[Frequently Asked Questions]

Role of the state and the market in economic growth and development

Subject:	Business Economics
Course:	B. A. (Hons.), 6th Semester, Undergraduate
Paper No. & Title:	Paper – 641 Elective PaperE2 – Economic Growth and Policy
Unit No. & Title:	Unit – 5 State and the Market
Lecture No. & Title:	Lecture – 1 Role of the state and the market in economic growth and development

Frequently Asked Questions

Q1. What is meant by a market in economics?

A1. Market is an organization which coordinates the activities of production and consumption through forces of demand and supply.

Market is not essentially a place or a shop. In a broader sense, it is a coordinating mechanism which functions through the invisible forces of demand and supply.

Q2. Which are the functions of a market?

A2. A market performs several functions such as,

a. Coordination: Market coordinates various economic activities like supply, stock maintenance, distribution, allocation etc. through a voluntary and invisible process.

b. Price-Setting: A market sets an equilibrium price. Through the invisible play of the forces of demand and supply, a market sets a price where demand is exactly equal to supply.

c. Determination of the Degree of Competition: Depending upon the size of buyers and sellers, a market determines the degree of competition among buyers and sellers.

d. Stock Regulation: A market regulates the stock of factors, resources and goods by taking signals from the forces of demand and supply.

For example, if suppliers stock up more than the demand, they will incur losses from wastages. A market provides signals regarding the amount of stocks to be maintained.

Q3. How can we define a state in economics?

A3. A state is an organization which has legitimate powers to direct economic activities by rules and enforcing mechanisms.

Q4. Which are the important aspects of a state mechanism?

A4. The state mechanism functions on certain aspects which can be stated as,

- Legitimate coercion.
- Coordination through policies and plans.
- Planning by making normative judgements.
- Deliberate action for inclusion.
- Decisions based on value judgements.

Q5. State the difference between coordinating mechanisms of a market and a state in performing economic activities. A5. The difference between coordinating mechanisms of a market and a state in performing economic activities may be stated as under,

	Market	State
Process of Coordination	Voluntary	Coercive
Mechanism	Invisible forces of demand and supply	Policies and plans
Planning Philosophy	Rational	Normative
Actions	Competitive	Deliberate
Decisions based on	Scientific market mechanism	Value judgements

Q6. What is meant by profit maximizing output?

A6. Profit is the difference between revenue and cost. Profit is maximum when MR=MC (marginal revenue = marginal cost). Hence, private producers will produce only up to the level of output where MR=MC.

Q7. What is meant by a socially desirable output?

A7. A socially desirable output is that which is produced at the minimum point of AC (average cost). Hence, the market can charge a price which is equal to the minimum AC where the producers make only normal profits and consumers pay the lowest possible price.

Under perfect competition the profit maximizing and socially desirable levels of output are the same.

Under imperfect competition, the profit maximizing point occurs before the minimum point of AC is reached. Hence, under imperfect competition, the output produced is lower and price is higher than the socially desirable level of output.

Q8. What are externalities?

A8. Externalities are the spill-over effects of an economic activity which occur outside the sphere of the activity. That is, there are effects of an economic activity on the non-stakeholders.

For example, research activity conducted by a company for improving emission technology for vehicles benefits millions of people who do not own vehicles but breathe the air polluted by vehicle emissions. Thus good research has a positive externality. While pollution created by a factory has a negative externality on people residing in that area.

Development economics discusses such effects of investments in research, capital formation, technology, human capital etc.

Q9. What is meant by non-exclusion?

A9. When people cannot be excluded from using certain goods then it is termed as the principle of non-exclusion.

For example, if a road is constructed outside a housing society, the passersby cannot be excluded from using that road by the residents of the society. Hence, such goods are by and large provided by the public system.

Q10. What is meant by zero-marginal cost?

A10. Marginal cost is the addition to the total cost by the production of an extra unit of output. If no additional cost is incurred when an additional unit is produced then such goods are known to have zero marginal cost. In other words, the total cost remains constant when additional units are supplied.