixed Economic System</b> Mixed Economies and their Problems: Characteristics - Role of Public Sector in India - Factors Responsible for Privatisation in India - Globalisation and its Impact on Indian Economy.	11	4
<b>Suggested Readings:</b> 1. Desai, S.S.M., (1982), Economic Systems, Himalaya Publishing House, Bombay; 2. Halm, George N., (1968), Economic Systems, Oxford & IBH Publishing Co., New Delhi 3. Sen, K.K., (1994), Comparative Economics Systems, Sultan Chand & Sons, New Delhi 4. Grossman, Gregory, (1978), Economic Systems, Prentice Hall, New Delhi.			

# LESSON 1

## ECONOMIC SYSTEM

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### STRUCTURE

1.0 Objectives

1.1 Introduction

1.2 Economic System

1.2.1 Functions of an Economic System

1.3 Primitive Communism

1.4 Feudal System

1.5 Summary

1.6 Glossary

1.7 Answers to self Check exercises

1.8 Suggested Readings

1.9 Terminal Questions

### 2.0 Objectives

After going through this lesson you will be able to;

- Define economic system
- Identify the main functions of economic system
- Explain Primitive Communism
- Explicate Feudal system

### 1.1 Introduction

Economic systems are the means by which countries and governments distribute resources and trade goods and services. They are used to control the five factors of production, including labor, capital, entrepreneurs, physical resources and information resources. In everyday terms, these production factors involve the employees and money a company has its disposal, as well as access to entrepreneurs, the people who want to run companies or start their own businesses. The physical materials and resources needed to run a business, along

with the data and knowledge companies use to be successful, are also factors in production. Different economic systems view the use of these factors in different ways.

## 1.2 Economic System

An economic system is the structure of production, allocation of economic inputs, distribution of economic outputs, and consumption of goods and services in an economy. It is a set of institutions and their social relations. Alternatively, it is the set of principles by which problems of economics are addressed, such as the economic problem of scarcity through allocation of finite productive resources. An economic system is composed of people and institutions including their relationships to productive resources, such as through the convention of property. Examples of contemporary economic systems include capitalist system, communist system, socialist system and mixed economy.

### 1.2.1 Functions of an Economic System

Economic systems everywhere may perform similar functions. These functions may be traditional or non-traditional. As mentioned, the traditional functions include the following:

- What to produce.
- How to produce, i.e. what method of factor combination to adopt in order to maximize the use of the resources.
- For whom to produce.
- How to distribute the goods and services produced.

Economists have realized the importance of economic growth and the attainment of full employment, if the system must achieve the best use of its scarce resources. Attainments of full employment and high economic growth have become the non-traditional functions.

### Traditional Functions of Every Economic System

The traditional functions of every economic system include the following:

- ***What not to produce.*** In deciding on what goods to produce, an economic system also decides in what not to produce. For example, if the system wants to provide roads and recreational facilities, it may have problems since it may lack enough resources to do so at the same time. It will be necessary that it chooses between the two. It may for instance have to choose roads. An economic system can

consider a wide variety of goods than the other which is poorly endowed.

- ***What method to use.*** Economic systems also function to decide on the particular technique to be used in production. Here, the economic system decides what method of factor combination to be employed in order to maximize the use of the scarce resources, by minimizing cost and increasing productivity. The decision may involve whether to employ labor-intensive or capital-intensive methods of production. In a free exchange economy, its choice will depend on relative factor endowment and factor prices. In developing countries for instance, labor is more abundant and cheap. A labor-intensive method may be preferred.
- ***For whom to produce.*** Another problem the economic system is faced with is for whom to produce. To get maximum use from the scarce resources, the commodity must be produced in an area where it would be demanded and where costs will be minimized. The production unit may be sited near the source of raw material or the market centre depending on the nature of the product.

### **Non-Traditional Functions of Every Economic System**

- ***Enduring economic growth.*** Economic systems must ensure economic growth. Owing to scarcity of resources, the society must know whether its capacity to produce goods and services is expanding or decreasing. Some major ways to promote economic growth include ensuring adequate rate of growth of per capita income, improvement in technology through the adoption of superior techniques of production, and better and more extensive education and training of the labor force and others.
- ***Ensuring full employment.*** Society must also ensure full employment. It is the task of economic systems to ensure that resources are not idle or unemployed, since resources are scarce. In the market economy, full employment is achieved by stimulating demand.

### **1.3 Primitive Communism**

**Primitive communism** is a concept originating from Karl Marx and Friedrich Engels who argued that hunter-gatherer societies were traditionally based on egalitarian social relations and common ownership. A primary inspiration for both Marx and Engels were Lewis Henry Morgan's descriptions of 'communism in living' as practised by the Iroquois Indians of North America. In Marx's model of socioeconomic structures, societies with primitive communism had no hierarchical social class structures or capital accumulation.

Engels offered the first detailed theorization of primitive communism in 1884, with publication of *The Origin of the Family*. Marx and Engels used the term more broadly than Marxists did later, and applied it not only to hunter-gatherers but also to some subsistence agriculture communities. There is also no agreement among later scholars, including Marxists, on the historical extent, or longevity, of primitive communism.

In a primitive communist society, all able bodied persons would have engaged in obtaining food, and everyone would share in what was produced by hunting and gathering. There would be no private property, which is distinguished from personal property such as articles of clothing and similar personal items, because primitive society produced no surplus; what was produced was quickly consumed. The few things that existed for any length of time (tools, housing) were held communally, in Engels' view in association with matrilineal residence and matrilineal descent. There would have been no state. Domestication of animals and plants following the Neolithic Revolution through herding and agriculture was seen as the turning point from primitive communism to class society as it was followed by private ownership and slavery, with the inequality that they entailed. In addition, parts of the population specialized in different activities, such as manufacturing, culture, philosophy, and science which is said to lead to the development of social classes.

### **Basic Characteristics of Hunter-Gatherer Societies**

The archaeological record, consisting almost entirely of skeletons and tools, provides insufficient insight into human patterns of behavior. However, a rich and detailed ethnographic literature describes hunter-gatherer people and near hunter-gatherer people who have survived into the modern era. This literature definitely establishes the distinct features of hunter-gatherer behavior that appear in nearly every primitive society—the “stylized facts” of hunter-gatherer societies that provide important insights into man as an economic and political animal. The most important of these stylized facts are as follows:

1. The basic unit of society is the band, which typically consists of a small number of nuclear families related by kinship. Bands rarely exceed fifty persons (Fried 1967, 113). The widespread nature of this basic unit is impressive. All known foraging groups seem to take this form. Moreover, the band form of social organization also predominates among our closest primate species. We can be fairly confident, therefore, that this form of social organization prevailed throughout

human history (and probably prehuman history as well) until the advent of settled agriculture.

2. Bands are widely scattered over relatively large territories, yielding population densities from perhaps one person for every five square miles to one person for every fifty or more square miles (Steward 1955, 125). The total human population was apparently extremely small until fairly recent times. Some estimates place the entire population of Europe at no more than one hundred thousand people as recently as twenty thousand years ago.

3. Bands have no effective government or formal laws. They frequently do have one or two men who command more respect than their peers and might be referred to as "headmen." But whatever their designation, they typically have little more authority than other men in the band. According to Fried, any band leader is "unable to compel any of the others to carry out his wish" (1967, 83). Of course, bands have norms of behavior that apply, sometimes rather strictly, to all band members.

4. Food is typically hunted or gathered, not produced, as in pastoral or agricultural societies. Yet some primitive groups who have survived into the modern era (such as the Yanomamo of remote South America) may engage in a limited amount of gardening while still maintaining basic hunter-gatherer characteristics (Chagnon 1992, 79).

5. Most goods are perishable. Primitive people have limited means of preserving food. Even non-food items may have to be abandoned when the band moves to a different location. This characteristic of foraging society has obvious implications for the accumulation of property.

6. Goods are exchanged according to a system of reciprocal gift giving. This system is of course the only practical one for a society that has no money or even a workable substitute for money. It is a much-discussed characteristic of foraging societies and one that must be thoroughly understood in order to answer the questions raised in this article.

7. There is generally a division of labor between the sexes but not within the sexes. Thus, each adult male performs more or less the same work as every other adult male, and each adult female performs more or less the same work as every other adult female, but the work of men and the work of women are quite different. Women tend to care for children and to gather food and material, whereas men tend to hunt.



8. Although hunter-gatherers have individual rights to personal property, no property rights typically exist in the natural resources the band uses. With very few people and abundant natural resources, creating property rights in those resources yields no advantage. This common-property condition probably prevailed with few exceptions until the development of agriculture some ten thousand years ago.

9. Life in the band is characterized by extreme lack of privacy. Individuals therefore have extensive information about the activities of other individuals in the band.

10. Intra-band conflict is relatively minor despite the lack of laws, police, and judges, but inter-band conflict may be significant. Marvin Harris concludes that a majority of hunter-gatherer societies engaged in interband warfare, not ordinarily caused by disputes over territories or resources, but by disputes over personal grievances (1977, 47–49). Disputes over women and the widespread practice of capturing women were prominent causes of warfare (Chagnon 1992, 218–19)

## 1.4 Feudal System

A system of ownership usually associated with pre-colonial England, in which the king or other sovereign is the source of all rights. The right to possess real property was granted by the sovereign to an individual as a life estate only. Upon the death of the individual, title passed back to the sovereign, not to the decedent's heirs.

**Feudalism** was the medieval model of government predating the birth of the modern nation-state. Feudal society is a military hierarchy in which a ruler or lord offers mounted fighters a **fief** (medieval *beneficium*), a unit of land to control in exchange for a military service. The individual who accepted this land became a **vassal**, and the man who granted the land become known as his **liege** or his **lord**. The deal was often sealed by swearing oaths on the Bible or on the relics of saints. Often this military service amounted to forty days' service each year in times of peace or indefinite service in times of war, but the actual terms of service and duties varied considerably on a case-by-case basis. Factors such as the quality of land, the skill of the fighter, local custom, and the financial status of the liege lord always played a part. For instance, in the late medieval period, this military service was often abandoned in preference for cash payment, or agreement to provide a certain number of men-at-arms or mounted knights for the lord's use.

In the late medieval period, the fiefdom often became hereditary, and the son of a knight or lesser nobleman would inherit the land and the

military duties from his father upon the father's death. Feudalism had two enormous effects on medieval society.

(1) First, feudalism discouraged unified government. Individual lords would divide their lands into smaller and smaller sections to give to lesser rulers and knights. These lesser noblemen in turn would subdivide their own lands into even smaller fiefs to give to even less important nobles and knights. Each knight would swear his oath of **fealty** (loyalty) to the one who gave him the land, which was not necessarily the king or higher noblemen. Feudal government was always an arrangement between individuals, not between nation-states and citizens. It meant that, while individual barons, dukes, and earls might be loyal in theory to the king or centralized noble family, there was no strong legal tradition to prevent them from declaring war on each other. The bonds of loyalty often grew so entangled that a single knight might find himself owing allegiance to two different dukes or barons who were at war with each other. There was no sense of loyalty to a geographic area or a particular race, only a loyalty to a person, which would terminate upon that person's death.

(2) Second, feudalism discouraged trade and economic growth. The land was worked by peasant farmers called **serfs**, who were tied to individual plots of land and forbidden to move or change occupations without the permission of their lord. The feudal lord might claim one-third to one-half of their produce in taxes and fees, and the serfs owed him a set number of days each year in which they would work the lord's fields in exchange for the right to work their own lands. Often, they were required to grind their grain in the lord's mill, and bake all their bread in the lords' oven, and to use roads and bridges the lord had built. Each time they did this, of course, they would have to pay him a toll or a fee of some sort. They were, however, forbidden to set up their own roads, bridges, mills, and ovens--the lord had a legal monopoly and would milk it for all it was worth. In exchange for other hefty fees, various peasants might set up a **commune** (a cooperative government amongst themselves), or pay the lord for the right to try their own court cases by juries. Other ambitious communities might pool their resources and purchase a **charter**, a legal document that gave the inhabitants of a town or village certain economic freedoms to buy and sell their own land or produce. In practice, these occurrences were often economic necessities, but in theory, these freedoms were generous gifts given by the lord to his former serfs in exchange for various financial considerations.

**Main Features of Feudalism are as follows:**

Feudalism was a novel social system. It had several features.

### **1. Castle:**

The Castle was the chief characteristic of feudalism. The feudal Lords lived in huge castles or forts. The living house and court of the Lord existed inside the castle. The Lords stored arms and weapons and found grains inside the castle. At the time of external invasion, it provided shelter to the common people. There was strong and high wall with towers at intervals around the castle. In some cases the castles were surrounded by wide ditch or moat. From towers one could watch the movement of enemies. The gateway of the castle was very strong. Deep ditches were dug around the castle and filled up with water. This was connected with a bridge.

During the attack, this bridge was lifted off Mild the enemy could not enter into the castle. A feudal Lord had many castle and he lived inside different castles at different time.

### **2. Manor:**

Another significant mark of feudalism was Manor. The land associated with the castle was known as Manor. This was like a small estate. The castles, cultivated land, dwelling houses of barons and Church were associated with it. A feudal Lord had one or more manors. According to the possession of Manors, the strength of a feudal Lord was known.

### **3. Demense:**

Another feature of feudalism was 'Demense'. After distributing the land among his serfs whatever land remained with him was known as Demense. This law entirely belonged to the Lord which he could use according to his whims and caprices.

### **4. The Feudal Society:**

The division of a feudal society followed a pyramidal pattern. This society was largely an agrarian society. The 'King' was at the top of the society and he was quite powerless. Below him was placed the 'Feudal Lord'. Then came the 'Vassels' or 'Independent Farmers'. They could resort to independent profession and move from one place to another according to their own hill.

The lowest stratum in the society projected the 'Serfs'. They had neither the land of their own, nor they were independent. They worked in the land given to them by their Lord. In one day of the week, they worked in the field of their Lord without payment which was known as 'Forced Labour'. They remained inside small huts with their domestic animals like cows and pigs in a very unhealthy condition. They had to lead a miserable life.

### **5. The Knight:**

Another characteristic feature of the feudal society was 'Knighthood'. A Knight took oath to fight with enemy and to protect the weak. Generally, the sons and relatives of a Lord received education and training to be a Knight. When one wanted to be a Knight, he had to work as a 'Page' or servant near another Knight. When he could serve properly, he was appointed as a 'Squire' or body-guard of that Knight.

During that period he learnt how to clean the weapons and prepare a horse. After he achieved mastery in these works, he was to be appointed as a Knight. He had to spend a night inside the Church in prayer.

Then he had to kneel down before priest who would deliver a light blow of his palm on the young man's neck with the blessings-"Be a Valiant Knight". This act was famous as 'Accolade'. After becoming a Knight, he had to purchase horse and arms for himself. By exhibiting chivalry he could save an old man, destitute, weak man from the clutches of injustice and tyranny. A Knight also respected a lady. They also spent their time in different plays and gymnastics. The medieval European literature sang the glory of these Knights in no uncertain terms.

### **6. The Rights and Duties of Feudal Lords:**

The Lords had many duties to perform. Most of them were employed in the work of the Government, army and diplomacy. They also looked to the administration of estates, draining of swamps and trade and commerce. Their main duty was to save their subjects from the invaders. The Lords enjoyed certain rights too. A Lord became the owner of the land of a vassal who died leaving a minor son.

This ownership was called 'Wardship' and it continued till the minor came of age. In that case, the land was to be handed over the heir on payment of a sum known as 'Relief, when a Vassal died without the heir, his fiefs was taken over by the Lord. This was called 'Escheat'. Thus, the feudal Lords had many duties which they discharged and they also enjoyed certain rights inside the society.

### **7. Duty of Vassals:**

In the feudal society, the vassals or subjects had certain duties towards the Lord. The vassal had to be present in the court whenever the Lord needed. The Vassal rendered compulsory military service to the Lord for forty days in a year. He accompanied his master to the battle field and guarded his castle.

The vassal had to pay money to his Lord or Master on the occasion of his eldest daughter's marriage, when the Lord's eldest son became a Knight and when the Lord became captive in the hands of his enemy and was to be released. The vassals had to render these duties

because the Lord guaranteed them security of Life and property against external invasions and gave them justice.

### **8. Ceremony of Homage:**

The leading feature of feudalism prevailing in Europe was the Ceremony of Homage. This Ceremony was organised to cement the bond between the 'Lords' as 'Vassal'. After assembling in the castle of the noble each man used to Kneel down before the Lord with uncovered head. Then each one placed his folded hands on the hands of the Lord. He then took the oath to be his "man" or "Vassal". This ceremony was famous as "Homage" in which the Vassal took vow to remain loyal to his Lord.

### **9. Investiture:**

After the Vassals showed homage, then the Lord raised him up and kissed them. He recognised them as his 'Subject' or 'Vassal'. Then the Lord placed in the hands of the Vassal a little earth or some leaves or a sword as a token of gift. A legal document concerning 'fief (land given to vassal), a staff and a flag were also handed over to the Vassal. This Sanction was termed as Investiture.

## **Exercise 1.1**

Q1. Demonstrate your understanding of the following terms by using each one in a sentence.

A. economic system

B. Primitive Communism.

Q2. Which of the following statements are True or False?

- (i) On the basis of ownership of resources we can classify an economy as Rich economy and Poor economy.
- (ii) Socialist economy aims at maximization of social welfare.
- (iii) Freedom of choice, profit maximization and private property are the characteristics of a Socialist economy.
- (iv) In a mixed economy public and private sectors co exist.

## **1.5 Summary**

Economic systems are distinguished according to how the dominant class in the economy gets the surplus. The ways that the dominant class can get control over the surplus is limited only by the imagination. An astounding number of different economic systems have appeared in human history. A relatively small number of economic systems, however, have played a central role in economic history: kinship production, feudalism, capitalism, slavery, and socialism. Some

of these economic systems have been around for a long time. Kinship production and slavery, for instance, are ancient. These two economic systems date from the beginning of human history approximately 100,000 years ago. Other economic systems have not been around so long. Indeed, some economic systems appeared only very recently.

## 1.6 Glossary

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

2. **Primitive communism** is the earliest mode of production in Marxist thought. Karl Marx proposed that Asiatic, ancient, feudal, and bourgeois modes of production are epochs that mark the transitions of societies.

3. **Feudalism**. A political and **economic** system of Europe from the 9th to about the 15th century, based on the holding of all land in fief or fee and the resulting relation of lord to vassal and characterized by homage, legal and military service of tenants, and forfeiture.

## 1.7 Answers to self Check exercises

### Exercise 1.1

Answer 1. Refer to section 1.2 and 1.3.

Answer 2. (i) False (ii) True (iii) False (iv) True

## 1.8 Suggested Readings

1. Desai, S.S.M., (1982), Economic Systems, Himalaya Publishing House, Bombay;
2. Halm, George N., (1968), Economic Systems, Oxford & IBH Publishing Co., New Delhi
3. Sen, K.K., (1994), Comparative Economics Systems, Sultan Chand & Sons, New Delhi
4. Grossman, Gregory, (1978), Economic Systems, Prentice Hall, New Delhi.

## **1.9 Terminal Questions**

Q1. What is meant by an economy? Give the major characteristics of a primitive communism economy.

Q2 “Economy is a system of mutual cooperation and exchanges.” Discuss.

## LESSON 2

### MERCANTILISM AND CAPITALISM

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#### STRUCTURE

2.0 Objectives

2.1 Introduction

2.2 Mercantilism

2.2.1 Definition

2.2.2 Causes of the Rise of Mercantilism

2.2.3 Characteristics of Mercantilism

2.3 Capitalism

2.4 Summary

2.5 Glossary

2.6 Answers to self Check exercises

2.7 Suggested Readings

2.8 Terminal Questions

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#### 2.0 Objectives

After going through this lesson you will be able to;

- Explain Mercantilism
- Elucidate Capitalism

#### 2.1 Introduction

**Mercantilism**, economic theory and practice common in Europe from the 16th to the 18th century that promoted governmental regulation of a nation's economy for the purpose of augmenting state power at the expense of rival national powers. It was the economic counterpart of political absolutism. Its 17th-century publicists—most notably Thomas Mun in England, Jean-Baptiste Colbert in France, and Antonio Serra in Italy—never, however, used the term themselves; it



was given currency by the Scottish economist Adam Smith in his *Wealth of Nations* (1776).

Mercantilism contained many interlocking principles. Precious metals, such as gold and silver, were deemed indispensable to a nation's wealth. If a nation did not possess mines or have access to them, precious metals should be obtained by trade. It was believed that trade balances must be "favourable," meaning an excess of exports over imports. Colonial possessions should serve as markets for exports and as suppliers of raw materials to the mother country. Manufacturing was forbidden in colonies, and all commerce between colony and mother country was held to be a monopoly of the mother country.

A strong nation, according to the theory, was to have a large population, for a large population would provide a supply of labour, a market, and soldiers. Human wants were to be minimized, especially for imported luxury goods, for they drained off precious foreign exchange. Sumptuary laws (affecting food and drugs) were to be passed to make sure that wants were held low. Thrift, saving, and even parsimony were regarded as virtues, for only by these means could capital be created. In effect, mercantilism provided the favourable climate for the early development of capitalism, with its promises of profit.

## **2.2 Mercantilism**

Adam Smith, the 'Father of Economics' had first used the word 'Mercantilism' in his famous book 'Wealth of Nations'. Mercantilism means-"Governmental regulation of economic affairs, especially, trade and industry". The exponents of Mercantilism opined that Commerce is the key to progress of every country and it can be achieved at the cost of the interest of other country. Although they put emphasis on economy, they never wanted the intervention in politics.

### **2.2.1 Definition**

Mercantilism, according to Laura LaHay, in the Library of Economics and Liberty, "is economic nationalism for the purpose of building a wealthy and powerful state." Economist Adam Smith coined the term mercantile system. The system was most popular between the 16th and 18th centuries in Europe. Countries tried to maintain a balance of imports to bring money into the country and exports to keep up domestic employment. The theory states that an economy needs to export more than it imports to remain economically and politically viable.

### **2.2.2 Causes of the Rise of Mercantilism:**

Mercantilism grew due to several reasons.

At first, the Renaissance did not accept the religious doctrine of Medieval Europe. It explained 'Materialism' as one of the mediums of human happiness. So, everybody dreamt to lead a happy and prosperous life. This gave birth to Mercantilism.

Secondly, the Fall of Feudalism was another cause for the rise of Mercantilism. With the fall of feudalism, the fate of agriculture was doomed. This encouraged the small-scale industries. The towns and guilds wanted the increase of these industries. They wanted to export the surplus of these productions. This led to the rise of Mercantilism.

Thirdly, the Reformation Movement encouraged the merchants. The results of the Reformation Movement carried on by Martin Luther in Germany and Henry VIII in England were far reaching. They condemned the unnecessary intervention of Pope in Political and Economic affairs except religion.

Martin Luther opposed the Pope so much so that he was issued 'Bull of excommunication' by the Pope. However, Luther did not bend before it. In a similar vein Henry VIII of England did not obey Pope and brought reformation in the Church of England. All these activities encouraged the merchants to take up their business independently. This encouraged Mercantilism.

Fourthly, the Guilds and Banking System gave great impetus for the growth of Mercantilism. The guilds acted as distribution centres and exported the surplus to outside countries. This encouraged the international trade which was well-regulated by the banking system. Thus, Mercantilism grew out and out.

Fifthly, the Geographical Discoveries encouraged Mercantilism. The sea voyage of Columbus, Vascodagama, Magellan and others encouraged Mercantilism.

Sixthly, Political Patronage established Mercantilism on sound footing. The kings wanted to reduce the power of the feudal Lords and Barons. So, they encouraged the merchants for trade. Henry, 'the Navigator' of Portugal and Henry VIII and Queen Elizabeth of England patronised sailors. Their patronage established Mercantilism on sound footing.

At last, Scientific Invention and Discoveries helped a lot in the growth of Mercantilism. The telescope invented by Galileo helped the

merchants in their journey. The Mariner's Compass also helped the merchants a lot to determine direction inside the deep sea. These inventions made merchants confident for maritime trade which galvanised Mercantilism.

### **2.2.3 Characteristics of Mercantilism**

Mercantilism had many characteristics. It was seen mostly in the European countries. Among those countries, England, France, Germany, Italy etc. were prominent.

**The characteristics of Mercantilism were as such:**

#### **1. Foreign Trade**

In the first place the mercantilists laid great emphasis on a favourable balance of trade. They held that the strength and richness of a country depends on two things-the possession of gold and silver mines and favourable balance of trade. As all the countries did not possess mines of gold and silver, they could built up rich stocks of these metals by exporting maximum of their manufactured articles and importing minimum of commodities from other countries. Highlighting the importance of foreign trade Thomas Mun wrote: "The ordinary means....to increase our wealth and treasure is by Foreign Trade....This ought to be encouraged, for upon it hangs the great revenue of the king, the honour of the kingdom, the noble profession of the merchant, the school of our arts, the supply of our poor, the improvement of our lands, the nursery of our mariners, the walls of the kingdom, the means of our treasures, the sinews of our wars and the terror of our enemies."

For the maintenance of a favourable balance of trade the mercantilists favoured commercial regulation. They insisted on discouraging the imports through imposition of heavy duties and prohibitions on foreign goods. On the other hand, the exports should be encouraged through bounties and other artificial stimulation of domestic agriculture and industry. For the promotion of the country's trade a number of Navigation laws were passed to ensure that the country's trade remained in the hands of the native shippers.

The mercantilism not only laid emphasis on the regulation of foreign trade but also emphasized the principle of monopoly. In most of the European countries the right to engage in foreign trade was vested only in a small privileged section of the society.

For example, the British government allowed its subjects to trade freely only with a small area (viz. France, Spain and Portugal) while the rest of the world was divided for trading purposes amongst numerous joint stock companies. Each company was allotted a definite trading sphere.

Thus the East India Company enjoyed monopoly of trade with Asia, Africa Company with Africa and Levant Company with the Mediterranean. Similarly, the European powers also vested the right of trade in various joint stock companies. East India Companies were formed in France, Holland, Sweden and Denmark for carrying on trade with the East.

The mercantilists applied the principle of monopoly with regard to their colonies also. It was asserted that colonies had no right to regulate their economic independently and must try to meet the needs of the mother country through supply of raw materials for her manufacturers.

The other foreigners were excluded from the colonial trade. They were not permitted to carry on trade with the colonies except in some less important articles. Industries were permitted to develop in the colonies only if they did not compete with the mother country. Obviously this policy led to complete neglect of the interests of the colonial people.

## **2. Importance of Money**

Mercantilism attached great importance of money. It considered the wealth as the source of all powers and laid great emphasis on the importance of gold, silver etc. It also considered money as a significant factor for the commercial advancement. Further as the trade in those days was mostly carried on the basis of barter of goods, the people naturally preferred to keep gold and silver rather than the commodities.

The importance of money also increased because the state needed more taxes for the management of its affairs and it naturally preferred those taxes in money rather than in kind. The enormous amounts required for the conduct of commercial wars with other nations for the retention of colonies also greatly contributed to the importance of money.

Money was also considered essential for abundance of trade. It was commonly held that "where money was scarce, trade was sluggish, where it was abundant, trade boomed." In short, mercantilism emphasized the importance of money on account of numerous reasons.

## **3. Interest.**

The concept of interest formed an important part of mercantilism even though there was no unanimity among the various mercantilists regarding its use and importance. For example, Mun justified charging of interest on the money because it could be profitably employed in trade and enabled the borrower to make huge profits.

However, by and large the mercantilists favoured low rates of interests. They believed that the high rates of interests made the money scarce. Some of the mercantilist writers who favoured low rates of interests included Thomas Manley, John Locke, Nicholas Barbon etc.

This stand of mercantilist was quite natural in view of the fact that it was an age of great scarcity of liquid funds, underdeveloped banking facilities and growing antagonism between the merchant-manufacturers and the goldsmiths and big merchant financiers.

#### **4. Factors of Production.**

The mercantilists considered the land and the labour as the sole factors of production. Petty asserted, "Labour is the father and active principle of wealth, as lands are the mother." Similarly, Josiah Child held that land and trade went hand in hand.

Most of the mercantilists laid emphasis on the need of increasing production with a view to attain self-sufficiency in foodstuffs as well as encouragement of exports. Emphasis was laid on the cultivation of waste lands to increase . reduction of agriculture.

#### **5. Encouragement to Capitalism:**

Mercantilism was meant to encourage capitalism. The capitalists invested their capital and made mercantilism more mobile. It was difficult on the part of Mercantilism to thrive without capital. This helped in the growth of trade and commerce.

#### **6. The Golden Principles:**

The 'Golden Principles' of Mercantilism contained its chief characteristics. Those principles were self-dependency, industry, mine, commerce, naval power, colony, unity etc. Being guided by these principles, colonialism reached the pinnacle of success.

#### **7. Large Populations.**

Mercantilism emphasized the need of possessing large population for increasing production and participation in the war. Highlighting the importance of large population Davenant said, "The people are the real strength of the community; dense population made inventions. It also developed industries which brought riches to the nation. In view of the importance of the population Samuel Fortrey plead for freedom of immigration and granting of equal rights to the immigrants.

He argued the immigrants would bring riches with them and improve the condition of trade and industry in the country. Large population also made available cheap labour which helped a country to increase its

domestic population and successfully compete with the foreign countries. In view of this the state encouraged matrimony and parenthood.

## **8. Commercial Regulations.**

Mercantilists accepted the need of commercial regulation for the smooth working of the economy and promotion of social welfare. Almost all the European countries framed regulations with a view to restrict the imports of foreign goods and encourage exports.

Generally the import of raw materials was preferred over import of finished product because it helped the industrial development of the country. Most of the states imposed artificial restraints on internal and external trade keeping in view the national interests. As the mercantilists believed that a country could obtain an advantage at the expenses of another country only, the commercial regulations were framed keeping in view selfish national interests.

This explains why often the mercantilists did not permit the economic considerations to outweigh the political considerations and agreed to sub serve the economic life to the political end.

## **2.3 Capitalism**

Capitalism is a system of economics based on the private ownership of capital and production inputs, and on the production of goods and services for profit. The production of goods and services is based on supply and demand in the general market (market economy), rather than through central planning (planned economy). Capitalism is generally characterized by competition between producers. Other facets, such as the participation of government in production and regulation, vary across models of capitalism.

**A capitalist economy** is an economic system in which the production and distribution of commodities take place through the mechanism of free markets. Hence it is also called as market economy or free trade economy. Each individual be it a producer, consumer or resource owner has considerable economic freedom. An individual has the freedom to buy and sell any number of goods and services and to choose any occupation. Thus a market economy has no central coordinator guiding its operation. But self-organization emerges amidst the functioning of market forces namely supply, demand and price.

### **2.3.2 Features of Capitalist Economy**

**(i) Private property;** in a capitalism system all the individuals have the right to own property. An individual can acquire property and

use it for the benefit of his own family. There is no restriction on the ownership of land, machines, mines, factories and to earn profit and accumulate wealth. After the death of a person the property or wealth is transferred to the legal heirs. Thus the institution of private property is sustained over time by the right of inheritance.

**(ii) Freedom of enterprise;** In a capitalist economy the government does not coordinate production decisions of the citizens. Individuals are free to choose any occupation. Freedom of enterprise implies that business firms are free to acquire resources and use them in the production of any good or service. The firms are also free to sell their product in the markets of their choice. A worker is free to choose his/her employer. In small business units owner himself takes the risk of production and earns profit or loss for himself. But in modern corporations the shareholders take risks whereas paid directors manage business. Thus the individual supervision of one's own capital is now no longer required to earn profit. Government or any other agency does not impose restrictions/obstacles in the way of workers to enter or leave a particular industry. A worker chooses that occupation where his income is maximum.

**(iii) Consumer's Sovereignty;** In a capitalist economy consumers are like a king. They have the full freedom to spend their income on goods and services that give them maximum satisfaction. In capitalist system production is guided by consumer's choices. This freedom of consumers is called consumer's sovereignty.

**(iv) Profit Motive;** Self-interest is the guiding principle in capitalism. Entrepreneurs know that they will own the profit or loss after the payment to all other factors of production. Therefore they are always motivated to maximize their residual profit by minimizing cost and maximizing revenue. This makes the capitalist economy an efficient and self-regulated economy.

**(v) Competition;** There are no restrictions on the entry and exit of firms in a capitalism system. The large number of producers are available to supply a particular good or service and therefore no firm can earn more than normal profit. Competition is the fundamental feature of capitalist economy and essential to safeguard against consumer's exploitation. Although due to large-size and product distinction monopolistic tendencies have grown these days still the competition can be seen among a large number of firms.

**(vi) Importance of markets and prices;** The important features of capitalism like private property, freedom of choice, profit motive and

competition make a room for free and efficient functioning of price mechanism. Capitalism is essentially a market economy where every commodity has a price. The forces of demand and supply in an industry determine this price. Firms which are able to adjust at a given price earn normal profit and those who fail to do so often quit the industry. A producer will produce those goods, which give him more profit. (vii) Absence of government interference In a free enterprise or capitalist economy the price system plays an important role of coordinating agent. Government intervention and support is not required. The role of government is to help in free and efficient functioning of the markets.

### Exercise 2.1

Q1. What is meant by an mercantilism economy? Give the major characteristics of a capitalist economy.

Q2. Fill in the blanks with appropriate words given in the bracket.

- (i) Price mechanism plays ..... role in capitalist or free market economy (the most important/a very limited)
- (ii) the freedom of choice is called ..... in capitalist economy (consumers sovereignty/consumer surplus)
- (iii) People can accumulate wealth and transfer it to their legal heirs in ..... economy. (capitalist/socialist)
- (iv) Public sector and private sector ..... in a mixed economy (co-exist/does not exist)

## 2.4 Summary

In this lesson we learnt about two more forms of economic system. In the first section we learnt about mercantilism economic system. In the next section we have discussed the capitalism economic system. In the next chapter we will discuss the Socialism, Communism and Mixed Economy type of economic system.

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## 2.5 Glossary

**1. Mercantilism**, according to Laura LaHay, in the Library of Economics and Liberty, “is economic nationalism for the purpose of building a wealthy and powerful state.”

**2. A capitalist economy** is an economic system in which the production and distribution of commodities take place through the



mechanism of free markets. Hence it is also called as market economy or free trade economy.

## **2.6 Answers to self Check exercises**

### **Exercise 2.1**

Answer 1 Refer to section 2.2 and 2.3.

Answer 2 (i) the most important (ii) Consumer's sovereignty  
(iv) Capitalist (v) Co-exist

## **2.7 Suggested Readings**

1. Desai, S.S.M., (1982), Economic Systems, Himalaya Publishing House, Bombay;

2. Halm, George N., (1968), Economic Systems, Oxford & IBH Publishing Co., New Delhi

3. Sen, K.K., (1994), Comparative Economics Systems, Sultan Chand & Sons, New Delhi

4. Grossman, Gregory, (1978), Economic Systems, Prentice Hall, New Delhi.

## **2.7 Terminal Questions**

Q1. What is meant by an economy? Give the major characteristics of a Mercantilist economy

Q2. What drives the choices of consumers and producers in a market economy?

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## **LESSON 3**

### **SOCIALISM, COMMUNISM AND MIXED ECONOMY**

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#### **STRUCTURE**

3.0 Objectives

3.1 Introduction

3.2 Socialism

3.2.1 Features of Socialism

3.3 Communism

3.4 Mixed economy

3.4.1 Features of Mixed Economy:

3.5 Summary

3.6 Glossary

3.7 Answers to self Check exercises

3.8 Suggested Readings

3.9 Terminal Questions

#### **3.0 Objectives**

After going through this lesson you will be able to;

- Define socialism with its basic characteristics
- Explain the communism economic system
- Elucidate the mixed economy economic system

#### **3.1 Introduction**

An economic system consists of the institutions and the method by which resources are allocated and products and services are distributed. Economic systems differ primarily in who owns the factors of production, how the allocation of resources is directed and the method used to direct economic activity. The primary distinction between the different systems is the degree to which the government participates in the economy.

#### **3.2 Socialism**

Socialism is an economic and political system based on public or collective ownership of the means of production. Socialism emphasizes equality rather than achievement, and values workers by the amount of time they put in rather than by the amount of value they produce. It

also makes individuals dependent on the state for everything from food to health care. China, Vietnam and Cuba are examples of modern-day socialist societies. Twentieth-century socialist governments were overthrown in Czechoslovakia, East Germany and the U.S.S.R.

Central to the meaning of socialism is **common ownership**. This means the resources of the world being owned in common by the entire global population. But does it really make sense for everybody to own everything in common? Of course, some goods tend to be for personal consumption, rather than to share—clothes, for example. People 'owning' certain personal possessions does not contradict the principle of a society based upon common ownership.

In practice, common ownership will mean everybody having the right to participate in decisions on how global resources will be used. It means nobody being able to take personal control of resources, beyond their own personal possessions.

**Democratic control** is therefore also essential to the meaning of socialism. Socialism will be a society in which everybody will have the right to participate in the social decisions that affect them. These decisions could be on a wide range of issues—one of the most important kinds of decision, for example, would be how to organise the production of goods and services.

**Production** under socialism would be directly and solely **for use**. With the natural and technical resources of the world held in common and controlled democratically, the sole object of production would be to meet human needs. This would entail an end to buying, selling and money. Instead, we would take freely what we had communally produced. The old slogan of "from each according to ability, to each according to needs" would apply.

In socialism, everybody would have **free access** to the goods and services designed to directly meet their needs and there need be no system of payment for the work that each individual contributes to producing them. All work would be on a voluntary basis. Producing for needs means that people would engage in work that has a direct usefulness. The satisfaction that this would provide, along with the increased opportunity to shape working patterns and conditions, would bring about new attitudes to work.

A socialist economy is an economic organisation in which the means of production are owned and regulated by the state. The production and distribution of goods and factors of production are done by the state under the direction of the planning commission. The decisions as to how much to produce, which methods of production to employ and for whom to produce are taken by the planning authority. That is why a socialist economy is also called a planned economy. Such economies are China, Cuba, Vietnam, and North Korea.

They possess the following common features.

### **3.2.1 Features of Socialism**

The main features of this system are detailed below.

#### **(1) Public Ownership:**

A socialist economy is characterised by public ownership of the means of production and distribution. There is collective ownership whereby all mines, farms, factories, financial institutions, distributing agencies (internal and external trade, shops, stores, etc.), means of transport and communications, etc. are owned, controlled, and regulated by government departments and state corporations. A small private sector also exists in the form of small business units which are carried on in the villages by local artisans for local consumption.

#### **(2) Central Planning:**

A socialist economy is centrally planned which functions under the direction of a central planning authority. It lays down the various objectives and targets to be achieved during the plan period. Central economic planning means “the making of major economic decisions—what and how much is to be produced, how, when and where it is to be produced, and to whom it is to be allocated—by the conscious decision of a determinate authority, on the basis of a comprehensive survey of the economic system as a whole.”

And the central planning authority organises and utilises the economic resources by deliberate direction and control of the economy for the purpose of achieving definite objectives and targets laid down in the plan during a specified period of time.

#### **(3) Definite Objectives:**

A socialist economy operates within definite socio-economic objectives. These objectives “may concern aggregate demand, full employment, satisfaction of communal demand, allocation of factors of production, distribution of the national income, the amount of capital accumulation, economic development...and so forth.” For achieving the various objectives laid down in the plan, priorities and bold targets are fixed covering all aspects of the economy.

#### **(4) Freedom of Consumption:**

Under socialism, consumers’ sovereignty implies that production in state- owned industries is generally governed by the preferences of consumers, and the available commodities are distributed to the consumers at fixed prices through the state-run department stores.

Consumers' sovereignty under socialism is confined to the choice of socially useful commodities.

#### **(5) Equality of Income Distribution:**

In a socialist economy, there is great equality of income distribution as compared with a free market economy. The elimination of private ownership in the means of production, private capital accumulation, and profit motive under socialism prevent the amassing of large wealth in the hands of a few rich persons. The unearned incomes in the form of rent, interest and profit go to the state which utilises them in providing free education, public health facilities, and social security to the masses. "As far as wages and salaries are concerned, most modern socialists do not aim at complete and rigid equality. It is now generally understood that the maintenance offered choice of occupation implies wage differentials."

#### **(6) Planning and the Pricing Process:**

The pricing process under socialism does not operate freely but works under the control and regulation of the central planning authority. There are administered prices which are fixed by the central planning authority. There are also the market prices at which consumer goods are sold. There are also the accountings prices on the basis of which the managers decide about the production of consumer goods and investment goods, and also about the choice of production methods.

### **3.3 Communism**

**Communism**, also known as a **command system**, is an economic system where the government owns most of the factors of production and decides the allocation of resources and what products and services will be provided.

The most important originators of communist doctrine were **Karl Marx** and **Frederick Engels**. Like the socialists before them, they wanted to end the exploitation of the masses by the few. The capitalist system at that time required workers to work under harsh and dangerous conditions for little pay. The end goal of communism was to eliminate class distinctions among people, where everyone shared equally in the proceeds of society, when government would no longer be needed.

Karl Marx agreed with Louis Blanc in how labor and income should be managed: "*From each according to his abilities, to each according to his needs.*" However, it seems clear from history that Adam Smith had the correct principle, which is that people work in their own self-interest.

Marx and Engels believed that there was a class struggle between the masses, which Marx referred to as the **proletariat**, who could only offer their labor, and the owners of the means of production, which included land, raw materials, tools and machines, and especially money. Karl Marx called these members of the ruling class the **bourgeoisie**. He believed that a political revolution was essential because the state was a central instrument of capitalist society, and since the bourgeoisie had a stranglehold on the government, it would, in many cases, be necessary to use force and violence to overthrow the capitalists.

Communism is an economic and political ideology expressed in the Communist Manifesto by German philosophers Karl Marx and Friedrich Engels. Marx and Engels based their writing in turn on the ideas of the utopian socialists from France and British economists of the 18th century. Although communism came to be transformed by the later influences of historical figures from Vladimir Lenin to Mao Zedong, some of its most essential characteristics remained the same.

### **1. Class Struggle**

Central to communist ideology is the idea that human history is intertwined with economics and class struggle. It begins with primitive communist societies, where all members depend equally on whatever the society produces. Private land ownership has no meaning and individuals are entirely free. An excellent example of such a society is Native American cultures prior to the arrival of Europeans. Eventually, society evolves to a point where wealthy individuals, called the bourgeois, own all property and the means of production. Workers, called the proletariat, are enslaved through wages. Over time, they inevitably recognize their plight and rise up in an international movement to overthrow the bourgeoisie.

### **2. Ending Private Ownership of Property and the Means of Production**

Communism can never exist with private ownership of property and in order to achieve a classless society, all citizens work cooperatively. The Communist phrase of "From each according to his ability; to each according to his need," means that a person's contribution to production has no effect on their access to what society produces. In this way, there is no need for competition and private property. Since the workers control the means of production, all share equally in the benefit of success or the consequences of failure.

### **3. Communism through Socialism**

Socialism, referred by Marx as a lower form of communism, is necessary to alter society into a truly communistic state. In a socialized system, the state comes to control all of the utility and major economic

systems. Banks and all social services are nationalized. With careful centralized planning, a purely communist society that no longer needs money, trade, profits or wages evolves. Marx believed personal security would end psychological stress that resulted from feelings of isolation and powerlessness over one's destiny and inequality.

#### **4. Marxist-Leninist Communism**

Marx believed class warfare and the ultimate evolution of a communist society was an inevitable process within industrialized societies. By the early 20th century, however, communists like Lenin believed the process required revolutionary impetus. Industrialists and monarchies needed to be overthrown and replaced with socialist governments. Political opposition and religion were seen as threats to state cohesion, and thus in most communist nations religion is repressed and only the Communist party rules. Enforced patriotism and loyalty is an expressed goal in communist countries, where the fate and happiness of the individual is inextricably linked to that of the state.

#### **3.4 Mixed economy**

A mixed economy is a golden mean between a capitalist economy and a socialist economy. It is an economic system where the price mechanism and economic planning are used side by side. There is mixture of private and public ownership of the means of production and distribution. Some decisions are taken by households and firms and some by the planning authority. All developing countries like India are mixed economies. Mixed Economy is neither pure capitalism nor pure socialism but a mixture of the two system. In this system we find characteristics of both capitalism and socialism. Mixed economy is operated by both, private enterprise and public enterprise.

That is private enterprise is not permitted to function freely and controlled through price mechanism. On the other side, the government intervenes to control and regulate private enterprise in several ways. It has been realised that a free functioning of private enterprise results in several types of problems.

**According to J. W Grove**, "One of the presuppositions of a mixed economy is that private firms are less free to control major decisions about production and consumption than they would be under capitalist-free enterprise, and that public industry is free from government restraints than it would be under centrally directed socialist enterprise."

##### **3.4.1 Features of Mixed Economy:**

A mixed economy possesses the following features:

##### **1. Public Sector:**

The public sector is under the control and direction of the state. All decisions regarding what, how and for whom to produce are taken by the state. Public utilities, such as rail construction, road building, canals, power supply, means of communication, etc., are included in the public sector. They are operated for public welfare and not for profit motive. The public sector also operates basic, heavy, strategic and defence production industries which require large investment and have long gestation period. But they earn profits like private industries which are utilised for capital formation.

## **2. Private Sector:**

There is a private sector in which production and distribution of goods and services are done by private enterprises. This sector operates in farming, plantations, mines, internal and external trade, and in the manufacture of consumer goods and some capital goods. This sector operates under state regulations in the interest of public welfare. In certain fields of production, both public and private sectors operate in a competitive spirit. This is again in the interest of the society.

## **3. Joint Sector:**

A mixed economy also has a joint sector which is run jointly by the state and private enterprises. It is organised on the basis of a joint stock company where the majority shares are held by the state.

## **4. Cooperative Sector:**

Under a mixed economy, a sector is formed on cooperative principles. The state provides financial assistance to the people for organising cooperative societies, usually in dairying, storage, processing, farming, and purchase of consumer goods.

## **5. Freedom and Control:**

A mixed economy possesses the freedom to hold private property, to earn profit, to consume, produce and distribute, and to have any occupation. But if these freedoms adversely affect public welfare, they are regulated and controlled by the state.

## **6. Economic Planning:**

There is a central planning authority in a mixed economy. A mixed economy operates on the basis of some economic plan. All sectors of the economy function according to the objectives, priorities and targets laid down in the plan. In order to fulfill them, the state regulates the economy through various monetary, fiscal and direct control measures. The aim is to check the evils of the price mechanism.



## 7. Social Welfare:

The principal aim of a mixed economy is to maximise social welfare. This feature incorporates the merits of socialism and avoids the demerits of capitalism. To remove inequalities of income and wealth, and unemployment and poverty, such socially useful measures as social security, public works, etc. are adopted to help the poor. On the other hand, restrictions are placed on the concentration of monopoly and economic power in the hands of the rich through various fiscal and direct control measures.

### Exercise 3.1

Q1. What do you understand by socialism economic system how does it differ from communism economic system?

Q2. Write a note on mixed economic system.

## 3.5 Summary

Economic system is the socially and legally acceptable ways by which people get a living. An economy is also looked at as a system of cooperation for the satisfaction of human wants. In a modern complex economy, the cooperation exists in the form 'you do this for me and I will do that for you is not enough'. The cooperation can be seen across national boundaries. Thus economy can be seen as a system of mutual cooperation and exchanges. Economy can be classified into the following three categories on the basis of ownership and control over means of production. (i) Communism Economy (ii) Socialist Economy (iii) Mixed Economy. We have discussed the each system in detail.

## 3.6 Glossary

1. **Socialism** is an economic and political system based on public or collective ownership of the means of production. Socialism emphasizes equality rather than achievement, and values workers by the amount of time they put in rather than by the amount of value they produce. It also makes individuals dependent on the state for everything from food to health care.
2. **Communism**, also known as a **command system**, is an economic system where the government owns most of the factors of production and decides the allocation of resources and what products and services will be provided.

3. **Mixed economy;** It is an economic system where the price mechanism and economic planning are used side by side. There is mixture of private and public ownership of the means of production and distribution. Some decisions are taken by households and firms and some by the planning authority. All developing countries like India are mixed economies. Mixed Economy is neither pure capitalism nor pure socialism but a mixture of the two system. In this system we find characteristics of both capitalism and socialism. Mixed economy is operated by both, private enterprise and public enterprise.

### **3.7 Answers to self Check exercises**

#### **Exercise 3.1**

Answer 1 Refer to section 3.2 and 3.3.

Answer 2 Refer to section 3.4.

### **3.8 Suggested Readings**

1. Desai, S.S.M., (1982), Economic Systems, Himalaya Publishing House, Bombay;
2. Halm, George N., (1968), Economic Systems, Oxford & IBH Publishing Co., New Delhi
3. Sen, K.K., (1994), Comparative Economics Systems, Sultan Chand & Sons, New Delhi
4. Grossman, Gregory, (1978), Economic Systems, Prentice Hall, New Delhi.

### **3.9 Terminal Questions**

Q1. What are the different types of economic system? Discuss in detail.

# LESSON 4

## CAPITALISM

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### STRUCTURE

- 4.0 objectives
- 4.1 Introduction
- 4.2 Capitalism
- 4.3 Main Features of Capitalism
- 4.4 Merits of Capitalism
- 4.5 Demerits of Capitalism
- 4.6 The emergence of Capitalism
- 4.7 Summary
- 4.8 Glossary
- 4.9 Answers to self Check exercises
- 4.10 Suggested Readings
- 4.11 Terminal Questions

### 4.0 objectives

After going through this lesson you will be able to

- Define capitalism
- Identify the main features of capitalism
- Explain the merits and demerits of capitalism
- Discuss the emergence of capitalism

### 4.1 Introduction

Capitalism, as the term, can be defined as an indirect system of governance based on a complex and continually evolving political bargain in which private actors are empowered by a political authority to own and control the use of property for private gain subject to a set of laws and regulations. Workers are free to work for wages, capital is free to earn a return, and both labor and capital are free to enter and exit from various lines of business.

Capitalism relies upon the pricing mechanism to balance supply and demand in markets; it relies on the profit motive to allocate opportunities and resources among competing suppliers; and it relies upon a political authority (government) to establish the rules and regulations so that they include all appropriate societal costs and

benefits. Government and its agents are held accountable to provide physical security for persons and property as well as the laws and regulations. Capitalist development is built from investment in new technologies that permit increased productivity, where a variety of initiatives are selected through a Darwinian process that favors productive uses of those resources, and from the periodic modernization of the legal and regulatory framework as indicated by changing market conditions and societal priorities. Capitalist development requires that government play two roles, one administrative, in providing and maintaining the institutions that underpin capitalism, and the other entrepreneurial, in mobilizing power to modernize these institutions as needed. Capitalism contrasts with earlier economic systems characterized by forced labor, self-sufficiency, barter, and/or reciprocal relationships based upon family, tribe, or locally known relationships. It also contrasts with more recent systems where governments have acted directly through ownership and/or central planning to control of the use of resources.

Government's mode of intervention in a capitalist system is primarily indirect: it creates, legitimates, administers and periodically modernizes the various market frameworks that spell out the conditions in which the economic factors may acquire and employ capital and labor to produce, distribute, and sell goods and services. Accordingly, economic factors receive the right to use their power in competition with others, subject to prevailing laws and regulations. The market frameworks can have quite different policy priorities, from protecting the status quo to the promotion of growth and development, from protecting consumers to protecting producers, and from protecting labor to protecting capital.

Governments specify the responsibilities of the various participants in these transactions, e.g., for the safety and service ability of the products, as well as the conditions under which they are produced and distributed. Thus, this indirect system of governance inevitably embodies a strategy, though this strategy is often largely implicit rather than overt and created gradually over time rather than as a grand plan.

Capitalism is a system of governance for economic affairs that has emerged in different settings and continues to evolve over time. Capitalism contrasts with an earlier economic system, feudalism, in that it is characterized by the purchase of labor for money wages as opposed to the direct labor obtained through custom, duty or command in feudalism. Under capitalism, the price mechanism is used as a signalling system which allocates resources between uses. The extent to which the price mechanism is used, the degree of competitiveness in

markets, and the level of government intervention distinguish exact forms of capitalism.

This austere definition identifies capitalism as a social, political, and economic system that succeeded feudalism based upon recognition of the rights of private parties to choose how to employ their labor and capital in markets as indicated by market prices instead of tradition. It recognizes the price mechanism as its key coordinating device instead of command and control, and suggests that capitalist systems are distinguishable from one another based upon the extent and nature of governmental interventions and the competitiveness of their markets.

## **4.2 Capitalism**

The United States of America is an example of a capitalist economy. What do we know of the economy of USA? The ownership of means of production lies in the hands of private individuals and institutions. It is wholly market based and profit is the guiding principle of all economic activities, regulated by the forces of demand and supply – that whatever is in demand will be produced since it yields high profits. The consumer is the supreme factor around whose choices the goods and services are based. It is also called a 'Free Market Economy' since all citizens have the legal freedom to opt for any occupation or agreement.

- 1. The Macmillan Dictionary of Modern Economics** defines capitalism as a: Political, social, and economic system in which property, including capital assets, is owned and controlled for the most part by private persons.
- 2. In the words of R.T. Bye** "Capitalistic economy may be defined as that system of economic organisation in which free enterprise, competition and the private ownership of property generally prevail".

## **4.3 Main Features of Capitalism**

- 1. Price mechanism:** In the absence of external interference, the prices in a capitalist economy are determined in accordance with the movement patterns of demand and supply. The production decisions of quality, quantity and place of produce are decided in tune with the price mechanism.

2. **Freedom of enterprise:** The citizens are free to choose the occupation or profession based on his capability and liking. They can use their means of production as per their preferences.
3. **Competition:** The number of competitors is high because of the presence of market economy and price mechanism. Moreover, individuals can choose ways of using their means of production and with no restrictions on the profit motive.
4. **Profit orientation:** All the economic activities are profit driven.
5. **Sovereignty of the consumer:** 'Customer is king' principle prevails in a capitalist economy. Since the consumer, through his choices, decides on the demand and supply in the market, his satisfaction is given the utmost care.
6. **Labour as a commodity:** Labour is available in the market for a price called wages from people with inadequate means of production who are unable to utilize their own labour.
7. **No government interference:** The role of the government is protecting its citizens from foreign invasion, acts of terrorism and ensuring law and order in the state. It does not interfere in the economic activities.

#### **4.4 Merits of Capitalism**

1. Economic freedom
2. Equal right to work
3. Right to accrue wealth
4. Rich choice of goods and services
5. Encouragement to success and hard work
6. Consumer as prime focus
7. Quality production

#### **4.5 Demerits of Capitalism**

1. Disproportionate sharing of wealth
2. Neglect of public welfare
3. Risk of cyclical fluctuations
4. Ruthless competition
5. Discord between the haves and have-nots.

6. Consumer sovereignty becomes a myth as most of the consumption choices are directed by advertisement and sales propaganda.

## **4.6 The emergence of Capitalism**

Capitalism started to emerge during the 17th Century. At first the merchants, or “buyer uppers”, as they became known, were a link between the consumer and producer. However, gradually, they began to dominate the latter, first by placing orders and paying in advance, then by supplying the raw materials, and paying a wage for the work done in producing finished goods. The concept of a waged worker signalled a crucial stage in the development of capitalism. Its introduction was the final stage in the “buyer uppers” transition from merchant, (making money from trade), to capitalist (deriving wealth from the ownership and control of the means of production). The first stage of capitalism had come into being. This stage saw one new class, the primitive capitalists, exerting power over another new class, the waged workers.

Early capitalism also engendered new methods of production. The earliest was the ‘cottage industry’, which saw individual homes become mini-factories, with production directed by the capitalist. The cottage industry model became so widespread in the woollen textile industry that it became a method of mass production. In turn, the wool trade became Britain’s most important industry by the end of the 17th Century. Importantly, the hundred-year transition from feudalism to primitive capitalism had strong state support. The regionally based feudal economies and the power of the aristocracy ran counter to the interests of this alliance between capitalism and the increasingly centralised state. The state gained the wealth it desperately needed to maintain its growing bureaucracy and standing army, by tapping into capitalism through taxes, customs, duties and state loans. In return, it conquered colonies, fought for dominance of the world’s markets, and took measures against foreign competition and the power of the aristocracy. Such measures included bans on the import of manufactured goods, restrictions on the export of raw materials destined for competitors, and tax concessions on the import of raw materials. Restrictions on exporting raw materials hit the aristocracy particularly hard as agricultural produce is, by its very nature, raw materials. Thus, bureaucrats and capitalists defeated the aristocracy - though a section did survive the transition from feudalism by forming an alliance with the new capitalists.

It is worth noting here that the alliance between the state and capitalism occurred across Europe, though in different forms. instance, in Germany, where capitalism was much less developed and therefore weaker, the more powerful state was able to exercise much more

control. This was an early indication of the development of the social market in Germany under which the state has much more power. In Britain, capitalism was much more developed and so was able to exert much more influence, leading to the development of the free market system, under which the state has far less influence.

### **Social impact of capitalism**

The establishment of capitalism was a time of upheaval and bitter struggles between new and old power-brokers. At the same time, the mass of the population were dragged unwillingly into an increasingly violent conditioning process. The new capitalists needed to be able to exert ever more pressure on their producers to produce more for less, so that the capitalists could maintain trading prices and increase profits. They looked to the state to ensure pressure was brought to bear on workers who, for the first time, were being forced to sell their labour in an increasingly competitive work environment, which was itself aggravated by the swollen ranks of the new landless and unemployed. Laws were passed setting a rate for the maximum wage payable to peasants. The aim of all this brutal legislation was to turn the dispossessed into a disciplined obedient class of wage workers who, for a pittance, would offer up their labour to the new capitalism. The state also clamped down on beggars, whose ranks were swollen by dispossessed peasants and ruined craftsmen. Able-bodied vagabonds were lashed or branded with red-hot irons, while persistent vagrants were liable to execution.

The problem of creating a disciplined and regimented workforce should not be underestimated. Viewed from our advanced modern industrial perspective, submitting to the routine of going to work daily, for a set number of hours, usually inside a building, appears the norm. From the perspective of 16th and 17th Century peasants, however, this routine would have been alien. The working day under a pre-capitalist agrarian system would have been shaped by hours of light and hours of darkness, as most work took place out of doors. The intensity and length of labour was dictated by seasonal considerations, such as planting or harvest periods. Similarly, holiday periods, even those marked by the Church, were seasonally derived and often based on ancient pagan festivals. The number and extent of these holidays helped define and shape the working year; up until the Reformation during the 16th Century, it is estimated that around 165 days a year, excluding Sundays, were given over to celebrations and festivals.

### **The Rise of Manufacturing**

The spread of capitalism meant that the feudal economic system and the power of the aristocracy was in terminal decline by the late 17th Century. The establishment of mass production, based on the cottage



industry, meant England was well on the way to becoming a capitalist and industrially-based society. As the 18th Century progressed, this transition was completed.

During the 18th Century, a primitive form of manufacturing developed, which differed from cottage production in that workers did not work from home, but rather from single premises, or factory, owned by the capitalist. However, this early manufacturing differed from its later form in that it still depended on human physical power with little use of machinery. As such, early 18th Century manufacturing can be seen as a link between domestic production, based on cottage industry, and capitalist production, based on the mechanised factory system.

At first, the move towards factory production was driven by cost. Centralised production spared capitalists the cost of distributing raw materials to individual workers. Further, as the factory system developed, it soon became clear that it gave capitalism much greater control over the workforce, establishing tighter organisation of work and workers and thus higher productivity. Keeping production under one roof also meant the possibility of speeding it up by breaking the process down into planned stages. This entailed workers specialising in one particular component of the production process. Within this new system, the worker's role was reduced to repeating the same monotonous task over and over. This led to gains by the capitalist because of the greater speed of the production process and the better quality of the goods. Importantly, this division of labour into separate tasks significantly transformed the nature of work. It effectively de-skilled craftsmen and women who had been trained to produce finished goods by participating in the process of production from beginning to end and arguably, removing the sense of meaningfulness inherent in being present in the whole process of production to the point of completion.

These transformations, of the place and nature of work, lead to yet another fundamental change in social relations. Society rapidly evolved into two clearly defined social classes, the industrial capitalist and the waged worker. Capitalists broke their remaining links with their merchant past, giving up their commercial role to concentrate on organising the production process. Their sole source of income was profit, gained from the exploitation of the labour of the emerging working class.

Working class life also changed dramatically under the factory system. Even under the cottage industry system workers had had some independence. Owning their own basic tools and cultivating a plot of land enabled them to subsidise their income. This, and the fact that they worked unsupervised from home, gave them some degree of autonomy and control. In the factory, any semblance of autonomy was lost completely. Workers had to work a specific number of hours under the direct supervision of the capitalist, who owned the more specialised

tools. With no land or tools to earn extra income from, workers became totally dependent on their ability to sell their labour. Thus, a clearly defined working class was emerging, separated totally from even limited control of the means of production. The wage slave had been born. New social relations within the factory also developed. With the division of labour it was necessary for someone to co-ordinate the actions of many workers. The job of overseer, or foreman, came into being, separate from the rest of the skilled workers. Also, as production was increasingly simplified, the unskilled worker came into the process; a concept which had never before existed. Though the creation of the primitive factory system did greatly increase productivity, the savings made were not enough to entirely eliminate cottage industries, which still had many advantages.

Under the cottage system, the capitalist did not have to pay for a factory and its upkeep. Wages could be kept to a minimum, as cottage labourers paid for much of their own upkeep through growing their own food and working on their own behalf. As a result, production was often integrated, with the first and last parts of the process based in the factory, and the intermediate parts done by cottage labourers. Through such developments, manufacturing grew out of the cottage industry in Britain. This contrasted with the rest of Europe, where the state generally remained stronger, and attempted to introduce manufacturing by planning, providing factories and recruiting the workforce. For example, in France, capitalism was far more state-directed, and this remains the case today.

The needs of capitalism changed as factory production developed and the state was again enlisted to ensure continued expansion. Under existing apprenticeship laws, the right to engage independently in industry was only granted to men who had served a seven-year apprenticeship and who were members of a guild. This severely limited the number of workers that could be hired, which hampered the spread of factory production. At first, manufacturers by-passed guild regulations by setting up in rural areas and new towns where the guild system didn't operate and by investing in new industries not covered by guilds. However, as capitalism expanded, calls for an unregulated free labour market grew. The state responded by sweeping away the remaining restrictive guild regulations, bringing their power to an end. It also undermined the practice of local Justices of the Peace setting minimum wage levels. The free market form of British capitalism demanded and got a completely deregulated, unprotected workforce that it could then exploit to the full.

Capitalism developed quicker in Britain and was far more 'productive' than elsewhere - it produced more goods more cheaply. This brought calls from British capitalists for international free trade and for an end to protectionism. So, after centuries of building up the economy behind barriers to foreign competition, Britain suddenly

decided that protectionism is an abomination. This tactic has been used since by all advanced capitalist countries including the US, Germany and Japan. Current attempts by the developed nations to force underdeveloped nations to open their borders to free trade under so-called free trade agreements should be viewed in this light. The laws originally brought in by the state to protect the interests of capitalism against foreign competition were now a barrier, preventing the more dynamic sectors of British industry, most notably the cotton and metal trades, from exploiting overseas markets. By the late 18th Century, calls for free trade had gained widespread currency, particularly with the publication, in 1776, of Adam Smith's *The Wealth Of Nations*. These laissez faire free market ideas, upon which British capitalism developed, still dominate the British ruling elite's thinking, and helps explain why the Thatcherite free market "revolution" occurred in Britain in the 1980s, rather than elsewhere.

### **The Industrial Revolution**

By the early 1770s, the economic and social conditions were in place for the industrial revolution to explode on to the world's economies. Powered by a number of new inventions, the primitive factory system was transformed, as machine power drove productivity to unprecedented levels. With the factories transformed by the new machinery, the cottage industries could not possibly compete and soon collapsed. Between the 1770s and the 1830s, there was a boom in factory production with all manner of buildings being converted into factories and the majority of waged labour taking place within factory buildings. It would be over-simplistic, however, to see the industrial revolution merely as a result of the invention of machines that replaced many workers. As we have seen, the social relations needed for the industrial revolution to take place had taken centuries to evolve. Without the factory system, these inventions would have been meaningless. In the first place, the machinery introduced into the work places of late eighteenth and early nineteenth century England was specifically intended for factories, as they had developed within the economic and social conditions of the time. In this sense, we can see that these inventions themselves were largely products of a particular context within history. In addition, it should be noted that the invention of machines to aid production was hardly new. Under feudalism their introduction had been opposed by the guilds, often violently, with the audacious inventor occasionally being put to death. For example, the Ripon loom was banned in the 16th Century after guild opposition. But the demise of the guilds meant the way was opened for the introduction of all manner of labour-saving inventions. The water wheel, the blast furnace, pumping machines for mines, improved transmission of power through cog-wheels and fly-wheels, were just a few of the innovations which paved the way for the industrial revolution.

Given the pre-conditions for the development of capitalist industry, it is hardly surprising that the industrial revolution first took off in the cotton industry. Cotton production only appeared in Britain in the late 17th Century and was free of any guild restrictions. Further, it had to compete with the well-established woollen industry. Both these factors encouraged higher productivity, resulting in the invention of the spinning jenny in the 1730s, followed by the mule, followed by the mechanical loom. However, it was not until the invention of the steam engine that the industrial revolution truly took off. Steam power replaced human power, first in the cotton and metal industries, then throughout the rest of industry. This explosion in productive power transformed Britain's economy. As productivity increased, so the prices of manufactured goods plummeted, stimulating demand for British goods across the world. As a result, the value of British exports rose from £15million in 1760 to £59million in 1805. This new wealth, however, was not experienced by the workers whose labour had made it possible. Abroad, these were the black slaves upon whose backs the cotton industry in Lancashire grew and prospered. In Britain, it was concentrated amongst the few, capitalists who owned the means of production and 'bought' with capitalist-dictated wages, the labour of the workers.

It is important to note that ownership of the 'means of production' at this stage in the development of industrial capitalism meant not only the ownership of factories, machinery and the power to invest or withhold capital, but also the means of the production of knowledge. Capitalists who owned newspapers, for example, could exert great political influence to protect their own interests. Ownership of a newspaper meant not only the direct control of print workers, distributors and sellers, but control over the transmission of information. This could, for instance, extend to direct or indirect political influence through specific politicians or parties. It might also extend and protect capitalist interests by the spread of ideology and, less subtly, blatant propaganda.

Within the conditions engendered by the industrial revolution, workers faced up to eighteen hours a day in the factories and horrific living conditions in the "booming" manufacturing towns. The brutality of the new capitalist system is perhaps best summed up by its treatment of children. Women workers, from the onset of the industrial revolution, were used as cheap labour, while retaining child-raising responsibilities. With nowhere to leave children, women had little choice but to bring them to work. It was not long before they were seen by capitalism as an even cheaper source of labour. By the early 1800s, children as young as five could be found working up to twenty hours a day down mines, with conditions little better above ground in the factories. Orphanages systematised this slavery, handing over a steady stream of children to factory owners.

Along with terrible living and working conditions, wages fell in real terms, due to rocketing corn prices caused by the Napoleonic wars. In response to the rise in corn prices, and with an eye on the main chance, large farmers and the aristocracy rushed to grow wheat on every available patch of land. This caused the enclosure of yet more “common” land, emptying the countryside of ever-greater numbers of peasant farmers, and driving them into the misery of the industrial cities. This conclusive chapter in rural clearance completed the centuries-old process of transforming Britain from a feudal agricultural society into the world’s first capitalist industrial society. Demographic statistics of the period are extremely illuminating; in 1750 some 90% of the population of England lived in the countryside. By the time of the 1851 census the number of people living in urban settlements was greater than those living rurally.

#### **Exercise 4.1**

Q1. Define capitalism. What are its main features?

Q2. What are the merits and demerits of capitalism?

#### **4.7 Summary**

Capitalism is a social system based on the recognition of individual rights, including property rights, in which all property is privately owned. The recognition of individual rights entails the banishment of physical force from human relationships: basically, rights can be violated only by means of force. In a capitalist society, no man or group may initiate the use of physical force against others. The only function of the government, in such a society, is the task of protecting man’s rights, i.e., the task of protecting him from physical force; the government acts as the agent of man’s right of self-defence, and may use force only in retaliation and only against those who initiate its use; thus the government is the means of placing the retaliatory use of force under objective control.” Capitalism is a social system based on the principle of individual rights. Politically, it is the system of **laissez-faire** (freedom). Legally it is a system of objective laws (rule of law as opposed to rule of man). Economically, when such freedom is applied to the sphere of production its result is the **free-market**. Under capitalism the state is separated from economics (production and trade), just like the state is separated from religion.

## 4.8 Glossary

1. **Capitalism** is a social system based on the principle of individual rights. Politically, it is the system of laissez-faire (freedom). Legally it is a system of objective laws (rule of law as opposed to rule of man). Economically, when such freedom is applied to the sphere of production its result is the free-market.

## 4.9 Answers to self Check exercises

### Exercise 4.1

Answer 1 Refer to section 4.2 and 4.3.

Answer 2 Refer to section 4.4 and 4.5.

## 4.10 Suggested Readings

1. Desai, S.S.M., (1982), Economic Systems, Himalaya Publishing House, Bombay;
2. Halm, George N., (1968), Economic Systems, Oxford & IBH Publishing Co., New Delhi
3. Sen, K.K., (1994), Comparative Economics Systems, Sultan Chand & Sons, New Delhi
4. Grossman, Gregory, (1978), Economic Systems, Prentice Hall, New Delhi.

## 4.11 Terminal Questions

Q1. Define capitalism. Write a detailed note on the emergence of capitalism.

# LESSON 5

## TYPES OF CAPITALISM

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### STRUCTURE

- 5.0 Objectives
- 5.1 Introduction
- 5.2 Laissez Faire Capitalism
  - 5.2.1 History
  - 5.2.2 Advantages
  - 5.2.3 Disadvantages
- 5.3 Welfare capitalism
- 5.4 Regulated capitalism
- 5.5 Industrial capitalism
  - 5.5.1 The Consequences of Industrial Capitalism
- 5.6 Achievements of capitalism
- 5.7 Reasons Capitalism Has Failed
- 5.8 Summary
- 5.9 Glossary
- 5.10 Answers to self Check exercises
- 5.11 Suggested Readings
- 5.12 Terminal Questions

### 5.0 Objectives

After going through this lesson you will be able to

- Define laissez faire capitalism
- Explain the welfare and regulated capitalism
- Elucidate Industrial capitalism
- List the achievements and failures of capitalism

### 5.1 Introduction

Laissez-faire capitalism "Laissez Faire" is French for "leave alone" which means that the government leaves the people alone regarding all economic activities. It is the **separation of economy and state**. There are two ways that a government typically is tempted to interfere with the economy. The first is through the initiation of force, and the second is through socialized industries. Neither of these

activities is aligned with the proper role of government, and are both unacceptable.

"Laissez Faire Capitalism" is actually redundant, due to the nature of Capitalism. Therefore, simply "Capitalism" is sufficient to get the point across although historically it has been misrepresented as compatible with government economic interference.

## **5.2 Laissez Faire Capitalism**

**Laissez faire** is the belief that economies and businesses function best when there is no interference by the government. It comes from the French, meaning to leave alone or to allow to do. It is one of the guiding principles of capitalism and a free market economy. It is the belief that each individual's self-interest to do better, strong competition from others, and low taxes will lead to the strongest economy, and therefore, everyone will benefit as a result.

### **5.2.1 History**

Laissez faire is often associated with the well-known economist Adam Smith and his book *Wealth of Nations* (1776), which noted that human beings are naturally motivated by self-interest, and when there is no interference in their economic activities, a natural and more efficient balance in society exists. In the 18th century, French economists became upset with taxes and subsidies that were being imposed on their businesses. They believed that governments should leave the individual businesses alone, except when social liberties were infringed upon. In the 19th century, this philosophy became mainstream in the U.S. It wasn't long after this that the 'free market' approach started to display problems, such as large gaps in distribution of wealth, poor treatment of workers, and lack of safety in the workplace. By the mid-19th century, governments in most advanced countries became more involved in protecting and representing the safety and concerns of workers and the general population. This was the beginning of many of the factory laws and consumer protection laws that are being established and modified today.

Laissez-faire theory believes:

- The individual is the basic unit in society.
- The individual has a natural right to freedom.
- The physical order of nature is a harmonious and self-regulating system.
- Corporations are creatures of the State and therefore must be watched closely by the citizenry due to their propensity to disrupt the

### **5.2.2 Advantages**

- The government allows business to grow at will.
- To a point, it increases the overall efficiency of the economy.
- To a point, it reduces corruption.
- It increases economic freedom.

### **5.2.3 Disadvantages:**



- It leads to ultra powerful mega corporations that dominate the market and destroy fair competition and enterprise. Eventually, these mega corporations eventually corrupt the government and erode democratic and political freedoms.
- It results in a highly unstable economy which suffers numerous bubbles. When the bubbles burst, the corporation are not hurt as much as it hurts the people, especially the lower class.
- It causes degeneration and destruction of local environments, and puts local populations at serious health risks.
- It alienates foreign markets.
- It causes massive wealth disparity and a large portion of the society lives on meager wages.

### **5.3 Welfare capitalism**

Welfare capitalism is capitalism that is concerned with the social welfare of the worker, and includes such policies as social security, universal healthcare, collective bargaining, and industrial safety codes.

Welfare capitalism is the economic combination of traditional free market principles mixed with laws or practices from a welfare state. A welfare state helps individuals by offering minimum wage pay, short work days, restrictions on working ages, and unemployment benefits. In some countries, this type of economy involves the use of government regulation to force businesses to pay for these items in the form of taxes. Governments may require businesses to contribute a portion of their profits to funds that will help pay for workers who are injured on the job or receive termination from the company.

Welfare capitalism originated during the industrial revolution in 19th century Britain, when manufacturers began to offer benefits to their factory workers. Now, it's the mode of capitalism found in Northern and Continental Europe, where state welfare provisions, such as universal healthcare, are part of the capitalist system. In the U.S., providing social benefits mostly falls to private employers, and so welfare capitalism is practiced within companies, which individually determine the benefits they offer their employees.

The bottom line is that this type of economy provides a safety net for the individuals living and working in a society. Traditional liberal economic theory states that workers are at a severe disadvantage compared to companies. They are unable to pay for the bare minimum lifestyle needs if unemployed, and therefore require help when hard times arise. Through the payouts of government programs or transfer payments from corporations, individuals can at least maintain their lifestyle until they can find other sources of income to sustain themselves. In some ways, this is a form of socialism where common ownership is available for capital generated by organizations.

Harvard historian Lizabeth Cohen identified **five basic elements of welfare capitalism**:

1. A desire to improve workplace relations.
2. Financial incentives to raise productivity.

3. Experiments with shop-floor democracy (as long as it didn't include unions).
4. Programs to help the lives of employees outside of work.
5. Shouldering greater civic responsibilities.

## 5.4 Regulated capitalism

The term **regulatory capitalism** suggests that the operation maintenance and development of the global political economy increasingly depends on administrative rules outside the legislatures and the courts.

The term **regulatory capitalism** suggests that the operation maintenance and development of the global political economy increasingly depends on administrative rules outside the legislatures and the courts. The general trend despite and beyond the process of liberalization is that of growth rather than decline of regulation. Deregulation may represent trends in some industries (notably finance) but more regulation is the general trend beyond that characterize modern and post-modern capitalism alike. <sup>[1]</sup> Regulation in this interpretation is an instrument of organizations—states, business, civil and hybrid and is carried at all political arenas and levels. The concept of regulatory capitalism serves as an alternative to concepts like financial capitalism, welfare capitalism, casino capitalism, developmental capitalism, risk capitalism, state capitalism and crony capitalism in an attempt to shed more light on capitalism as a polymorphous order.

## 5.5 Industrial capitalism

Industrial capitalism refers to an economic and social system in which trade, industry and capital are privately controlled and operated for a profit. In a capitalist system, income, production, distribution, investments pricing and supply of goods and commodities and services are determined by private decisions usually within the context of markets. In a capitalistic state, property is privately owned and this is protected by the rule of law of government. Thus in the rise of industrial capitalism, we are looking at starting of when individuals in a society started acquiring property privately.

### 5.5.1 The Consequences of Industrial Capitalism

As a result of continued adherence to an industrial concept of the role of an economy, brought about by subscription to TEA and supported by unbalanced demographics and the availability of exploitable resources, there are consequences currently arriving at the doors of today's industrialized societies:

- Fiscal imbalance (budget deficits) caused by rising social costs.

- The rising costs of healthcare, pensions, elder care and education are exceeding the revenues available from a reasonable tax on the wealth economy, so societies across the world, through their governments, are borrowing to fund the cost of the needed social services.
- Infrastructure depreciation due to lack of investment, at exactly the time when massive infrastructure investments are required to meet the challenges of climate instability and the transition to renewable energy sources.
- Initial shortfalls in the tax revenues required to meet the social needs of advanced industrial capitalist societies was absorbed by reducing investment in and maintenance of infrastructure. Various attempts to move these infrastructure costs to the wealth economy through the “privatization” of public assets has failed to yield increased investment because core infrastructure projects are so large that they dwarf the ability of any private commercial entity to fund or manage them, and the return on the investment is over such a long term that private equity cannot meet the need.
- Inflated nominal costs that are distorting labor markets and inflating the nominal costs of the infrastructure projects necessary to mitigate climate instability and provision renewable energy sources.
- The TEA manifest in industrial capitalism leads to the creation of minimum monetary compensation regulations in an attempt to meet the social needs of its participants. This distorts the labour market and increases nominal costs for business which have to use wealth to satisfy social needs; leading to massive under utilization of available labour, decreased flexibility for businesses and workers, and stifled innovation.
- Attempting to use wealth to satisfy the social component of labour costs inflates the nominal cost of labour making large scale projects, such as infrastructure, seem even more expensive than they are. This discourages undertaking the projects in the first place.
- Paralysis of monetary management caused by the use of monetary instruments to provide social security, threatening the stability of the global capital structure.
- The massive sums stored in pension and other social security purposed financial instruments has made it politically untenable to allow wealth destruction that affects those instruments, blocking the functioning of a key mechanism for the health of a functional capitalist system. Instead of recognizing the destruction of capital (such as with the collapse of asset bubbles) corporations, bankers and politicians collude in the maintenance of money supply at above the level of real wealth.
- Governments are required to raise huge sums on the capital markets to finance their budget deficits, much of this borrowing is from the money set aside as savings for social security (pensions). The incestual nature of this financial arrangement encourages governments to engage in financial accounting manipulation as well as risk deferment and concealment.

- Central Bankers, who should be an importantly independent institution in a functional capitalist system charged with maintaining the value of the currency, are trying to keep the house of cards from imploding by using ever more complex accounting mechanisms designed to establish the future credibility of increasingly massive current debts. Precluded from providing honest appraisal of the total wealth in the economy, they cannot make effective use of money supply controls, thereby risking the mutual consent on which the entire system rests.
- Corruption of corporate governance, caused by massive flows of capital into investment instruments used as a store for future social security, leading to runaway executive compensation untied to performance.
- Huge investment funds managed by small groups of disengaged professionals dominate the shareholdings of major corporations. The fund managers are only concerned with return on capital and can move their investments at will from one corporation or asset to another. The fund managers do not contribute to the running of the businesses because they are disengaged and have only a passing interest in the workings of the business, so they rely on executive managers to generate the maximum return from the businesses in the short term. This elevates the role of the executives who can maximize short term profits and creates a culture that rewards financial accounting manipulation as well as risk deferment and concealment.
- The prerogative of the investment funds to maintain their value, because that value represents the social security of the society, adds to the pressure on the entire system (the corporations, their executives, the bankers and the politicians) not to recognize wealth destruction.
- Economic instability brought on by the imminent return of the previously unrecognized costs of exploitation .
- Deferred and concealed costs (“ghost costs”), that are known but as yet unrecognized, lurk in the wings awaiting recognition and threatening return as the result of some unforeseen event. These ghost costs cause instability in markets as players bet on their arrival or further deferral. Examples of these “ghost costs” include social unrest in oppressed and exploited populations, climate events caused by climate instability and swings in the costs of raw materials due to changes in the political leadership of origin nations.
- The most significant deferred costs at this time are the costs associated with mitigation for climate instability and the transition to renewable energy sources.
- Fraying of the social fabric caused by massive income and wealth inequality resulting from an overweight investment industry.
- As an advancing industrial capitalist society builds up ever greater reserves of capital assets in the form of savings to meet future social costs, the inertia behind corruption of money supply rectitude and corporate governance, as well as the continuous deferment of ghost costs, builds up; resulting in ever greater income disparities between those charged with the maintenance of the delusion (very important

jobs that are valued highly by the current holders of wealth) and those experiencing the reality of the delusion (due to the failure to actually provide social security).

- Corruption of the political system stimulated by inappropriate cost structures and labour provisions foisted on the commercial economy, in an attempt to try and deliver social security inside the framework of an industrial capitalist economy.
- Because a democratic industrial capitalist economy is forced through the democratic process to meet some social needs, it does so within the TEA frame by imposing conditions on the labour market, such as minimum wages and required benefits packages. These legislative manipulations of the labour market encourage businesses to act politically to defuse the impact on their particular operations, and they do so by using their wealth to restrain the political process from interfering in their business interests.

All of these consequences are appearing, and many are fully maturing now. They threaten the integrity of the industrial capitalist economic model and, given their natural and inexorable arrival, it is incumbent on us to review what is failing, determine the reality of the situation and develop alternatives that conform to the nature of the planet and its populations. We have both the need and the opportunity to replace our industrial economic model with a sustainable economic model in the very short term. Conformance with the natural shape of our populations, the natural resources available on our planet and the nature of our human character are all vital foundations for any model that lays a claim to sustainability. Using these guiding lights and a keen analysis of what is working, and what is not working, in today's economies we have fashioned a sustainable economic model that is accessible, practical and achievable.

## 5.6 Achievements of capitalism

**1. Capitalism produces faster growth than socialism.** Ever heard someone say, *"A rising tide lifts all boats?"* It's very true. Why do you think most poor people in this country have refrigerators, microwaves, and televisions that we think of as basic necessities even though those items are considered to be luxuries in much of the world? For all the Occupy Wall Street talk about the "1%," **if you make \$34,000 a year after taxes, you are part of the worldwide 1%** -- and Americans make up half of the total 1%ers on the planet. You can thank the growth created by capitalism for that. Even nations like China have figured this out and have seen their economies lift off by moving towards capitalism. If China keeps at it long enough, eventually the hundreds of millions of Chinese who're still living in huts and shacks

will be able to have the sort of lives and technology even the American poor take for granted.

**2) Capitalism works in concert with human nature while socialism works against it.** *"From each according to his ability, to each according to his needs."* That famous quotation from Karl Marx is at the heart of communism and socialism. It runs completely contrary to human nature. As a general rule, people will work hard for themselves and their families, but it's considered an imposition so large that **only God can ask them** to pay other people's bills without resentment. Put another way, the vast majority of human beings care far more about what they're going to eat for lunch today than they do about whether someone they've never met can pay his rent. (PS: And most of the people who claim to be part of that exceptional few are lying). Capitalism, on the other hand, relies on a **philosophy best described by Adam Smith.**

It is not from the benevolence of the butcher, the brewer, or the baker, that we expect our dinner, but from their regard to their own interest.

Because capitalism works hand in hand with human nature and asks people to serve themselves as they serve others, it creates a much more productive society that gets the maximum out of its citizenry.

**3) Capitalism rewards merit. Socialism rewards mediocrity.** Who gets rewarded in a capitalist society? People who can produce. If you come up with a hot new product, give people a service they want, or entertain them better than they can find elsewhere, they will pay you handsomely to do it. Some people complain about the people who get rewarded in a free market. Why should Peyton Manning make so much more than a school teacher? Why should a bank CEO make so much more than a teller at the same bank? Capitalism offers a simple solution to that problem: If the market rewards NFL quarterbacks and CEOs more than teachers and tellers, you can become a quarterback or a CEO -- if you're capable. If you can't and you don't like what you get paid as a teacher or a teller, the good news is that you're free to move on to somewhere that better rewards your talents. In this fashion, capitalism encourages people to make the best use of their talents.

Conversely, socialism rewards people for failure. Can't find a job? Great, here's your welfare and your food stamps. You haven't worked in

a year and a half? Fantastic, we'll keep incentivizing you not to work by extending your unemployment insurance. Are you a mediocrity who is so unskilled and unambitious that you'll stay at the lowest paying job you can find long-term instead of learning from it and moving on? No problem we'll raise the minimum wage for you. If you incentivize success like capitalism does, you get more growth, prosperity, and success. If you incentivize failure like socialism does, you get more sloth, poverty, and failure.

**4) Capitalism is freedom while socialism is slavery.** Socialists often use envy to trick people into becoming angry at successful people instead of the ones who are really taking away their freedom. For socialists to gain authority over your life, your own power has to shrink. The more the socialists take, the less of their own money the people get to spend. Capitalism reacts to the citizenry, while socialism tries to control and enslave the citizens. Capitalism will give you what you want for the right price, while socialism will give you what it thinks is best for you and tell you that you better like it!

**5) The marketplace does a much better job of allocating resources than socialism's central planning.** As Ronald Reagan noted, "*Millions of individuals making their own decisions in the marketplace will always allocate resources better than any centralized government planning process.*" How could it be otherwise? Is there any one person on the planet who truly understands all the ins-and-outs of making a television, an airplane, a computer, and a vending machine? No, of course not. So, how can some bureaucrat in a central location, who may have no practical experience with business at all, make wise decisions that impact tens of millions of products and hundreds of millions of consumers? They can't. That's why some people have to **wait more than six months for hip operations** under socialized medicine in Britain. It's also why people used to wait in long lines to buy poor quality toilet paper and toothpaste in the Soviet Union.

Conversely, under capitalism, the market reacts almost like a living thing and allocates resources where people want to spend their money. You may think that people aren't using their money "as they should." I might even agree with you in some cases, but the only thing the market "cares" about is finding a way to make a profit giving people

what they want. Complain all you want about capitalism, but you won't be waiting for hours to get toothpaste and toilet paper while you do it.

## **5.7 Reasons Capitalism Has Failed**

We live in interesting times. The global economy is splintering. U.S. voters hate all politicians and there's political unrest throughout the world. The root cause of this turmoil is the failure of the dominant economic paradigm -- global corporate capitalism.

The modern world is ruled by multinational corporations and governed by a capitalistic ideology that believes: Corporations are a special breed of people, motivated solely by self-interest. Corporations seek to maximize return on capital by leveraging productivity and paying the least possible amount for taxes and labor. Corporate executives pledge allegiance to their directors and shareholders. The dominant corporate perspective is short term, the current financial quarter, and the dominant corporate ethic is greed, doing whatever it takes to maximize profit.

Five factors are responsible for the failure of global corporate capitalism. First, global corporations are too big. We're living in the age of corporate dinosaurs. (The largest multinational is JP Morgan Chase with assets of \$2 Trillion, 240,000 employees, and offices in 100 countries.) The original dinosaurs perished because their huge bodies possessed tiny brains. Modern dinosaurs are failing because their massive bureaucracies possess miniscule hearts.

Since the Reagan era global corporations have followed the path of least resistance to profit; they've swallowed up their competitors and created monopolies, which have produced humongous bureaucracies. In the short-term, scale helps corporations grow profitable, but in the long-term it makes them inflexible and difficult to manage. Gigantism creates a culture where workers are encouraged to take enormous risks in order to create greater profits; it's based upon the notion that the corporation is "too big to fail."

Second, global corporations disdain civil society. They've created a culture of organizational narcissism, where workers pledge allegiance



to the enterprise. Corporate employees live in a bubble, where they log obscene hours and then vacation with their co-workers. Multinationals develop their own code of ethics and worldview separate from that of any national state. Corporate executives don't care about the success or failure of any particular country, only the growth and profitability of their global corporation

Third, global corporations are modern outlaws, living outside the law. There is no **invisible hand** that regulates multinationals. In 1759 Philosopher Adam Smith argued that while wealthy individuals and corporations were motivated by self interest, an "invisible hand" was operating in the background ensuring that capitalist activities ultimately benefited society. In modern times this concept became the basis for the pronouncements of the **Chicago School of Economics** that markets were inherently self regulating. However, the last five years have demonstrated that there is no "invisible hand" -- unregulated markets have spelled disaster for the average person. The "recovery" of 2009-10 ensured that "too big to fail" institutions would survive and the rich would continue to be rich. Meanwhile millions of good jobs were either eliminated or replaced by low-wage jobs with poor or no benefits.

Fourth, global corporations are ruining our **natural capital**. Four of the top 10 multinational corporations are energy companies, with Exxon Mobil leading the list. But there are **many indications** that our oil reserves are gone. Meanwhile, other forms of natural capital have been depleted -- arable land, water, minerals, forests, fish, and so forth. Multinational corporations have treated the environment as a free resource. When the timberlands of North America began to be depleted, lumber corporations moved to South America and then Asia. Now, the "easy pickings" are gone. Global corporations have ravished the world and citizens of every nation live with the consequences: dirty air, foul water, and pollution of every sort.

Fifth, global corporations have angered the world community. The world GDP is \$63 Trillion but multinational corporations garner a disproportionate share -- with banks accounting for an estimated \$4

trillion (bank assets are \$100 trillion). Global black markets make \$2 trillion -- illegal drugs account for at least \$300 billion. In many parts of the world, a worker is not able to earn a living wage, have a bank account or drive a car, but can always obtain drugs, sex, and weapons. And while the world may not be one big village in terms of lifestyle, it shares an image of "the good life" that's proffered in movies, TV, and the Internet. That's what teenagers in Afghanistan have in common with teenagers in England; they've been fed the same image of success in the global community and they know it's inaccessible. They are angry and, ultimately, their anger has the same target -- multinational corporations (and the governments that support them).

### Exercise 5.1

Q1. What are the achievements and failure of capitalism? Discuss.

Q2. Define the regulated capitalism.

## 5.8 Summary

Capitalism is a social system based on the principle of individual rights. Politically, it is the system of laissez-faire (freedom). Legally it is a system of objective laws (rule of law as opposed to rule of man). Economically, when such freedom is applied to the sphere of production its result is the free-market. In this chapter we have discussed different types of capitalism. In the last section of the chapter we have discussed the achievement and failures of capitalism.

## 5.9 Glossary

1. **Capitalism** is a social system based on the principle of individual rights. Politically, it is the system of laissez-faire (freedom). Legally it is a system of objective laws (rule of law as opposed to rule of man). Economically, when such freedom is applied to the sphere of production its result is the free-market.
2. **Laissez-faire capitalism**; "Laissez Faire" is French for "leave alone" which means that the government leaves the people alone regarding all economic activities. It is the **separation of economy and state**. There are two ways that a government typically is tempted to interfere with the economy. The first is through the initiation of force, and the second is through socialized industries. Neither of these activities is aligned with the proper role of government, and are both unacceptable.

3. **Welfare capitalism** is capitalism that is concerned with the social welfare of the worker, and includes such policies as social security, universal healthcare, collective bargaining, and industrial safety codes.
4. The term **regulatory capitalism** suggests that the operation maintenance and development of the global political economy increasingly depends on administrative rules outside the legislatures and the courts.
5. **Industrial capitalism** refers to an economic and social system in which trade, industry and capital are privately controlled and operated for a profit. In a capitalist system, income, production, distribution, investments pricing and supply of goods and commodities and services are determined by private decisions usually within the context of markets. In a capitalistic state, property is privately owned and this is protected by the rule of law of government.

## 5.10 Answers to self Check exercises

### Exercise 5.1

Answer 1 Refer to section 5.6 and 5.7.

Answer 2 Refer to section 5.4.

## 5.11 Suggested Readings

1. Desai, S.S.M., (1982), Economic Systems, Himalaya Publishing House, Bombay;
2. Halm, George N., (1968), Economic Systems, Oxford & IBH Publishing Co., New Delhi
3. Sen, K.K., (1994), Comparative Economics Systems, Sultan Chand & Sons, New Delhi
4. Grossman, Gregory, (1978), Economic Systems, Prentice Hall, New Delhi.

## 5.12 Terminal Questions

Q1. Write a detailed note on different types of capitalism.

Q2. What are the achievements and failures of capitalism?

## LESSON 6

### SOCIALISM

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#### STRUCTURE

6.0 Objectives

6.1 Introduction

6.2 Meaning and Definition of Socialism

6.3 Main Features of Socialism

6.4 Merits of Socialism

6.5 Demerits of Socialism 6.6 Evolution of Socialism

6.7 Summary

6.8 Glossary

6.9 Answers to self Check exercises

6.10 Suggested Readings

6.11 Terminal Questions

#### 6.0 Objectives

After going through this lesson you will be able to;

- Define socialism
- Discuss the main features of socialism
- List the merits and demerits of the socialism
- Explain the Evolution of Socialism

#### 6.1 Introduction

The **history of socialism** has its origins in the French Revolution of 1789 and the changes brought about by the Industrial Revolution, although it has precedents in earlier movements and ideas. The Communist Manifesto was written by Karl Marx and Friedrich Engels in 1848 just before the Revolutions of 1848 swept Europe, expressing what they termed 'scientific socialism'. In the last third of the 19th century in Europe social democratic parties arose in Europe

drawing mainly from Marxism. The Australian Labor Party was the world's first elected socialist party when the party won the 1899 Queensland state election.

In the first half of the twentieth century, the Soviet Union and the Communist parties of the Third International around the world mainly came to represent socialism in terms of the Soviet model of economic development, the creation of centrally planned economies directed by a state that owns all the means of production, although other trends condemned what they saw as the lack of democracy. In the UK Herbert Morrison said "Socialism is what the Labour government does", whereas Aneurin Bevan argued that socialism requires that the "main streams of economic activity are brought under public direction", with an economic plan and workers' democracy.<sup>[2]</sup> Some argued that capitalism had been abolished.<sup>[3]</sup> Socialist governments established the 'mixed economy' with partial nationalisations and social welfare.

By 1968, the prolonged Vietnam War (1959–1975), gave rise to the New Left, socialists who tended to be critical of the Soviet Union and social democracy. Anarcho-syndicalists and some elements of the New Left and others favored decentralized collective ownership in the form of cooperatives or workers' councils. At the turn of the 21st century, in Latin America, Venezuelan President Hugo Chávez championed what he termed 'Socialism of the 21st Century', which included a policy of nationalisation of national assets such as oil, anti-imperialism, and termed himself a Trotskyist supporting 'permanent revolution'.

## **6.2 Meaning and Definition of Socialism**

Socialism as an alternative to capitalism, has the widest appeal. A Swedish king once said to his council of ministers that – “if one is not a socialist up to the age of twenty five, it shows that he has no heart; but if he continues to be a socialist after the age of 25, he has no head.”

At present socialism seems to have caught the imagination of the youth all over the world.

### **Definition**

**1. The word socialism has been defined as** “such type of socialist economy under which economic system is not only regulated by the government to ensure, welfare equity of opportunity and social justice to the people.”

**2. According to Mr. Webb** “A socialised industry is one in which the national instruments of production are owned by public authority or voluntary association and operated not with a view to profiting by sale to other people but for the direct service of those whom the authority or association represents.”

This definition does not correspond to the present notion of socialism, because it does not imply any idea of planning.

**3. Prof. Dickinson** has defined socialism as such “Socialism is an economic organisation of society in which the material means of production are owned by the whole community and operated by representatives of the people, who are responsible to the community according to a general plan, all the members of community being entitled to the benefits from results of such socialised, planned production, on the basis of equal rights.”

There is no complete agreement as to what exactly socialism is. But the definition given by Prof. Dickinson seems to be better. Economists have compared socialism as a hat which has lost its shape because everybody wears it. It has been aptly remarked that “socialism has been called many things and many things have been called socialism”.

### **6.3 Main Features of Socialism**

A socialist economy has the following features:

**1. Socialism is Social or Collective Ownership of Resources:** In such an economy, all the means of production are owned and operated by the state in the interest of society as a whole. This is to ensure equality of opportunity to all the citizens with regard to earning of income. This is also aimed at full and efficient utilisation of the country's resources.

**2. It is a Fully Planned Economy:** A socialist economy is necessarily a fully planned economy otherwise the economic system cannot run. There is a choice between centralised and decentralised planning. All socialist economies were fully planned economies.

**3. It is the Responsibility of the Central Planning Authority:** Planning is the responsibility of an authority at the centre. It may be known as the Planning Commission in India or the Gos plan in the U.S.S.R. The main task given to this body is to formulate long-term and short term plans for the economy.

**4. It has Definite Aims and Objectives:** Socialist economy has specified aims or objectives. Generally, they are included in the constitution itself but these are given specific shape by the planners.

As far as possible the objectives are clearly and quantitatively defined. The competitiveness on complementary among these objectives is explicitly noted. This is meant to bring planning nearer to reality.

**5. Specific Long-Term Plans:** The Central Planning authority is given the responsibility to chalk out specific long-term plans for the country. These long-term plans are called “Perspective Plans”. These may range from twenty to thirty years.

These are in the nature of a blue-print of the path the economies have to follow in the near future. These perspective plans may be modified with changes in basic structure and objectives of the economy. This requires the use of input and output and activity analysis.

**6. Central Control and Ownership:** A fully planned economy is by implication a controlled economy. Government controls the main aspects of all economic activity. There are controls on production through licensing. Consumption is also controlled indirectly through controlled production. There are existing controls generally operated through the Central Bank of the economy.

Then there are controls on distribution. Government may have a public distribution system. It may have direct procurement and sale of essential commodities through fair price shops. However, the nature of controls and their intensity shall depend upon the economic conditions in the economy.

**7. Much Less Importance of Price Mechanism** A socialist economy gives much less importance to market forces and therefore, the price mechanism is given a minor role in resource allocation. A specific plan based on social needs guides the process of resource allocation. Private profit is not allowed. Public interest is given more importance. The means of production are directed by the Government and are used in promoting the general welfare of the people.

**8. People’s Co-operation is Essential:** A socialist economy is run with the active co-operation of the people in the fulfilment of plan targets. No plan can possibly succeed without people’s participation.

The plan is prepared and implemented by the Government but the main targets of the different activities in the plan are fixed by taking into account the resources which people will be able to mobilise. To encourage the people to participate in plan implementation, the Government may provide special incentives.

In short, a socialist economy is not run by the impersonal forces of supply and demand. It is a scientifically planned economy. As such its main features are quite different from those of capitalistic economy.

## 6.4 Merits of Socialism

A socialist economy has many alternative features. These have made socialism more and more popular. The main merits of the socialist economy are as under:

**1. Social Justice is Assured:** The chief merit of socialism is that it assures of social justice. Under socialism the inequalities of income are reduced to the minimum and the national income is more equitably and evenly distributed. The socialist principle provides for a fair share for all. No one is permitted to have unearned income. Exploitation of man by man to put an end to. Every individual is assured of equal opportunities, irrespective of caste, creed and religion. Every child whether he is born in a poor family or in a rich family is given an equal opportunity to develop his latent faculties through proper education and training.

**2. Rapid Economic Development:** A socialist economy is likely to grow much faster than a capitalist economy. The experience of the U.S.S.R. and other socialist countries amply proved this. The main factors making for the fast growth rate is the full use of resources, scientific planning and quick decisions.

**3. Production According to Basic Needs:** In this economy the production is directed to satisfy the basic needs of the people first. As far as possible, the production of food, clothing or building materials is guided by the basic needs of the people and is not according to the purchasing power of the rich section of the society. Therefore, the phenomenon of the poor going hungry while the rich feast cannot be seen in the socialist economy.

**4. Balanced Economic Development:** Economic planning is meant to carry out balanced development of the economy. All the regions of the country are taken care of. Development of the backward areas is also given a priority. Similarly, agriculture and industry, heavy and small industry develops side by side. As a result there is no lop-sided development of the economy.

**5. It has Economic Stability:** Another important merit is the economic stability which a socialist economy has. A capitalist economy is often suffering from economic fluctuations resulting in lot of unemployment and wastage of resources. There is a good deal of misery among the working classes in periods of depression in a socialist economy.

A socialist economy is able to control economic instability due to the planned nature of the economy. Price changes are taken care of under a perspective plan. Private investment is given a minor role. Therefore, there are no economic fluctuations.



**6. It has More Flexibility:** A socialist economy is much more flexible than a capitalist economy because of the control on market forces. The socialist economy can be geared to war times as early as it is operated during peace-time. Rather the state having ownership of means of production can meet the needed changes much better than the slow moving market mechanism of the capitalist economy.

**7. Conservation of Natural Resources:** A socialist economy has a great advantage of planning for the future. Wasteful use of the country's natural resources is a common problem in all the capitalistic economies. Private enterprise does not care for the future. A planning authority can take the interest of future generations into account by preparing plans for conservation of the country's non-renewable resources like coal, petroleum, forests and soil.

**8. Equitable Distribution of Wealth and Income:** A socialist economy is operated with the aim of providing equal opportunity for all citizens in earning incomes. Generally, private property is restricted to some basic needs. There is no amassing of wealth by a few. Wealth is also equitably distributed because private enterprise is given a limited role.

**9. No Exploitation and Class Struggle:** A socialist economy can also get rid of the basic maladies of the capitalist economy. There is no question of exploitation in as much as the state determines the distribution pattern of country's income. Further the whole society is the common aim of all planning. No sections are discriminated against. There is not special favour at any class. Therefore, there is no scope for anything like the class struggle which is a characteristic of the capitalist economy.

**10. Social Welfare Activities:** A Socialist Economy is oriented to the social needs. The government provides for full security. There is automatic care for the children of those who meet accidents while performing their duties. There is provision for old age pension for all. The slogan is "to each according to his needs, from each according to his capacity." Therefore, the employees in state enterprises can work without much worry. Their productivity is higher.

There are no labour disputes and no wastage of resources resulting there from as is the case in a capitalist economy.

**11. There is no Wastage of Competitive Advertisement:** A capitalist economy is not always able to achieve productive efficiency through competition. There is a good deal of wastage through competitive advertisement of different varieties. The consumer has to pay the price of the useless advertising. Prof. Chamberlin has tried "to show that capitalism leads to excess capacity when there is differentiation of the products."

In a socialist economy, there is no such wastage. In the first place only those goods and services are produced which are preferred by the consumers. Secondly, if at all there is any advertising, it is only meant for information about different products to consumers.

**12. Foresightedness:** A socialist economy can prepare for the future much better than a capitalist economy. Future is always uncertain. The planners take full note of the uncertainties while formulating the plan. Flexibility in planning is meant to provide for immediate changes in the plan as conditions change. Planners can anticipate some of the future changes and prepare for them so that the nation is not suddenly caught unawareness.

## **6.5 Demerits of Socialism**

The merits of socialism given above should not lead us to the conclusion that socialist economy is all virtue. There are certain demerits of this system which are as follows:

**1. No Suitable Basis of Cost Calculation:** Von Hayek and Bobbins have pointed out that there is not proper basis of cost calculation in a socialist economy. They say that the means of production being owned by the government, there is no market price for the factors of production. In the absence of market mechanism there is no standard way of calculating costs of production for different goods and services.

**2. Choice of Working Incentives:** The most difficult problem in this system is the choice and working of incentives in the absence of profit motive. The Russian Government has been using the policy of “Carrot and the Stick”. Some national honours are given to those showing outstanding results. Those shirking work or proving irresponsible are punished. There is decentralisation of authority along-with responsibility. This ensures freedom at the lower level and scope for initiatives. However, there is no comparable system of incentives and dis-incentives to the profit motive in a capitalist economy.

**3. It Becomes Lack of Incentives:** In this system, it has also been seen that incentive of hard work and inclination to self-improvement will disappear together when personal gain or self-interest is eliminated. People will not give their best. Incentive, ability, enterprising spirit and the go-ahead attitude will languish and creative work will become impossible. It is said that “a Government could print a good edition of Shakespeare’s work but it could not get them written.”

**4. There is Loss of Economic Freedom:** A very important charge against socialism is that, when freedom to enterprise dis-appears, even the free choice of occupation will go. Workers will be assigned certain jobs and they cannot change them without the consent of the planning

authority. Every worker will have to do work what he will be asked to do.

**5. Lack of Data, Experts and Administrators for Planning:** Operating a socialist economy as a planned economy requires huge data, a good number of experts and an equal number of administrators at different levels for administering the plan. No doubt machine can help to process the data and experts can advise but there has to be decision-making at different levels of government. It is difficult to find out enough data with the result that decisions are delayed, mis-carried or wrongly implemented. Ultimately, the common people have to pay the price for these mistakes.

**6. Loss of Economic Freedom and Consumer Sovereignty:** Under socialism all economic activity is directed by the central planning authority. There is no significant role given to private investment and initiative. Consumers are compelled to accept whatever public enterprises produce for them. Generally, there is limited variety of goods and restricted available choice. Prices are fixed by the government and consumers just cannot do anything about them. Consumer's preferences are just guessed by the planners who have no compulsion to study the people's preferences deeper.

**7. Imperfections in Planning Lead to Dissatisfaction on a Big Scale:** Imperfection may creep in the formulations of the plan, its assumptions, statistics or analysis. Further, imperfection may enter at the stage of implementation of the plan. Further, there may be lack of adjustment between prices and wages. As a result of these imperfections there is lot of wastages of resources, slowing down of work, shortfalls in targets and the dissatisfaction resulting there-from.

Mistakes made by individuals harm them only. National mistakes are costly for the common man. In fact, this has been the cause of dis-integration of the U.S.S.R., when the other economics of Europe were booming the U.S.S.R. could not provide the minimum comforts of life.

**8. Too Much Power is Concentrated in the State:** Under socialism the state is not merely a political authority but it also exercises unlimited authority in the economic sphere. In this, all power is concentrated in the state. It means the state is everything and individual nothing. He is reduced to a cypher. After all the human institutions are for man and not man for these institutions.

**9. There is Loss of Personal Liberty:** In socialism there is no unemployment. But the critics retort by saying that there is also no unemployment in a jail. They regard a socialist state as one big prison

house and they do not think that employment is any compensation for the loss of liberty.

**10. Bureaucracy and Red-Tapism:** A socialist economy is a state enterprise economy. Every bit of the plan is to be cleared by bureaucrats. This often leads to red-tapism. Even simple state forward jobs may take unduly long-time to be done. The work of Government departments or even autonomous bodies is slow moving. As a result inefficiency creeps in through bureaucracy. In many countries where socialism had been brought about hastily, work came to a stand-still leaders had to revert to liberal policies containing elements of the capitalist economy.

## **6.6 Evolution of Socialism**

The Term 'SOCIALISM' made its appearance in print in England in 1827. Five years later, the term was used for the first time in a French publication. It is no accident that the socialist idea --and the socialist movement--first appeared in England and France. For socialism was a product of two revolutions in human affairs, each with their respective roots in those two countries: the industrial revolution in England and the popular-democratic revolution in France.

The great French revolution of 1789-1799 involved the most massive popular struggles that had yet been seen in history. Rooted in popular hatred of an oppressive monarchy, the revolution rose on the backs of the masses of poor people in Paris who united under the banner of 'liberty, equality and brotherhood'. Beginning as a rebellion against the abuses of the monarchy, the revolution grew into a massive challenge to all forms of oppressive authority-- whether it was that of lords, priests or factory owners. Initially, the battle against the monarchy unified large sections of society. As the revolution advanced, however, a new ruling group tried to halt the process in order to maintain their grossly unequal system of property and power. As a result, the popular movement divided into conservative and revolutionary camps.

In the conservative camp were those who saw freedom simply in terms of the freedom to own property. In the revolutionary camp were those who represented the Paris poor and who recognised that freedom was impossible without equality; that it was meaningless to talk of liberty if this was confined to the right of some men and women to starve to death while others grew rich off the labour of others. As the radical leader Jacques Roux put it at the height of the French Revolution in 1793:

Liberty is no more than an empty shell when one class of men is allowed to condemn another to starvation without any measures being taken against them. And equality is also an empty shell when the rich,

by exercising their economic monopolies, have the power of life or death over other members of the community.

Out of the French Revolution, then, emerged the essential socialist idea that democracy and freedom require a society of equality. The French radicals recognised that genuine freedom presupposed the liberty of all to participate equally in producing and sharing the wealth of society. They understood that if some had the unequal right to own and monopolise land, wealth or factories, then others might just as unequally be condemned to a life of drudgery, misery and poverty.

But a society of equality requires a state of abundance. So long as economic life remains relatively backward, equality can only mean the common hardship of shared poverty. A healthy and thriving popular democracy requires a state of prosperity in which all the basic needs of people can be satisfied. Without a certain level of economic development, therefore, the French revolutionaries' demand for liberty and equality remained utopian. It was only with the enormous economic development unleashed by the industrial revolution in England that a society based upon equality and abundance became a realistic possibility.

The English industrial revolution conjures up images of dark and dirty textile mills, of ten-year-old children labouring in coal mines, of women and men working 12 and 14-hour days--in short, of suffering and misery. Such an image is largely correct. The industrial revolution that swept Britain, beginning in the last quarter of the eighteenth century, was a massive dislocation in social life: old communities were destroyed; people were forced off the land and into the tyranny of the factory; industrial diseases multiplied; hunger, poverty and illness spread; life expectancy fell. At the same time, however, several ingredients of the industrial revolution held out the prospect of an end to these ills. The new machinery of production that developed, especially during the early 1800s, offered the possibility of sharply reducing drudgery and toil and of massively increasing the production of wealth so as to eliminate poverty forever.

In reality, the industrial revolution did no such thing. Rather than leading to an improvement in the conditions of labour, the new industry was used to increase the fortunes of a few--the new industrial capitalists. Nonetheless, some writers saw in the industrial revolution an enormous potential for improving the human condition. Even some well-intentioned bankers and factory owners came to believe that the forces of the industrial revolution should be harnessed to serve human ends. Many of these became early advocates of what has become known as 'utopian socialism'.

Britain's best known utopian socialist was the cotton manufacturer Robert Owen. Like most of the early socialists drawn from the capitalist class, Owen did not call for a mass, democratic restructuring of society. For Owen, the working class was a pathetic and pitiful group. Owen's socialism was based on appealing to wealthy leaders of business and government in order to persuade them to improve the wretched conditions of the labouring masses.

In this respect, Owen was similar to the two earliest French utopian socialists, Henri Saint-Simon and Charles Fourier. Saint-Simon was a real estate speculator turned banker who rose to great wealth in the decades after the French Revolution. Fascinated by the enormous potential of science and technology, Saint-Simon began to argue the case for a 'socialist' society that would eliminate the disorderly aspects of capitalism. Saint-Simon's 'socialism' was decidedly anti-democratic. He did not envisage an expansion of human rights and freedoms. Instead, he hoped for a planned and modernised industrial society ruled over by an international committee of bankers. In many respects, Saint-Simon anticipated the development of state capitalism; he looked forward to a capitalist system in which industry would be owned and directed by a government made up of a scientists, managers and financiers.

The socialism of Charles Fourier had more to commend it. A self-taught eccentric, Fourier developed some highly original ideas. But Fourier's outlook suffered from two main defects. First, he dismissed the potential of modern industry for bringing into being a society of abundance and looked nostalgically for a return to preindustrial conditions of life. Secondly, Fourier looked not to the masses of working people but to enlightened rulers to usher in the socialist utopia. He spent his time drawing up rigid blueprints for the new society and sent copies to rulers like the Czar of Russia and the President of the United States.

Indeed, this is the common thread that runs through the outlook of all the early utopian socialists. Each of them looked to some well-intentioned members of the ruling class to bring about a socialist transformation of society. Each rejected the notion that socialism could only be achieved democratically--through the mass action of working people. For this reason, all their views can be described as variants of socialism from above--a view in which the masses of people are mere playthings of an enlightened elite who will change society in the interests of the masses of people. As the historian of socialism, George Lichtheim, has put it:

French socialism, at the start, was the work  
of men who had no thought of overturning society,  
but wished to reform it, by enlightened  
legislation if possible. This is the link  
between Robert Owen, Charles Fourier, and Henri  
de Saint-Simon.

There was, however, one revolutionary doctrine of socialism during this period. This consisted of what can best be called conspiratorial communism. Out of the defeat of the popular struggles of the French Revolution, one far-sighted group of rebels centered around a man named Gracchus Babeuf, developed a communist perspective. Babeuf and his followers believed that true democracy could only be constructed on the basis of common ownership of wealth. But they could see no way of winning a majority of society to support their communist programme. The masses of French people sought little else

than protection of their own private property--their plot of land or their workshop. They showed little interest in a socialist transformation of society. For this reason, Babeuf--and his later follower, Adolphe Blanqui-- could only conceive of a revolution made by a minority, the communist elite. As a result, democracy remained foreign to their socialist programme as well

### **Exercise 6.1**

Q1. Define socialism. State the merits and demerits of socialism.

Q2. What are the main features of socialism?

## **6.7 Summary**

Whatever the difficulties of running a socialist economy, the appeal for socialism was great especially, in less developed countries. For over populated countries having national problems, socialism seemed to be the only hope of the masses. Free market economy in its pure form is a thing of the past. Mixed Capitalist Economy is already the order in all the western countries. In the Less Developed Asian Countries Government has not only to regulate economic activity but positively direct it by active participation for the fast development of the country. As for the difficulties, they exist and can be eliminated through co-operation between the administration and the people. As the country develops economic planning gets a stronghold and difficulties wear away.

## **6.8 Glossary**

**1. Socialism:** a political and economic theory of social organization which advocates that the means of production, distribution, and exchange should be owned or regulated by the community as a whole.

## **6.9 Answers to self Check exercises**

### **Exercise 6.1**

Answer 1 Refer to section 6.2., 6.4 and 6.5.

Answer 2 Refer to section 6.3.

## **6.10 Suggested Readings**

1. Desai, S.S.M., (1982), Economic Systems, Himalaya Publishing House, Bombay;

2. Halm, George N., (1968), Economic Systems, Oxford & IBH Publishing Co., New Delhi
3. Sen, K.K., (1994), Comparative Economics Systems, Sultan Chand & Sons, New Delhi
4. Grossman, Gregory, (1978), Economic Systems, Prentice Hall, New Delhi.

### **6.11 Terminal Questions**

Q1. What do you understand by socialism? What are the features of socialism?

Q2. Write a note on evolution of socialism.



# LESSON 7

## TYPES OF SOCIALISM

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### STRUCTURE

- 7.0 Objectives
- 7.1 Introduction
- 7.2 Types of Socialism
  - 7.2.1 Utopian Socialism
  - 7.2.2 Marxian socialism
  - 7.2.3 Market Socialism
- 7.3 Summary
- 7.4 Glossary
- 7.5 Answers to self Check exercises
- 7.6 Suggested Readings
- 7.7 Terminal Questions

### 7.0 Objectives

After going through this lesson you will be able to;

- Explain the Utopian Socialism
- Elucidate the Marxian Socialism
- Explicate the Market Socialism

### 7.1 Introduction

In the last lesson we were introduced to socialist type of economic system. In that chapter we discussed the meaning of socialism. Its main features, merits and demerits. In the last section of the previous chapter we discussed the evolution of socialism. In this chapter we will discuss the different types of socialism.

### 7.2 Types of Socialism

Following are the different types of socialism.

#### 7.2.1 Utopian Socialism

Utopian Socialism is a term used to define the first currents of modern socialist thought in the first quarter of the 19<sup>th</sup> Century. In general, it was used by later socialist thinkers to describe early socialist, or quasi-socialist, intellectuals who created hypothetical visions of perfect egalitarian and communalist societies without actually concerning themselves with the manner in which these societies could

be created or sustained. They rejected all political (and especially all revolutionary) action, and wished to attain their ends by peaceful means and small experiments, which more practical socialists like Karl Marx saw as necessarily doomed to failure. But the early theoretical work of people like Robert Owen (1771-1858), Charles Fourier (1772-1837) and Étienne Cabet (1788-1856) gave much of the impetus to later socialist movements.

The origins of socialism as a political movement lie in the Industrial Revolution. Its intellectual roots, however, reach back almost as far as recorded thought—even as far as Moses, according to one history of the subject. Socialist or communist ideas certainly play an important part in the ideas of the ancient Greek philosopher Plato, whose *Republic* depicts an austere society in which men and women of the “guardian” class share with each other not only their few material goods but also their spouses and children. Early Christian communities also practiced the sharing of goods and labour, a simple form of socialism subsequently followed in certain forms of monasticism. Several monastic orders continue these practices today.

Christianity and Platonism were combined in More’s *Utopia*, which apparently recommends communal ownership as a way of controlling the sins of pride, envy, and greed. Land and houses are common property on More’s imaginary island of Utopia, where everyone works for at least two years on the communal farms and people change houses every 10 years so that no one develops pride of possession. Money has been abolished, and people are free to take what they need from common storehouses. All the Utopians live simply, moreover, so that they are able to meet their needs with only a few hours of work a day, leaving the rest for leisure. More’s *Utopia* is not so much a blueprint for a socialist society as it is a commentary on the failings he perceived in the supposedly Christian societies of his day. Religious and political turmoil, however, soon inspired others to try to put utopian ideas into practice. Common ownership was one of the aims of the brief Anabaptist regime in the Westphalian city of Münster during the Protestant Reformation, and several communist or socialist sects sprang up in England in the wake of the Civil Wars (1642–51). Chief among them was the Diggers, whose members claimed that God had created the world for people to share, not to divide and exploit for private profit. When they acted on this belief by digging and planting on land that was not legally theirs, they ran afoul of Oliver Cromwell’s Protectorate, which forcibly disbanded them.

Whether utopian or practical, these early visions of socialism were largely agrarian. This remained true as late as the French Revolution, when the journalist François-Noël Babeuf and other radicals complained that the Revolution had failed to fulfill the ideals of liberty, equality, and fraternity. Adherence to “the precious principle of equality,” Babeuf argued, requires the abolition of private property and common enjoyment of the land and its fruits. Such beliefs led to his execution for conspiring to overthrow the government. The publicity that followed his trial and death, however, made him a hero to many in

the 19th century who reacted against the emergence of industrial capitalism.

### *Utopian socialism*

Conservatives who saw the settled life of agricultural society disrupted by the insistent demands of industrialism were as likely as their radical counterparts to be outraged by the self-interested competition of capitalists and the squalor of industrial cities. The radicals distinguished themselves, however, by their commitment to equality and their willingness to envision a future in which industrial power and capitalism were divorced. To their moral outrage at the conditions that were reducing many workers to pauperism, the radical critics of industrial capitalism added a faith in the power of people to put science and an understanding of history to work in the creation of a new and glorious society. The term *socialist* came into use about 1830 to describe these radicals, some of the most important of whom subsequently acquired the title of “utopian” socialists.

One of the first utopian socialists was the French aristocrat Claude-Henri de Saint-Simon. Saint-Simon did not call for public ownership of productive property, but he did advocate public control of property through central planning, in which scientists, industrialists, and engineers would anticipate social needs and direct the energies of society to meet them. Such a system would be more efficient than capitalism, according to Saint-Simon, and it even has the endorsement of history itself. Saint-Simon believed that history moves through a series of stages, each of which is marked by a particular arrangement of social classes and a set of dominant beliefs. Thus, feudalism, with its landed nobility and monotheistic religion, was giving way to industrialism, a complex form of society characterized by its reliance on science, reason, and the division of labour. In such circumstances, Saint-Simon argued, it makes sense to put the economic arrangements of society in the hands of its most knowledgeable and productive members, so that they may direct economic production for the benefit of all.

Another early socialist, Robert Owen, was himself an industrialist. Owen first attracted attention by operating textile mills in New Lanark, Scot., that were both highly profitable and, by the standards of the day, remarkably humane: no children under age 10 were employed. Owen's fundamental belief was that human nature is not fixed but formed. If people are selfish, depraved, or vicious, it is because social conditions have made them so. Change the conditions, he argued, and people will change; teach them to live and work together in harmony, and they will do so. Thus, Owen set out in 1825 to establish a model of social organization, New Harmony, on land he had purchased in the U.S. state of Indiana. This was to be a self-sufficient, cooperative community in which property was commonly owned. New Harmony failed within a few years, taking most of Owen's fortune with it, but he soon turned his attention to other efforts to promote social cooperation—trade unions and cooperative businesses, in particular.

Similar themes mark the writings of François-Marie-Charles Fourier, a French clerk whose imagination, if not his fortune, was as

extravagant as Owen's. Modern society breeds selfishness, deception, and other evils, Fourier charged, because institutions such as marriage, the male-dominated family, and the competitive market confine people to repetitive labour or a limited role in life and thus frustrate the need for variety. By setting people at odds with each other in the competition for profits, moreover, the market in particular frustrates the desire for harmony. Accordingly, Fourier envisioned a form of society that would be more in keeping with human needs and desires. Such a "phalanstery," as he called it, would be a largely self-sufficient community of about 1,600 people organized according to the principle of "attractive labour," which holds that people will work voluntarily and happily if their work engages their talents and interests. All tasks become tiresome at some point, however, so each member of the phalanstery would have several occupations, moving from one to another as his interest waned and waxed. Fourier left room for private investment in his utopian community, but every member was to share in ownership, and inequality of wealth, though permitted, was to be limited.

The ideas of common ownership, equality, and a simple life were taken up in the visionary novel *Voyage en Icarie* (1840; *Travels in Icaria*), by the French socialist Étienne Cabet. Icaria was to be a self-sufficient community, combining industry with farming, of about one million people. In practice, however, the Icaria that Cabet founded in Illinois in the 1850s was about the size of a Fourierist phalanstery, and dissension among the Icarians prompted Cabet to depart in 1856.

### **7.2.2 Marxian socialism**

Despite their imagination and dedication to the cause of the workers, none of the early socialists met with the full approval of Karl Marx, who is unquestionably the most important theorist of socialism. In fact, Marx and his longtime friend and collaborator Friedrich Engels were largely responsible for attaching the label "utopian," which they intended to be derogatory, to Saint-Simon, Fourier, and Owen, whose "fantastic pictures of future society" they contrasted to their own "scientific" approach to socialism. The path to socialism proceeds not through the establishment of model communities that set examples of harmonious cooperation to the world, according to Marx and Engels, but through the clash of social classes. "The history of all hitherto existing society is the history of class struggles," they proclaimed in the *Manifesto of the Communist Party*. A scientific understanding of history shows that these struggles will culminate in the triumph of the working class and the establishment of socialism.

According to Engels, the basic elements of Marx's theory are to be found in German philosophy, French socialism, and British economics. Of these, German philosophy was surely the formative influence on Marx's thinking. Born in Trier in the German Rhineland, Marx was a philosophy student at the University of Berlin when the idealism of G.W.F. Hegel dominated German philosophy. Hegel maintained that history is the story of the unfolding or realization of "spirit"—a process that requires struggle, agony, and the overcoming

of obstacles to the attainment of self-knowledge. Just as individual persons cannot realize their potential—especially the potential for freedom—if they remain forever in a childish or adolescent condition, so spirit must develop throughout history in a dialectical fashion. That is, individuals and even nations are characters in a drama that proceeds through the clash of opposing ideas and interests to a greater self-awareness and appreciation of freedom. Slavery, for example, was long taken for granted as a natural and acceptable practice, but the slave's struggle to be recognized as a person was bringing an end to slavery as master and slave came to recognize their common humanity—and thus to liberate themselves, and spirit, from a false sense of the master's superiority.

Like Hegel, Marx understood history as the story of human labour and struggle. However, whereas for Hegel history was the story of spirit's self-realization through human conflict, for Marx it was the story of struggles between classes over material or economic interests and resources. In place of Hegel's philosophical idealism, in other words, Marx developed a materialist or economic theory of history. Before people can do anything else, he held, they must first produce what they need to survive, which is to say that they are subject to necessity. Freedom for Marx is largely a matter of overcoming necessity. Necessity compels people to labour so that they may survive, and only those who are free from this compulsion will be free to develop their talents and potential. This is why, throughout history, freedom has usually been restricted to members of the ruling class, who use their control of the land and other means of production to exploit the labour of the poor and subservient. The masters in slaveholding societies, the landowning aristocracy in feudal times, and the bourgeoisie who control the wealth in capitalist societies have all enjoyed various degrees of freedom, but they have done so at the expense of the slaves, serfs, and industrial workers, or proletarians, who have provided the necessary labour.

For Marx, capitalism is both a progressive force in history and an exploitative system that alienates capitalists and workers alike from their true humanity. It is progressive because it has made possible the industrial transformation of the world, thereby unleashing the productive power to free everyone from necessity. Yet it is exploitative in that capitalism condemns the proletarians, who own nothing but their labour power, to lives of grinding labour while enabling the capitalists to reap the profits. This is a volatile situation, according to Marx, and its inevitable result will be a war that will end all class divisions. Under the pressure of depressions, recessions, and competition for jobs, the workers will become conscious that they form a class, the proletariat, that is oppressed and exploited by their class enemy, the bourgeoisie. Armed with this awareness, they will overthrow the bourgeoisie in a series of spontaneous uprisings, seizing control of factories, mines, railroads, and other means of production, until they have gained control of the government and converted it into a revolutionary dictatorship of the proletariat. Under socialism or communism—Marx and Engels drew no clear or consistent distinction between the two—government itself

will eventually wither away as people gradually lose the selfish attitudes inculcated by private ownership of the means of production. Freed from necessity and exploitation, people will finally live in a true community that gives “each individual the means of cultivating his gifts in all directions.”

Marx maintained that the revolution by which socialism would be achieved was ordained by the logic of capitalism itself, as the capitalists’ competition for profits led them to create their own “grave diggers” in the proletariat. Even the role of the revolutionary, such as Marx, was confined to that of “midwife,” for revolutionaries could do no more than speed along the inevitable revolution and ease its birth pangs.

This, at least, was Marx’s more or less “official” doctrine. In his writings and political activities, however, he added several qualifications. He acknowledged, for example, that socialism might supplant capitalism peacefully in England, the United States, and other countries where the proletariat was gaining the franchise; he also said that it might be possible for a semifeudal country such as Russia to become socialist without first passing through capitalist industrialism. Moreover, Marx played an important part in the International Working Men’s Association, or First International, formed in 1864 by a group of labour leaders who were neither exclusively revolutionary nor even entirely committed to socialism. In short, Marx was not the inflexible economic determinist he is sometimes taken to be. But he was convinced that history was on the side of socialism and that the equal development of all people to be achieved under socialism would be the fulfillment of history.

### **7.2.3 Market Socialism**

Market Socialism is a term used to define an economic system in which there is a market economy directed and guided by socialist planners, and where prices would be set through trial and error (making adjustments as shortages and surpluses occur) rather than relying on a free price mechanism.

By contrast, a Socialist Market Economy, such as that practiced in the People’s Republic of China, is one where major industries are owned by state entities, but compete with each other within a pricing system set by the market and the state does not routinely intervene in the setting of prices.

**Market socialism** is a type of economic system involving the public, cooperative, or social ownership of the means of production in the framework of a market economy. Market socialism differs from non-market socialism in that the market mechanism is utilized for the allocation of capital goods and the means of production. Depending on the specific model of market socialism, profits generated by socially owned firms (i.e. net revenue not reinvested into expanding the firm) may variously be used to directly remunerate employees, accrue to

society at large as the source of public finance, or be distributed amongst the population in a social dividend.

Although economic proposals involving social ownership with factor markets have existed since the early 19th century, the term "market socialism" only emerged in the 1920s during the socialist calculation debate. Contemporary market socialism emerged from the debate on socialist calculation during the early-to-mid 20th century among socialist economists who believed that a socialist economy could neither function on the basis of calculation in natural units nor through solving a system of simultaneous equations for economic coordination, and that capital markets would be required in a socialist economy.

Early models of market socialism trace their roots to the work of Adam Smith and the theories of classical economics, which consisted of proposals for cooperative enterprises operating in a free-market economy. The aim of such proposals was to eliminate exploitation by allowing individuals to receive the full product of their labor while removing the market-distorting effects of concentrating ownership and wealth in the hands of a small class of private owners. Among early advocates of market socialism were the Ricardian socialist economists and mutualism philosophers. In the early 20th century, Oskar Lange and Abba Lerner outlined a neoclassical model of socialism which included a role for a central planning board (CPB) in setting prices equal marginal cost to achieve Pareto efficiency. Even though these early models did not rely on genuine markets, they were labeled "market socialist" for their utilization of financial prices and calculation. In more recent models proposed by American neoclassical economists, public ownership of the means of production is achieved through public ownership of equity and social control of investment.

Market socialism is distinguished from the concept of the mixed economy, because unlike the mixed economy, models of market socialism are complete and self-regulating systems. Market socialism is also contrasted with social democratic policies implemented within capitalist market economies: while social democracy aims to achieve greater economic stability and equality through policy measures such as taxes, subsidies and social welfare programs; market socialism aims to achieve similar goals through changing patterns of enterprise ownership and management.

## Exercise 7.1

Q1. Discuss Utopian socialism.

Q2. Explain market socialism.

## 7.3 Summary

In this lesson we have gone through the different types of socialism. In the first section of the chapter we have discussed the Utopian socialism and its evolution. In the second section of the lesson we have learnt about Marxism socialism. In the last section of the chapter we have discussed another form of socialism known as market socialism.

## 7.4 Glossary

**1. Socialism:** a political and economic theory of social organization which advocates that the means of production, distribution, and exchange should be owned or regulated by the community as a whole.

**2. Market socialism** is a type of economic system involving the public, cooperative, or social ownership of the means of production in the framework of a market economy.

**3. Utopian Socialism** is a term used to define the first currents of modern socialist thought in the first quarter of the 19<sup>th</sup> Century. In general, it was used by later socialist thinkers to describe early socialist, or quasi-socialist, intellectuals who created hypothetical visions of perfect egalitarian and communalist societies without actually concerning themselves with the manner in which these societies could be created or sustained. They rejected all political (and especially all revolutionary) action, and wished to attain their ends by peaceful means and small experiments.

## 7.5 Answers to self Check exercises

### Exercise 7.1

Answer 1 Refer to section 7.2.1.

Answer 2 Refer to section 7.2.3.

## 7.6 Suggested Readings

1. Desai, S.S.M., (1982), Economic Systems, Himalaya Publishing House, Bombay;



2. Halm, George N., (1968), Economic Systems, Oxford & IBH Publishing Co., New Delhi
3. Sen, K.K., (1994), Comparative Economics Systems, Sultan Chand & Sons, New Delhi
4. Grossman, Gregory, (1978), Economic Systems, Prentice Hall, New Delhi.

## **7.7 Terminal Questions**

Q1. What do you understand by socialism? Write a note on different types of socialism.

## **LESSON 8**

### **MIXED ECONOMIC SYSTEM-I**

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#### **STRUCTURE**

- 8.0 Objectives
- 8.1 Introduction
- 8.2 Meaning and Definition of Mixed Economy
- 8.3 Types of Mixed Economies
- 8.4 Features of Mixed Economy
- 8.5 Problems of Mixed Economy
- 8.6 Measures for the Efficient Working of a Mixed Economy
- 8.7 Summary
- 8.8 Glossary
- 8.9 Answers to self Check exercises
- 8.10 Suggested Readings
- 8.11 Terminal Questions

#### **8.0 Objectives**

After going through this lesson you will be able to;

- Define mixed economy
- List and explain types of mixed economies
- Explain the features mixed economy
- Identify the problems of mixed economy

#### **8.1 Introduction**

India's development experience is inextricably linked with India's decision to opt for a mixed economy in the beginning of her own planning process. There neither was nor is even now a consensus among social scientists whether the choice of the mixed ' economy concept was right for India. On the one hand, the heavy industry bias, insufficient resource allocation, non competitive nature of Indian economy in the global context, (high cost economy and' shackling of the growth impulses) are all traced to this decision to opt for mixed

economy. It implied a significant degree of government intervention and control. On the other hand, the left-wing economists **have** viewed the adoption of mixed economy framework as being "little more than a device for legitimising the rule of the capital in direct collaboration with the State.

They seem to regard it as axiomatic that a mixed economy represents nothing more than a compromise weighted heavily in favour of the vested interests." It has nevertheless to be conceded that market forces left to themselves can offer a solution to the problem of poverty, when millions of people live so close to subsistence and a large number below subsistence level. Also, given the way India's culture has evolved, a centrally planned economy with the State steering the social and economic change is an impossible model for the country. Pursuit of a mixed economy, therefore, has been the only feasible proposition.

## 8.2 Meaning and Definition of Mixed Economy

1. Mixed Economy is a two Wheel economy in which Private Sector and Public Sector run together. In other words—it is neither pure capitalism nor pure socialism but it is the mixture of the two. In this economy private enterprise is not permitted to function freely and uncontrolled. The Government intervenes to control and regulate private enterprise.

2. **Hanson** has written that—"Mixed Economy is a golden mean by socialism and capitalism".

3. **Joseph E. Stigitz** has defined the concept in a much simpler manner. He says that Mixed Economy is a "Mixture of Public and Private Decision making."

4. **Prof. A. Samuelson** has defined—"Mixed Economy as on which primarily relies on price mechanism for economic organisation but uses a variety of government interventions, such as taxes, spending and regulation to handle macroeconomic instability and market failures."

Further, a mixed economy implies the operation of both Private Sector and Public Sector. The enterprises in the private sector are not permitted to work freely through price mechanism and are often controlled by the state in order to stimulate them to work within the frame work of the national economic planning.

On the other hand the state in the underdeveloped countries like India actively participates in economic activities, so as to minimise the evils of pure capitalism and to realise the benefits of the socialism as well. The evolution of the concept of "Mixed Economy" is the development of the 20th Century. It emerged as a measure to avoid the evils of economic liberty or "Laissez Faire" on the one hand and to realise simultaneously the good qualities of socialisation of means of production on the other.

### 8.3 Types of Mixed Economies

There are two types of mixed economies:

In one type the ownership of the means of production i.e., farms and factories is owned and controlled by the private sector and the Government merely controls and regulates the functioning of the private sector.

In the second type the government directly participates in productive enterprise side by side with private enterprise. The government sets up industries of its own and invests its own capital and purchases or hires the productive resources and takes the risk of profit or loss like an ordinary entrepreneur.

There are also Joint Sector which is shared both by Private and the Public Sector. The U.S.A. and the U.K. are prominent examples of first type of mixed economy while India represents the second type of mixed economy.

### 8.4 Features of Mixed Economy

The following are the main features of the mixed economy:

**1. Coexistence of Public and Private Enterprises:** The main feature of a mixed economy is the coexistence of both Public and Private enterprises. They work together. The industries in Private Sector are managed and operated completely by the Private entrepreneurs. The private entrepreneurs are fully free to develop their industries and to start new industries in this sector. On the other hand there is Public Sector in which the enterprises are owned and managed by the State.

Usually the basic industries like defence; equipment's, atomic energy, telecommunication, heavy engineering etc. are allocated in the public sector where as the consumer goods industries, small and cottage industries, agriculture etc. are often given to the Private Sector. Besides this, the State also ensures to the Private Sector not to intervene in its functioning and provides several incentives and facilities for the development and the smooth functioning of the sector, so as to make the country's economy rather more economically strong and powerful.

**2. State Control over Private Sector:** In such an economy the State imposes certain necessary measures to regulate and control the enterprises relating to the private sector, so that they make undertake their work in accordance with the national objectives and not only in their own interests. The Licensing System is an effective instrument in the hands of the State by which it controls and regulates the direction of private industrial investment and production. The other measures of control over private sector which it generally uses are appropriate monetary and fiscal policies. As such the State gives them rebates and tax concessions and credit facilities at the reasonable rates, so as to encourage the private entrepreneurs to invest their savings in the required and right direction.

**3. Price Mechanism and State Directions:** Other important characteristics of a mixed economy may be its operation – both by the price mechanism and the state directives. In the public concern all economic decisions relating to production, prices, marketing and investments are taken by the state authorities. On the other hand it is price mechanism which decides all the important economic policy matters in private sector. The private entrepreneurs take the important economic decisions on the basis of the price and cost analysis of the market and with an object of realising maximum profits.

**4. Consumer's Sovereignty is Protected:** In a mixed economy the sovereignty of the consumers is almost protected which is not possible in a socialist economy. The consumers can purchase commodities freely from the market of their own choice which are produced by the private entrepreneurs according to the consumer's demand or preferences. The state sometimes imposes price control over the goods produced by the private entrepreneurs so as to protect the consumers against the ruthless exploitation undertaken by the capitalists or producers of the private sector.

Besides this, the state also introduces public distribution mechanism followed by the rationing of essential goods in short supply, so that the limited available goods may be fairly supplied and distributed among the people in the society.

**5. Proper Protection is provided to Weaker Sections of the Society Specially Workers and Labourers:** In the initial stage of Industrial Revolution, the producers or capitalists ruthlessly exploited the working class. The state thus realised its responsibility to protect this class from exploitation by the industrialists and producers. It is with this view that the state has implemented a number of Labour Acts to regulate and control the working conditions of labour, such laws are Minimum Wages Act; Industrial Dispute Act; The Workman's Compensation Act; The Maternity Benefit Act; The Employees State Insurance Act; The Employees Provident Fund Act etc.; provide protection to the workers in respect of employment, injury or casualty by accident, disease, maternity and old age benefits. The state also takes essential steps if there is any dispute arisen in the industry in the interest of the workers.

**6. State Takes Measures to Control Monopoly and Concentration of Economic Powers in the Hands of Few:** In a mixed economy a monopolist uses his powers against the interest and welfare of the consumers and wants to realise maximum profits out of his total production which is possible either by reducing the total output or by raising the prices of the commodity. It results in the growing inequalities in the society and enlarging exploitation of the workers. In 1969 MRTP Act was passed to control or restrict monopolist and the concentration of economic power in the Indian economy.

**7. It Reduces Economic Disparities:** A Mixed Economy is often blamed for stimulating economic disparities in the country. But the

states in such economies take necessary steps to reduce inequalities of income and wealth. The growing inequalities of income usually may create disparities of opportunities of education and jobs and may further generate class struggle between the rich and poor workers.

Ultimately, the entire society may be divided into two major camps the rich and the poor or the 'haves' and the 'have not's'. It is with this view that a welfare state always tries to reduce economic disparities through the proper fiscal and credit policies. With the elements or characteristics written above we can come to this conclusion that in a mixed economy both sectors Public and Private work together. On the one hand there are Public and Private work together on the other hand there are Public enterprises completely owned and managed by the state and the private concerns fully organised and managed by the individual owners on the other.

However, both the sectors still need a few restrictions to remove or minimise all other economic distortions and disparities existing in the economy; so as to develop those sectors according to the main stream of the economic developments.

## **8.5 Problems of Mixed Economy**

Sometimes it has been experienced that the economy does not work well successfully under a mixed economy. In Indian economy, there is a Public Sector to a large extent on the one hand and a weak and controlled Private Sector on the other. As a matter of fact, the Public Sector flourishes in a planned economy.

The undue importance to the first at the cost of the latter tends to some sort of problems in the pace of economic development. The difficulties may follow as under:

1. The Private Sector has to work under certain restrictions and control and it is likely to carry out its programmes under a National Plan. But it is experienced in Indian Economy that the process of private sector ultimately depends on the profit motive system and it is generally against the objectives of national planning.
2. The transportation of Private Sector into Public Sector, as a State Policy of nationalization of private enterprises, tends to a lot of fear and confusions against private entrepreneurs.
3. The Public Sector is encouraged throughout the planning period but its performance is not satisfactory and is almost misfit in the framework of national planning. With the result that none of them fulfills the objectives of national planning and hence it is one of the major factor causing the failure of a long term planning in India.

## **8.6 Measures for the Efficient Working of a Mixed Economy**

Following are the important steps which can be taken up for the efficient working of a Mixed Economy:

- 1. Political Stability at the Centre:** There should be a strong central government along with the political stability.
- 2. Timely Execution of Plans is Essential:** The prompt and timely execution of plans is inevitably necessary.
- 3. State Policy should be Clear:** The state policy of nationalisation should be clear and understandable to general public.
- 4. Private Sector should Work within the National Guidelines:** The Private Sector should work strictly within the structure of National Economic Planning.
- 5. To Maintain balance between Public and Private Sector:** The Government of India has made it clear that in future, the Government has no programme of nationalisation of any industry and therefore has decided to maintain a balance between the two sectors. So no danger of takeover by the Government.

#### **Exercise 8.1**

Q1. Define mixed economy.

Q2. What are the features of mixed economy?

### **8.7 Summary**

In this system, a major part of the economy, the private sector, is allowed to function on the principles of free enterprise system or free market mechanism within a broad political and economic policy framework. The other part of the economy, the public sector, is organized and managed along the socialist pattern. The public sector is created by reserving certain industries, trade, services, and activities for the government control and management. The government prevents by an ordinance the entry of private capital into the industries reserved for the public sector. Another way of creating or expanding the public sector is nationalization of existing industries. The promotion, control and management of the public sector industries are the sole responsibility of the state. Apart from controlling and managing the public sector industries the government controls and regulates the private sector through its industrial, monetary and fiscal policies. If necessary, direct controls are also imposed.

### **8.8 Glossary**

**1. Public Sector:** The section of a nation's economy, which is under the control of government, whether it is central, state or local, is known as the Public Sector.

**2. Private Sector:** The section of a nation's economy, which owned and controlled by private individuals or companies is known as Private Sector.

## **8.8 Answers to self Check exercises**

### **Exercise 8.1**

Answer 1. Refer to section 8.2.

Answer 2. Refer to section 8.4.

## **8.9 Suggested Readings**

1. Desai, S.S.M., (1982), Economic Systems, Himalaya Publishing House, Bombay;

2. Halm, George N., (1968), Economic Systems, Oxford & IBH Publishing Co., New Delhi

3. Sen, K.K., (1994), Comparative Economics Systems, Sultan Chand & Sons, New Delhi

4. Grossman, Gregory, (1978), Economic Systems, Prentice Hall, New Delhi.

## **8.10 Terminal Questions**

Q1. What do you understand by mixed economy? Discuss the features of mixed economy. What are the problems of mixed economy?



## **LESSON 9**

### **MIXED ECONOMIC SYSTEM-II**

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#### **STRUCTURE**

9.0 Objectives

9.1 Introduction

9.2 Role of Public Sector enterprises in India

9.3 Important Reasons for Privatisation in India

9.4 Globalisation

9.4.1 Reasons for Globalisation

9.4.2 Globalisation and its Impact on Indian Economy

9.5 Summary

9.6 Glossary

9.7 Answers to self Check exercises

9.8 Suggested Readings

9.9 Terminal Questions

#### **9.0 Objectives**

After going through this lesson you will be able to;

- Identify the Role of Public Sector enterprises in India
- Explain the reasons for Privatization in India
- Define Globalization
- Identify the impact of globalization on Indian Economy

#### **9.1 Introduction**

Since 1948, when for the first time the importance of the public sector in the Indian economy was recognized, the public sector has experienced a phenomenal growth both in terms of number and volume of investment. The Government has made sustained efforts to break the vicious circle of poverty and un development by setting up public sector enterprises or by nationalizing certain key industries. The most recent instances are the nationalization of the bigger commercial banks and that of coal mines.

## **9.2 Role of Public Sector enterprises in India**

We may enumerate below the various arguments put forth in support of the public sector in India.

### **1. Maximizing the rate of economic growth:**

Originally, the activity of the public sector enterprises was to be limited to a definite field of basic and key industries of strategic importance. There were certain fields where the private enterprise was shy to operate as they involved huge investment or risk. It was the public sector alone which could build the economic overheads such as power, transport, etc. Since then the ideological objective of capturing the “commanding heights” by the public-sector has been duly fulfilled, it succeeded in creating the necessary infrastructural base for sustained industrial growth. It has tremendously boosted the technological capabilities.

The public enterprises have firmly established the foundation for the construction of a self-generating, industrial economy. During the planned era, the public sector has diversified its activities to cover a wide spectrum of industries. The public sector today has entered into the production of consumer goods such as bread, paper, watches, scooters, T.V. and transistor parts, cement, drugs,, etc. Prof. Lakdawala is of the view that the public sector should now enter the fields of distribution and rural development as well.

### **2. Development of capital-intensive sector:**

Industrial development of a country necessitates the foundation of an infrastructure! base. This foundation is provided by the development of capital-intensive industries and the basic infrastructure. The private sector neither has the zeal nor the capacity to invest in such infrastructural programmes. From this point of view, the public sector has a magnificent record. The State has successfully implemented various schemes of multi-purpose river projects,, hydroelectric projects, transport and communication, atomic power,, steel, etc. It has vastly contributed in the fields such as nuclear or steel technology, aeronautics, and defence materials, ship-building and so on. It has laid down a good network of transport and communications.

### **3. Development of agriculture:**

The public sector has an important role in the field of agriculture as well. The public sector assists in the manufacture of fertilizers, pesticides, insecticides and mechanical implements used in agriculture. Through the various research institutes the public sector has augmented agricultural productivity by introducing new high-yielding

variety of seeds, preventing crop diseases and innovating new agricultural practices.

#### **4. Balanced regional development:**

In the pre-independence period a major problem was regional economic disparities. There were certain areas where there was a heavy concentration of industrial activity. On the other hand, there were certain backward areas which went without industries. Industrial development was highly lopsided. Thus Maharashtra, West Bengal, Gujarat and Tamil Nadu, etc., were highly developed industrially. States like Orissa, Assam, Bihar, Madhya Pradesh etc. were highly backward. Besides, industries used to be gravitated towards the metropolitan areas, rather than the smaller towns. But imbalanced economic development is as bad as underdevelopment.

Through the extension of public sector enterprises the Government desired to remove such regional imbalances. The State, consequently, participated in the industrial growth of the less developed areas by setting up public enterprises. Normally the private sector cannot be induced to start industries in the backward areas. While locating new public enterprises the claims of the relatively backward areas are given due consideration. The policy of dispersal of Industries aims at removing regional disparities. A conscious attempt has been made in the successive five-year plans to accelerate the development of relatively backward areas.

#### **5. Development of ancillary industries:**

Establishment of a few big public enterprises is not enough to unleash forces of industrial development in an area. There are states like Bihar where in spite of lavish public sector investment, industrial development has not been satisfactory. On the other hand, States like Punjab have made a vast progress because of the development of small and ancillary units. This realization made the public sector take a close interest in the development of small and ancillary units. It is expected that the development of ancillaries would have the way for rapid industrial growth of a region and lead to balanced economic development. The number of such ancillary units was 432 in 1974-75 and the number rose to 888 in 1979-80 with purchases from them increasing from Rs. 29 crores to Rs. 120 crores. It is expected that in future, ancillary development would receive more attention from the Government.

#### **6. Increasing employment opportunities:**

The growth of the public sector has led to the expression of gainful employment opportunities. In addition to the primary effect of

the public sector in creating employment opportunities, public sector investments also have a multiplier effect on other sectors of the economy. This has a beneficial effect on the total employment position. In 1963-61, the number of people employed in public enterprises was only 1.82 lakhs. This figure rose to 14.08 lakhs in 1974-75 involving an increase of 671 per cent. Similarly the total amount of salaries and wages increased from Rs. 40.91 crores to Rs. 1,053.35 crores, involving an increase of 2,474.8 per cent, during the same period. In 1986-87 the number of working population in these industries stood at 22 lakhs.

### **7. Model employer:**

Dr. R.K. Gupta has observed that in India "the State has inaugurated the era of the model employer in contrast to the employer with a feudal outlook. It has laid down guidelines for employer-employee relations and for developing good and efficient personnel." The public sector has been the pacesetter in the field of labour welfare and social security. The State aims at establishing an industrial democracy which will provide a fair deal to the workers. The public enterprises have been investing liberally on matters pertaining to labour welfare and social security. Not only the wages have been substantially increased, conditions of service have vastly improved. For instance, wages in the coal industry have nearly trebled since nationalization and many other amenities also are being provided.

### **8. Preventing concentration of economic power:**

Preventing private monopolies and concentration of economic power is the avowed objective of our economic policy. Nationalization is considered as an antidote for the concentration of economic power in private hands. In India the public sector enterprises have grown both in number and in strength. Today, the public sector not only occupies the commanding heights in the economy, it has also penetrated into the production of essential consumer goods. The share of the public sector in the overall industrial production, has substantially gone up. This has effectively curbed the concentration of economic power. It has created a countervailing force against the growth of larger industrial houses.

### **9. Export promotion:**

The public sector enterprises are substantially contributing to the country's export earnings. The public sector has built up a reputation abroad in selling plants, heavy equipment's, machine-tools and other industrial products. She has created a goodwill in the third world countries for her consultancy services and technical know-how. Public sector exports also include consumer goods. The role of the State

Trading Corporation, or the Minerals and Metals Trading Corporation has been quite creditable in promoting exports. The public enterprises, thus had a splendid performance.

#### **10. Import substitution:**

The public sector enterprises have also-succeeded in their efforts in import substitution. Today many commodities starting from basic drugs to highly advanced equipments are manufactured in the public sector, which previously used to be imported from abroad. In certain fields public enterprises were specially started to reduce imports from abroad, and achieve self-sufficiency. Public enterprises like Hindustan Antibiotics Ltd. or Bharat Electronics Ltd. or Hindustan Machine Tools etc., have done a remarkable job in import substitution. This has resulted in saving of precious foreign exchange. Today there is a special drive in the public enterprises to utilize indigenous materials and domestic skill.

#### **11. Production and sales:**

While taking up the production of any goods or services, the private entrepreneur is guided solely by the profit motive. To maximize profit, he even does not hesitate to exploit the consumers. Very often maximization of profit is achieved at the cost of public welfare. It is only the public sector which can produce according to special needs. Sometimes it may even sell at a price lower than its cost. This indicates that the contribution of the public sector to the flow of goods and services in the economy was quite considerable.

#### **12. Mobilization of resources:**

The public sector undertakings have played an important role in financing the planned development of the country. They have significantly contributed to the Central Exchequer in the form of interest and various taxes, etc. Besides public enterprises show an increasing trend in the generation of internal resources. In the total capital formation of the country more than 50 percent is contributed by the public sector.

#### **13. Research and development:**

Today no country can industrially prosper without research and development. Such research is highly essential for the introduction of new goods and new technologies of production, lowering the cost of production and improving the quality of the product. In this respect the public sector is playing a crucial role. A lot of research activities are being carried on in the laboratories of the public sector undertakings.

#### **14. Establishment of a socialist pattern:**

In India the public sector was desired to be extended rapidly so as to establish a socialist pattern of economy. There was abject misery and poverty all round prior to the adoption of planning. Through our planned effort we not only wanted rapid economic growth but also social justice. The public enterprises aim at achieving equality of opportunity and reduction of economic inequalities.

### **9.3 Important Reasons for Privatisation in India**

- 1) Releasing the large amount of public resources locked up in non-strategic PSEs, for redeployment in areas that are much higher on the social priority, such as, basic health, family welfare, primary education and social and essential infrastructure;
- (2) Stemming further outflow of these scarce public resources sustaining the unviable non strategic PSEs;
- (3) Reducing the public debt that is threatening to assume unmanageable proportions.
- (4) Transferring the commercial risk, to which the taxpayers' money locked up in the public sector, is exposed, to the private sector where ever the private sector is willing and able to step in.
- (5) Releasing other tangible and intangible resources, such as, large manpower currently locked up in managing the PSEs, and their time and energy, for redeployment in high priority social sectors which are short of such resources.

The need for privatisation arises out of the situations like

- (1) Control of budgetary deficit
- (2) Resource mobilisation
- (3) Reduction of extra tax burden
- (4) Flow of funds to public
- (5) Production increase
- (6) Retrieval of civil servants from public enterprises to better utilisation in governance and administration.
- (7) Increase in competition, both in domestic as well as international markets.

Based on the recommendations of the Arjun Sen Gupta Committee on Public Sector Enterprise, the privatisation of public enterprises in India can take one of the following forms:

- (1) Complete privatisation

- (2) Partial privatisation
- (3) Privatisation of the management
- (4) Creating competitive conditions
- (5) Deregulation
- (6) Delicensing and
- (7) Disinvestments and other liberalisation measures.

As a consequence, they must also follow the trend of the overall economic policy, which, in the current context, is heavily tilted towards liberalisation, democratisation, marketisation and globalisation, and a decisive move away from extensive social controls.

State intervention in the market arises out of two main reasons. Either, the market does not exist at all, as was the case with most developing countries who had acquired independence from colonial rule in the second half of the 20th century, mainly located in Asia-Africa and Latin America; or, there were cases of severe market failures which required governments to intervene decisively in public interest as was the case in many developing and even developed economies, like the UK, France, Italy, etc.

### **Benefits of disinvestment**

(1) Disinvestment would expose the public sector companies to market discipline, thereby forcing them to become more efficient and survive on their own financial and economic strength or cease.

(2) Disinvestment would result in wider distribution of wealth through offering of shares of privatised companies to small investors and employees.

(3) Disinvestment would have a beneficial effect on the capital market; the increase in floating stock would give the market more depth and liquidity, give investors easier exit option, help in establishing more accurate benchmarks for valuation and pricing, and facilitate raising of funds by the privatised companies for their projects of expansion, in future.

(4) Opening up the public sector to appropriate private investment would increase economic activity and have an overall beneficial effect on the economy, employment and tax revenues in the medium to long term

## **9.4 Globalisation**

In simple terms Globalisation means integrating the economy of a country with the world economy. According to the Chambers 20th Century Dictionary, globalisation means “to make global, that is worldwide, or effecting or taking into consideration the whole world or all people.” Globalisation implies having the entire world as one market. It is a process of increasing economic integration and growing economic interdependence between countries in the world economy. It involves not simply cross-border movement of goods, services, capital, technology, information and people, but also an organisation of economic activities which crosses national boundaries. Globalisation means adopting a global outlook in manufacturing, marketing, financing, human resource management and all other areas of business. A timely global corporation views the entire world as a single market.

#### **9.4.1 Reasons for Globalisation**

The main factors that lead to globalisation are as follows: Growing similarities of countries in terms of available infrastructure, distribution channels and marketing approaches. There will be increase in employment opportunities over a period of time. Efficiency of banking and financial sectors will improve with the opening of these areas to foreign banks and capital. Products becoming available to more global consumers due to reduced costs and global distribution systems. Globalisation will help the developing countries to improve the allocative efficiency of resources, reduce the capital-output ratio and increase the productivity of labour. It can increase the influence of foreign capital and technology and stimulate exports. Widening of competition from domestic markets to global markets. Globalisation will help to restructure the production and trade pattern in favour of labour intensive goods and technologies. With reduction in capital output ratio, the growth rate will increase. National capital markets are growing into global capital markets due to the large flow of funds between countries. Technological restructuring, i.e. technological revolutions such as microelectronics reshaping competition globally. Globalisation exposes firms to international competition. In order to survive in global markets, firms have to improve efficiency of operations, reduce costs and improve quality. Globalisation and Its Impact on Indian Economy Globalisation is considered as an important element in the reform package. But what constitutes globalisation? The term globalisation has four parameters: (i) Reduction of trade barriers so as to permit free flow of goods across national frontiers; (ii) creation of an environment in which free flow of capital can take place among nation-states; (iii) creation of environment, permitting free flow of technology; and (iv) from the point of view of the developing countries, creation of an environment in which free movement of labour can take place in



different countries of the world. The advocates of globalisation, more especially from developed countries, limit the definition of globalisation to only three components, viz., unhindered trade flows, capital flows and technology flows. They insist on the developing countries to accept their definition of globalisation and conduct the debate on globalisation within the parameters set by them. However, several economists in the developing world believe that this definition is incomplete and in case the globalised s ultimate aim is to look upon the world as a 'global' village, then the fourth component, unrestricted movement of labour cannot be left out. But the entire issue whether debated at the World Trade Organisation (WTO) or at other forums blacks out the 'labour flows' as an essential component of globalisation.

#### **9.4.2 Globalisation and its Impact on Indian Economy**

##### **(1) Effect of Globalisation on Students and Education Sectors:**

Due to globalisation, the availability of study books and information on the internet or the World Wide Web (www) have increased tremendously. However, the exorbitant cost factors have made higher and specialised education beyond the reach of poor and middle class students.

Hundreds of foreign universities have started collaborating with Indian universities and study institutions. This has affected the course fees. For Engineering, Medical and Management studies, the course fees are hovering around Rs.20 to Rs.50 lakhs. Intelligent students from middle and poor class may have to settle for daily wages earning in future as they cannot afford for the same.

##### **(2) Effect on Health Sectors:**

It is unbelievable that in India, poor people have to spend a minimum of Rs.200 for a mere seasonal cold or minor stomach ailments, thanks to the multinationals pharmaceutical companies engaged in sky rocketing cost of common medicines under their brand names. The private sector hospitals like Apollo, Medicare will be only too happy to prepare a bill of Rs.5 lakh to Rs.10 lakh for heart or Kidney operation. The monitoring of health electronically through the internet will worsen the situation further in the years to come. Death will be the easiest option for poor following the effect of globalisation in health sector.

##### **(3) Effect on Agricultural sector:**

The globalisation of trade in the agricultural sector is perhaps proving to be a big blunder. The farmers will have to pay a very heavy price, for better variety of imported seeds having resistance to

diseases, because of the patent rights imposed by WTO. Over and above, the Indian farmer cannot export their products to rich countries because of inferior technology and stringent quality parameters imposed by foreign consumers. The large scale suicide by Indian farmers in Karnataka, Punjab and Haryana under the burden of heavy loans is directly attributed to this. The Indian agriculture is almost on its deathbed. The minimum cost of eatable rice is Rs.12 per kg and apples from Australia at Rs. 100 to Rs.150 per kg cannot be afforded by poor.

#### **(4) Effect on Employment sector:**

The employment scenario in India is probably the worst in recent years due to globalisation. The restrictions of use of child labour and fair pay to workers have badly affected the traditional industries like cottage, handloom, artisans and carving, carpet, jewellery, ceramic, and glassware etc., where the specialised skills inherited for generations were passed on to the next generation from the early age of 6 to 7 years. The globalisation and trade restrictions under the influence of WTO have virtually killed business in these sectors.

#### **(5) Effects on Indian Industry**

WTO has been urging India to lower import duties, remove controls on consumer goods imports, reduce quantitative restrictions, etc. Under the Uruguay Round Agreement, India offered to reduce tariffs on capital goods, components, intermediate goods and industrial raw materials to 40% in case our tariffs were above that percentage; to 25% in case our tariffs were between 25 to 40 per cent and to bind the tariff ceiling at 25 per cent in case our tariffs were below that percentage. This reduction in tariffs was to be achieved by the year ending 2000. Since India scrupulously followed the agreement, the tariffs have been reduced year after year to conform with the WTO provisions. As the protection afforded by import duties gradually disappeared, Indian industry had to face increasing competition from foreign goods. Confederation of Indian Industry, the apex body expressed its disapproval against duty free status of capital goods sector. As a result, Confederation of Indian Industry estimated that indigenous capital goods industry on a conservative estimate lost orders worth Rs. 5,000 crores from foreign countries. Instead of ensuring level playing field, indigenous industry has to pay excise, sales tax, octroi, turnover tax while imported goods are allowed duty-free access to our market. Not only the entire manufacturing industry is faced with a crisis, even machine tools industry, gen sets and boiler producers are put at a serious disadvantage. Consequently, imports of finished products are

displacing indigenously produced products. As a result, many industrial units are being closed and cheap imports have become an important cause of recession in Indian industry.

### **Exercise 9.1**

Q1. Define globalization.

Q2. What is the role of public sector in India?

### **9.5 Summary**

A survey of the globalisation policies followed in India reveals that the promised benefits of globalisation in the form of sharp increase in GDP, exports, foreign direct investment, reduction of poverty, deceleration of unemployment could not be realised by India during the 1990s. Globalisation has adversely affected Indian industry, it has enabled the developed countries to push their exports to India at a much faster rate, but did not facilitate the process of access to international markets; small scale industry has suffered due to the policy of dumping practiced by developed countries, more especially in consumer goods. The most distressing part of the story is the double standards practiced by the developed countries which manifest in the form of unfair agreement on textiles; a policy marked by a bias in favour of the farmers of developed countries as against the poor farmers in India. Developed countries brought forth spurious environmental and social issues to prevent the exports from India of such commodities in which the country possessed comparative advantage. Mr. V S Vyas rightly points out: "The international agreements, particularly under World Trade Organisation (WTO) have not helped the developing countries as was professed at the time of the establishment of WTO". All these factors have resulted in an erosion of faith in globalisation as the new "mantra" for stimulating development in India.

### **9.6 Glossary**

**1. Privatization:** Privatisation refers to the participation of private entities in businesses and services and transfer of ownership from the public sector (or government) to the private sector as well.

**2. Globalization:** the process by which businesses or other organizations develop international influence or start operating on an international scale. "fears about the increasing globalization of the world economy"

## **9.7 Answers to self Check exercises**

### **Exercise 9.1**

Answer 1 Refer to section 9.4.

Answer 2 Refer to section 9.2.

## **9.8 Suggested Readings**

1. Desai, S.S.M., (1982), Economic Systems, Himalaya Publishing House, Bombay;
2. Halm, George N., (1968), Economic Systems, Oxford & IBH Publishing Co., New Delhi
3. Sen, K.K., (1994), Comparative Economics Systems, Sultan Chand & Sons, New Delhi
4. Grossman, Gregory, (1978), Economic Systems, Prentice Hall, New Delhi.

## **9.9 Terminal Questions**

Q1. Define privatization. What are the reasons for privatization in India?

Q2. Define globalization. What is the impact of globalization on Indian economy?