**SEMESTER 6th (UG)**

**Subject: BUSINESS ENVIRONMENT**

**Unit III Economy Evironment**

**Capitalism Economy**

Capitalism is an economic order in which the resources are owned by a few rich and private people, and production will be done for profit. There will be complete free trade and competition. There will be no restriction or interference by the government. Everything is left to private enterprise.

Capitalistic system is also called free and private enterprise. In this system, the factors of production (resources) are owned by a few rich people called capitalists. The rest will sell their services for wages. Capitalism emerged as a result of Industrial Revolution and the factory system.

This type of pure capitalistic system prevailed only in the 18th and 19th centuries. Now-a-days, with the increasing role of the government, the State regulates the working of the capitalistic system.

**Features of Capitalism**

**1. Private property :** Capitalistic system allows and recognizes the institution of private property. Anyone can earn, acquire or sell property. The property can be passed on to the heirs in inheritance. Thus private individuals come to have lands, houses, buildings, sites, factories and business establishments.

**2. Profit motive :** This is the essence of capitalism. The motive of every economic activity will be profit. Profit motive is the driving force in an individual, partnership and joint-stock companies. Utilization of resources d production will be done for profit. Business people will take huge risks to earn large profits.

**3. Personal freedom :** People enjoy personal freedom in economic activities. This implies:

1. Freedom of enterprise;
2. Freedom of contract;
3. Freedom in production and
4. Freedom in consumption.

**4. Perfect competition:** This is the corollary from the above three features. Since everyone is free in economic field, many people would compete in production and distribution. Sellers and producers freely compete among themselves. Buyers will compete to buy their goods. Workers will compete for getting employment. Due to competition, the fittest will survive.

**5. Price mechanism :** Under capitalism, the price mechanism makes an automatic adjustment in production, distribution and consumption. All activities revolve round price mechanism.

**Merits of Capitalism**

The following merits or advantages are attributed to capitalism.

**1. Encourages production:** Capitalism enables the economy to reach a high level of production, as production is guided by profit. The wealth of the community would increase. It is said that the standard of living of people had increased remarkably in western countries due to capitalistic system.

**2. Best resource utilization:** Best utilization of resources is possible only in capitalism. There will be no wastage of scarce resources. This is because of the working of the system on profit and loss basis. Due to self interest, the producers will use minimum resource for producing maximum goods in order to get good profit.

**3. Availability of goods at cheaper price:** Due to free competition, the consumers will get the goods at the cheapest price. They also get the goods they want. Goods will be produced according to the wishes of the consumer. The consumer will be a king in capitalism.

**4. Stimulates invention:** Competition in production stimulates invention. This promotes development and progress in the economy.

**5. Simple and Automatic:** This system is simple and automatic in its working. The price mechanism adjusts production and consumption. The utilization of resources is done without any external direction.

**Demerits of Capitalism**

The following are some of the major disadvantage or defects of capitalism

**1. Inequality in the Society:** The main defect of capitalism is its gross inequality in the society. Private property, profit motive and inheritance of property have created a separate class of people called capitalists who are wealthy and rich. As they own the factors of production, they become richer and richer and they exploit the poorer classes.Though the capitalistic system affords equal opportunity for all, this will be only in theory. In practice, only the richer class will have more opportunities. Further, to become rich only by means of hard work is very rare.Capitalistic system will make a big gap between the rich and the poor. The inequalities of income and wealth is the worst feature of capitalism.

**2. Waste of resources:** The competition in the economy will lead to wastage of resources. Advertisement by competing firms will be a wastage of resource. Different firms will be producing. the same basic commodity with product differentiation. This will result in unnecessary transport of goods from one place to another (Example: Toilet soaps, Toothpastes, Silk sarees, etc.).

**3. Monopoly in competition:** Competition in the long run will eliminate inefficient producers and finally only a few producers will be producing. These producers (firms) will combine and production will be done as monopoly. In capitalism, there will be many monopolistic firms exploiting the consumers and making huge profit. The benefits of competition will be lost. When there is monopoly, there is no freedom of choice.

**4. Economic Instability:** Another bad feature of capitalism is its economic instability. The competitive system will result in periodic cycles of depression and prosperity called Trade Cycles. During the period of depression, there will be mass unemployment and the poorer classes and the working classes will be suffering.The root-cause for this trade cycle is the unplanned nature of the system and the failure of price mechanism. In the period of depression, the governments have to come to the rescue of the economy.

**5. Frequent labour unrest:** In capitalism, there will be poverty in the midst of plenty. There will be no security for labour and the poorer classes. There will be frequent labour unrest. In this economy, only the fittest will survive.

**Socialism Economy**

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.

**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.

**Merits of Socialism:**

**(1) Greater Economic Efficiency:** Economic efficiency under socialism is greater than under capitalism. The means of production are controlled and regulated by the central planning authority towards chosen ends. The central planning authority makes an exhaustive survey of resources and utilises them in the most efficient manner. Increased productivity is secured by avoiding the wastes of competition and by undertaking expensive research and production processes in a coordinated manner. Economic efficiency is also achieved by utilising resources in producing socially useful goods and services which satisfy the basic wants of the people, like cheap food, cloth, and housing.

**(2) Greater Welfare due to Less Inequality of Income:** In a socialist economy there is less inequality of income as compared with a capitalist economy because of the absence of private ownership of the means of production, private capital accumulation, and private profit. All citizens work for the welfare of the state and each is paid his remuneration according to his ability, education and training. All rents, interests and profits from various sources go to the state which spends them for public welfare in providing free education, cheap and congenial housing, free public health amenities, and social security to the people.

**(3) Absence of Monopolistic Practices:** Another advantage of socialism is that it is free from monopolistic practices to be found in a capitalist society. Since under socialism all means of production are owned by the state, both competition and monopoly are eliminated. The exploitation by the monopolistic is absent. Instead of private monopoly, there is the state monopoly of the productive system but this is operated for the welfare of the people. In the state-owned factories, socially useful commodities are produced which are of high quality and are also reasonably priced.

**(4) Absence of Business Fluctuations:** A socialist economy is free from business fluctuations. There is economic stability because production and consumption of goods and services are regulated by the central planning authority in accordance with the objectives, targets and priorities of the plan. Thus there is neither overproduction nor unemployment.

**Demerits of Socialism:**

**1. Loss of Consumers’ Sovereignty:** There is loss of consumers’ sovereignty in a socialist economy. Consumers do not have the freedom to buy whatever commodities they want. They can consume only those commodities which are available in department stores. Often the quantities which they can buy are fixed by the state.

**2. No Freedom of Occupation:** There is also no freedom of occupation in such a society. Every person is provided job by the state. But he cannot leave or change it. Even the place of work is allotted by the state. All occupational movements are sanctioned by the state.

**3. Malallocation of Resources:**Under socialism, there is arbitrary allocation of resources. The central planning authority often commits mistakes in resource allocation because the entire work is done on trial and error basis.

**4. Bureaucratic:** A socialist economy is said to be a bureaucratic economy. It is operated like a machine. So it does not provide the necessary initiative to the people to work hard. People work due to the fear of higher authorities and not for any personal gain or self-interest.There is no doubt that a socialist economy is better than a capitalist economy because of its overwhelming merits. But it is disliked for the loss of political, economic and personal freedoms.

**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.

**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.

**Merits of Mixed Economy:**

 **(1) Best Allocation of Resources:** Since a mixed economy incorporates the good features of both capitalism and socialism, the resources of the economy are utilised in the best possible manner. The price mechanism, the profit motive, and the freedoms of consumption, production, and occupation lead to the efficient allocation of resources within the economy. But where the possibility of mal-allocation of resources appears, the state regulation and control rectifies it. Thus shortages are avoided, productive efficiency increases, and cyclical fluctuations are eliminated.

**(2) General Balance:** A mixed economy maintains a general balance between the public sector and the private sector. There is competition as well as cooperation between the two sectors which are conducive for achieving a high rate of capital accumulation and economic growth. Further, an estimate of the successes and failures of the two sectors can be made by comparing their respective performances, and corrective measures are adopted accordingly. Thus the inconsistencies of the private enterprise economy and the ‘paper guesses’ of the planned economy are avoided in a mixed economy. By maintaining a higher level of production in the two sectors, the state is able to achieve the targets laid down in the plan.

**(3) Welfare State:** A mixed economy contains all the features of a welfare state. There is no exploitation either by the capitalists as under a free enterprise economy or by the state as under a socialist economy. The workers are not forced to work, Workers are provided monetary incentives in the form of bonus and cash rewards for inventions. Labour laws are passed fixing minimum wages, hours of work, and laying down the working conditions of

workers in factories and on farms.

Social security is also provided to workers in the event of unemployment, disablement, death, illness, etc. The production and sale of noxious articles are banned, while those of essentials are increased for the benefit of the people at large. Legislative measures are adopted to remove the concentration of economic power in the hands of the few rich, and to lessen inequalities of income and wealth.

**Demerits of Mixed Economy:**

A mixed economy has also certain defects which are discussed below:

**(1) Non-Cooperation between the Two Sectors:**

The experience of the working of mixed economies reveals that the public sector and the private sector do not see eye to eye with one another. The private sector is treated like a step-child and groans under the various restrictions imposed upon it by the state. The private sector is taxed heavily, while the public sector is given subsidies and preference over the former in the supplies of inputs. Thus a sense of bitterness and non-cooperation develops between the two sectors.

**(2) Inefficient Public Sector:**

**T**he public sector of a mixed economy is a big burden on the economy because it works inefficiently. Bureaucratic control brings in inefficiency. There is over-staffing of the personnel, red-tapism, corruption and nepotism. As a result, production falls and losses

emerge.

**(3) Economic Fluctuations:**

The experience of the working of the mixed economic system in the developed countries also reveals that they have not been able to remove economic fluctuations. This is because of the improper mixture of capitalism and socialism. The private sector is allowed to operate freely under a loose system of government regulations and controls. The public sector also does not operate under the rigid conditions which are laid down under a planned economy.

It has to depend for its supplies of raw materials, intermediate products and factors on the vagaries of the market mechanism. If in the market, the prices of inputs are increasing due to their shortages, the public sector will be equally experiencing these shortages and price increases. Hence economic fluctuations which are a characteristic feature of a capitalist economy are equally experienced in a mixed economy.

**Conclusion:**

But the demerits of the mixed economy enumerated above are not so acute that they cannot be overcome. Given efficient and honest administrative machinery, the defects of the public sector can be removed. The private sector can be made to work more efficiently by proper control and direction. By adopting fiscal, monetary and physical control measures, economic fluctuations can be eliminated.

**Difference between capitalistic , Socialistic and Mixed economy**

