Study notes for economy topic - Types of economy

Today we will be studying about types of economy. India is a rapidly developing country and it is the world's sixth-largest economy by nominal GDP. In terms of Purchasing Power Parity (PPP), India is the third-largest in the world after China and the US. So let's explore deep.

India has a mixed economy where both private sector and public sector companies co-exist in perfect harmony. The agricultural sector is a major contributor to the Indian economy. More than 2/3rd of India's working population is engaged in agriculture. India has one of the fastest-growing service industries in the world. There are different types of Economies around the world. Each type has its own distinguishing characteristics, but they all share some basic features.

The Indian economy is divided into three sectors: the primary, secondary, and tertiary economies. The Indian economy is split between organised and unorganised sectors in terms of operations. In contrast, ownership is split between the public and private sectors.

1. Primary Sector: The services provided by this sector are totally dependent on the availability of natural resources to maintain daily operations. Examples include agriculture, mining, fishing, forestry, and dairy. The three industries that collectively make up one-third of India's GDP are agriculture, forestry, and fisheries. The primary sector generates 18.20 percent of GDP. India's economy has always been based primarily on agriculture. In addition, India is the second-largest producer of groundnuts, wheat, sugar, freshwater fish, and milk in the world. The underemployment and covert employment that this sector experiences is one of its main issues. Underemployment is the cause of employees not performing to the best of their ability, whereas underemployment is the cause of employees not performing to the fullest of their capacities. The state and federal governments might enhance funding for irrigation systems and offer loans for the purchase of high-quality seeds and fertilisers as a solution to the issues.

2. Secondary Sector: Natural resources are used to create the commodities and services that are provided and then consumed, which is the basis of the sector's economics. This industry turns the output of the primary sector (raw resources) into completed commodities that can be exported or sold to consumers or enterprises domestically (via distribution through the tertiary sector). These industries are frequently categorised as being "light" or "heavy" based on the extent to which they require vast amounts of energy, factories, and machinery.

3. Tertiary Sector: The term "service sector" is used to describe the tertiary sector. Instead of producing finished goods, the service industry creates services. Services (sometimes referred to as "Intangible Products") include things like emotional labour, access, direction, and access. The tertiary sector of the industry is in charge of providing services to end customers as well as corporations. By interacting with customers and offering customer service, the emphasis is on people rather than changing actual physical objects. Certain important services that don't directly support the production of commodities are included in the service sector.

The main types of economies are - Traditional Economy, Command Economy, Market Economy, Mixed Economy, Capitalism and Socialism.

Traditional Economy

This is practiced in rural areas and third-world countries that are fully dependent on land through farming. Culture determines the traditional economy. Goods are produced mainly for consumption; there is little or no surplus production. There is a lack of technology and modern medicine in this type. It uses the Barter system as the concept of money and currency is not formulated in this economy. One example can be some tribes in Africa.

Command Economy

In a command economy, the whole economy is controlled by a centralized power which happens to be the central government of that country. The best example is Soviet Russia where all decisions regarding the economy were made by the central communist government. This economy is found in communist and socialist states. Government has a monopoly over all businesses and industries. Modern examples are China and North Korea. There is a lack of innovation as there is no incentive to take risks.

Market Economy

It is based on the philosophy that individuals (firms and consumers) act rationally in self-interest and determine how resources get allocated, what goods get produced, and who buys the goods. There is very little or no government intervention in a market economy. It is also called a “laissezfaire” economy which means ‘the policy of leaving things to take their own course, without interfering. Hong Kong was an example of a market economy, but the government there too has started framing policies for the economy. The economy produces only profitable goods and services. Disadvantaged sections that don’t have much purchasing power are marginalized and ignored. It is characterized by an uneven distribution of resources. There is a high chance that consumers are exploited by monopolies.

Mixed Economy

It is a combination of command and market economic systems in different proportions. It is found in almost all countries today. It is also known as a Dual Economy. The government doesn’t control and own, but regulates the business, except for some key sensitive industries like railways and defense. For example India, USA, UK, etc. Governments can make policies of social security like PM-JAY, Pension, etc. also, taxation is used to redistribute wealth and reduce inequality.

Capitalist

It is a system of production where business owners produce goods for sale in order to make a profit and not for personal consumption. Capitalists own the factory as well as the final product, and workers are paid wages to work for the capitalist. The concept of private property is the main idea behind this. It is also known as the Free Economy. Almost all modern economies have capitalist characteristics, for example, the USA, India etc.

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Socialist

In this system of production, workers collectively own the business, the tools of production, and the finished product. It may or may not produce profits from surplus production. Socialist production often produces for profits and utilizes them. There is no concept of private property, everything in the production process is collectively owned. Social welfare is the primary motive. It is mainly found in command economies.

Gross Domestic product(GDP)

GDP is the value of final goods and services produced in a country, or it is the sum of value-added in the economy during a given period. It is the measure of aggregate output. It is expressed in two different ways: **1. Nominal GDP:** It is the sum of quantities of final goods produced multiplied by their current price. It doesn't take into account the effects of inflation. **2. Real GDP:** It is an inflation-adjusted measure that reflects the value of all goods and services produced by an economy in a given year, expressed in base-year prices. It is also referred to as constant price.

Gross National product (GNP)

It is the value of all finished goods and services owned by a country's residents over a period of time.

Foreign remittance

It is a transfer of money from a foreign worker to their family or other individuals in their home countries. For example, people from Kerala earning wages in Dubai send money back home. So, **GDP – foreign remittances (if positive) = GNP**

Fiscal Policy

It is the use of government spending and tax policies to influence economic conditions, especially macroeconomic conditions.

Budget Deficit: It is the excess of total expenditure over total receipts. It happens when expenses exceed revenue. There are three types of deficit:

1. Revenue deficit = Total revenue expenditure – Total revenue receipts.
2. Fiscal deficit = Total expenditure – Total receipts excluding borrowings.
3. Primary deficit = Fiscal deficit-Interest payments.

1. Revenue Deficit: It is an excess of the total revenue expenditure of the government over its total revenue receipts. It shows that the government's own earnings are not enough to meet the normal functioning of the government. **Revenue deficit = Total Revenue expenditure – Total Revenue receipts** Revenue deficit results in borrowing and sale of its assets.

2. Fiscal Deficit: It happens when the government's total expenditures exceed the revenue that it generates excluding the money from borrowings. It is a measure of how much the government needs to borrow from the market to meet its expenditure when its resources are inadequate. **Fiscal deficit = Total expenditure – Total receipts excluding borrowings** The fiscal deficit is equal to borrowings.

3. Primary Deficit: It is defined as a fiscal deficit of the current year minus interest payments on previous borrowings. It shows borrowing requirements inclusive of interest payment. **Primary deficit = Fiscal deficit – Interest payments**

This was all about types of economy. Its important to understand types of economy. Hope you learned. Stay connected for more such blogs.