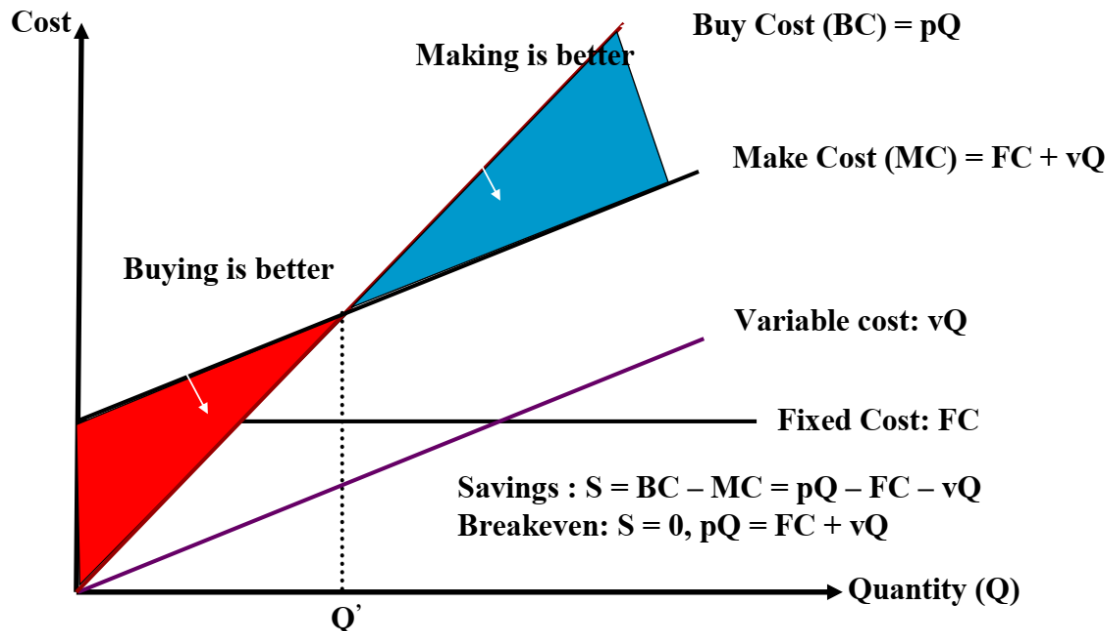


Sub-sector Analysis

BREAKEVEN ANALYSIS

- Breakeven Analysis in the context of Production planning addresses the decision of whether to make or buy a product.
- Making the product involves two cost elements:
 - Fixed costs such as machine renting cost and operation expenses
 - Variable costs such as raw material cost
- Buying the product involves only one cost element, the selling price. However, the price may either be constant or variable based on the quantity.

Breakeven Point = $\frac{\text{Fixed Costs}}{(\text{Unit Selling Price} - \text{Variable Costs})}$



Meaning and Need for Planning:

The 20th century was an era of planning. Almost every country had some sort of planning. In socialist countries, planning is almost a religion. Even in countries like the U.S.A. and the U.K. with a capitalistic system, they have partial planning. The 19th century State was a *Laissez faire* state. It followed a policy of non-intervention in economic affairs. But the modern State is a Welfare State. The two World Wars, the Great Depression of 1930s and the success of planning in former Soviet Russia have underlined the need for planning. Planning is a gift of former Soviet Russia to the world.

For, it was the first country to practice economic planning on a national scale. According to Lionel Robbins, "strictly speaking, all economic life involves planning.... To plan is to act with a purpose, to choose and choice is the essence of economic activity".

In the words of Barbara Wootten, "Planning may be defined as the conscious and deliberate choice of economic priorities by some public authorities". Many economists today agree that planning is an organized,

conscious and continuous attempt to select the basic available alternatives to achieve specific goals. Planning involves the economizing of scarce resources.

Most of the underdeveloped countries of the world became independent only fifty or sixty years back and most of them were poor at that time. So it became the main business of the Governments of the newly emergent nations to provide food, clothing and shelter to their people. For that, first of all, they had to increase their national income. Since most of them were agricultural countries, they had to evolve some programmes for agricultural development. Not only that, they had to industrialize their economies. And they had to

provide more jobs to their people. That means, they had to do something for expanding employment opportunities. Further, as most of them were wedded to some kind of socialism, they had to reduce inequalities of income and wealth. All these things, the poor countries attempted to do by means of economic planning.

Laissez faire policy is a luxury for modern governments. So they have economic plans. In the developed nations of the world, they plan for economic stability. But in the underdeveloped nations, they plan for economic growth and development.

Another main reason for the emergence of planning in underdeveloped countries is the failure of the market mechanism. The capitalist economy is basically a market economy and price mechanism works through the market system. The price system is a basic institution of capitalism. The allocation of resources and distribution of rewards are done through the price system. All decisions of the businessmen, farmers, industrialists and so on are guided by the profit motive. If the market is perfect, price system is good. But if there is monopoly and other types of imperfect competition, the market system fails. And it calls for government intervention by way of planning.

The dispute between planning and *Laissez faire* is essentially about efficiency. The case against *Laissez faire* rests on the following grounds:

1. Under *Laissez faire*, income is not fairly distributed. As a consequence, less important and less urgent goods are produced for the wealthy people while the poor lack basic goods like education, health, housing, good food and ordinary

comforts. Under such a situation, the State can control economic activity by means of planning and reduce inequalities of income and wealth.

2. The market economy is a victim of trade cycles. And there will be alternating periods of prosperity and depression. And during depression, there will be bad trade, falling prices and mass unemployment. So there is need for state intervention. By means of proper planning, the State can control trade cycles as they did in the case of former Soviet Russia. During the latter half of the 20th century, planning was popular in many underdeveloped countries, in addition to former Soviet Russia and Eastern European countries. It does not mean that they believed in complete central planning. The central issue in planning is not whether there shall be planning but what form it shall take. The debate, in fact, centered on whether the State shall operate through the price system or by getting rid of it.

Problems of Planning in backward countries

Planning is much more necessary and much more difficult to execute in backward than in advanced countries. First of all, "planning requires a strong, competent and incorrupt administration". But most of the economically backward nations have weak, incompetent and corrupt administration. Further, they have democratic planning. So they cannot do things in a quick manner as was done in former Soviet Russia. They have to go slow. And agriculture is the main stay of their economies. Since agriculture depends upon natural factors which are uncertain, there is a lot of uncertainty about their agricultural programmes. Over-population and low capital formation are some other important problems of planning in underdeveloped nations.

Characteristics of Economic Planning

In a planned economy, major economic decisions such as what and how much is to be produced, when and where it is to be produced and to whom it is to be allocated will be determined by a central authority such as the State, through the Planning Commission.

And the Government will have the powers of implementation. Before the Plan is drawn up, a detailed survey of all available resources – physical resources, financial resources and human resources – has to be made. For example, in the former Soviet Russia, after the Revolution in 1917, there was War Communism between 1918 – 1921. And there was New Economic Policy (NEP) from 1921 to 1924. And from 1924, the Government made a detailed survey of all available resources and only in 1928, it implemented its First Five Year Plan. After the survey of resources, the objectives of planning will be determined. For example, one of the long term objectives of Soviet Planning was that Soviet Russia should catch up with the production levels of the leading capitalist nation of the world, namely U.S.A., in steel, coal and electricity. Keeping in mind, the objectives of the Five Year Plan, the physical targets will be fixed. And ways and means of mobilizing financial resources will be explored. The Plan will also spell out the details in which the fruits of planning will be distributed in a fair and just manner.

The nature of planning is determined by the type of economic system – capitalism, socialism, mixed economy - in which it is practiced.

There will be partial planning in a capitalist economy, (e.g., U.K.) but a socialist economy is a totally planned economy (e.g., Former Soviet Russia). In a mixed

economy both public sector and private sector play important roles in economic planning.

Types of Planning

1. Centralized Planning :

In a socialist economy (eg. Former Soviet Russia), there was centralized planning; it was planning by direction. In a socialist state, most of the means of production are owned by the State. All basic economic decisions such as whether priority is to be given for industrialization or for development of agriculture ; if it is decided to give importance to industrialisation, whether to give importance to basic and heavy industries or for consumer goods industries will be made by the central authority.

2. Planning by Inducement:

In a democracy, Planning is done by inducement. For example, ours is a mixed economy where there is a public sector and a private sector. The government has to persuade the industries in the private sector to fulfil the goals of the Plan through inducements such as tax concessions and by providing incentives.

3. Indicative planning – In this type of planning, the government invites representatives of industry, and business and discuss with them in advance what it proposes to do in the Plan under question and indicates to them its priorities and goals. Then the Plan is formulated after detailed discussions with varied interests. Planning in France is a good example of indicative planning.

After we embraced liberalization and privatization policies in 1991, even Indian planning, in a way, has become indicative planning.

Economic plans can also be divided into midterm plans, shortterm plans and perspective plans. Our Five Year Plans are in fact, midterm plans. Short term plans are Annual Plans. During the period of implementation, Five Year Plans

COMMUNITY ECONOMIC ANALYSIS

operated by dividing them into Annual Plans. Perspective Plans are long term plans and the period ranges from 20 to 25 years. The Five Year Plans are formulated by taking into account the long term objectives of the Perspective Plan.

Rolling Plan :

Unlike the Five Year Plan with fixed targets, in the case of the rolling plan, at the end of each year, targets will be fixed by adding one more year to the Plan. That is, without fixed targets for all the five years, depending upon the performance of the Plan in the current year, targets will be fixed for one more year. Like this, it will go on a continuous basis. That is the idea behind the rolling plan.

A great advantage of centralized planning is that plans can be implemented with great speed and targets and goals can be achieved. For example, by means of planning, former Soviet Russia transformed its economy, which was predominantly agricultural into a predominantly industrial nation, within a short span of 12 years. But a demerit of centralized planning is that as the State enjoys a considerable degree of monopoly, in the absence of competition, it is rather difficult to test the productive efficiency of state owned units. Under planning by inducement (democratic planning), though there is a good deal of freedom for people, because of the procedures and delays associated with the democratic process and because of Parliamentary democracy, there will be a lot of delay in the implementation of programmes and economic growth will be slow.

COMMUNITY ECONOMIC ANALYSIS

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