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SUBJECT = ME & IB

UNIT I – MONEY (PART – VI)

Importance of Money in Mixed Economy

Mixed economy, which has been regarded as a golden mean between capitalism and socialism, is a compromise between these two opposite economic systems. The rational for such a compromise is to integrate the good features of capitalism and socialism, i.e., to take advantage of the market forces while keeping its bad effects under check.

In a mixed economy, private and public sectors co-exist. The private sector operates on capitalist lines, guided by the market mechanism and the principle of maximum profit. But its activities are subject to government controls and regulation to ensure that this sector grows in a manner that would be beneficial to the economy. In this way, the economy is not left entirely to the market forces, but is regulated by fiscal, monetary and direct controls to achieve the national goals.

In a mixed economy of a developing nation, like India, the public sector has to play a dynamic role to achieve the objective of planned economic development. The public sector in India has been given an important place in different Five-Year Plans of development.

Prices and money, therefore, play an important part in a mixed and developing economy in determining the volume of output and employment in the private sector, as it is solely guided by the profit expectations calculated in terms of money. Further, in a developing and expanding economy, which has adopted 'Mixed Economy' as the pattern of development, more and more money is needed for the rapid monetisation of the non-monetised sector of the economy.

Moreover, money will influence not only the relative shifts in the distribution of income in an expanding economy, but will also determine the allocation of limited resources to different sectors of the economy. The role of money in a developing and mixed economy assumes greater importance as money becomes an important factor of development and capital formation.

A developing economy is characterized by an increase in national and per capita income. It is an economy in motion in which stagnation lags behind and dynamic forces of growth are constantly at work to break through the old values and institutions. The use of money is, therefore, at best limited.

In a developing mixed economy (like India), the public sector is affected by the use of money partly because goods and materials have to be purchased from the private sector at rising prices, thereby raising the cost of production of various productive units in the public sector.

Again, if the rate of interest shows a tendency to rise on account of inadequate supply of money (funds), the public sector may have to pay more on loans borrowed from the public and the burden of the public debt may be increased. Thus, the role of money in a developing and mixed economy is more complex, for its true and real nature is not revealed during transition and, therefore, lot of control is needed so as to avoid its evil effects without affecting the tempo of development.

Money plays a significant role in a mixed economy. The importance of money in mixed economy is –

1) **Money as a Mobilising agent -** Apart from performing the conventional functions, i.e., as a medium of exchange, as a measure of value, as a standard of deferred payment and as a store of value, money, through the expansion of monetary economy and the development of money market, plays an active and developmental role in a developing and mixed economy. Money acts as a great mobilising agent in these economies in a number of ways by increasing resources, generating new resources and channelizing resources into productive uses.

2) **Mobilisation of Saving -** In the developing economies, saving and investment habits of the people are very poor. Expansion of money market promotes liquidity and safety of financial assets and thus encourages saving and investment.

3) **Allocation of Resources -** Money market allocates savings into productive investment channels and thus helps in achieving equilibrium between the demand for and supply of loanable funds. In this way, it leads to rational allocation of resources.

4) **Resource Mobility -** Expansion of money economy increases the mobility of financial resources by enabling the transfer of funds from one sector to another. Such flow of funds is essential for the growth of the economy and commerce.

5) **Increase in Investible Profits -** Expansion of money, through its inflationary effect, redistributes income and wealth in favour of the entrepreneurial classes who have high propensity to save. With this redistribution, the profits and savings in the economy increase. The increase in savings is used for investment purpose.

6) **Resource Generation through Deficit Financing -** Deficit financing or inflation tax (i.e., covering the budget deficit through printing new money) can provide adequate fundi to the government for financing development programmes in underdeveloped countries. In an underdeveloped country, where there is little scope for additional taxation due to low income of the people and public borrowing is limited due to low levels of saving, the government can resort to deficit financing to cover the deficit in the budget.

7) **Mobilisation of Human Resources -** Monetisation of the economy by facilitating system of payments encourages the mobilisation of human resources. Money, through its inflationary role, increases the aggregate demand and thus permits fuller utilisation of manpower. This leads to quicker achievement of the objective of full employment.

8) **Implementation of Monetary Policy -** A well-developed money market is a precondition for the effective and successful implementation of the monetary policy of the central bank aiming at mobilisation and channelization of essential resources for economic development.

9) **Role in Private Sector -** Money, through market mechanism, influences the decisions regarding produc-tion and resource allocation in the private sector of the developing mixed economies because these decisions are solely guided by profit motive.

10) **Monetisation of the Economy -** An important feature of a less- developed economy is the prevalence of a vast non-monetised sector. As the economy develops, more and more money and monetary institutions are needed for the monetisation of the economy.