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1 Unlimited Needs, Wants and Scarce Resources

Needs are things we really require to survive, such as basic food, clean water, shelter, and basic clothing.

Wants are things we feel will improve our lives, but we do not really need these things to survive. A luxury car, the latest smartphone, concert tickets for your favorite artist's show, designer clothes, and accessories are not essential to survive, but are nice to have.

The Child has unlimited wants to have different food items but limited resources (money).

Economics starts from the basis that **people's wants are unlimited, but resources are scarce**.



1.1 Scarce Resources

There are simply **not enough resources** to produce all the things we need and want. Resources are scarce and limited.

It is because of these unlimited needs and wants, on the one hand, and our limited resources, on the other, that the economic problem, **the scarcity problem, exists**. The study of economics is about how we as a society deal and should deal with this scarcity problem.

Resources include everything in the world around us that we can use to produce goods and services to satisfy our needs and wants. It is usually classified into the following three main groups:

- **Natural resources**, such as land, water, minerals, animals, and plants
- **Human resources**, such as entrepreneurs or labor such as economists, builders, architects, accountants, lawyers, and cleaners
- **Man-made resources** such as machines and infrastructure that are available to use to produce goods – in economics we call these resources capital.

Now, we know that there is **scarcity of resources** therefore, choices must be made. **Thus, comes the Problem of choice**.

1.2 Scarcity and Problem of Choice

Scarcity refers to the **finite nature and availability of resources** while choice refers to people's decisions about sharing and using those resources in different uses.

The problem of choice lies at the very heart of economics, which is the study of how individuals and society choose to **allocate scarce resources**.

For example, Land is scarce, a piece of land can be used for building a factory, building a house, producing wheat, grazing, etc. The choice has to be made regarding the use of the scarce resource, that is land here.

Due to **limited resources** complete satisfaction is not achieved by human beings as their wants are unlimited but by **allocating the given resources efficiently, humans can achieve maximum satisfaction** that could be gained from the given resources. Thus, the choice must be made regarding the allocation of the resources in such a way that maximum satisfaction can be achieved from the resource.

So, after understanding the problem of scarcity due to the unlimited wants and limited means, let's move ahead to the actual definition of Economics.

2 Economics and Economy

Economics refers to the study of **choices or decisions** made by **individuals, businesses, and governments** to allocate the **limited resources** for production, distribution, and consumption of goods and services.

Economy is the **system of production, distribution, and consumption of goods and services in a geographical area**. It exists in a geographical area e.g. a local area, country, or the world where the economic agents (individuals, Business and Government) are present. Individuals, businesses, and governments (also known as Economics Agents) make choices and decisions regarding production, distribution, and consumption despite limited resources.

2.1 Branches of Economics - Macroeconomics and Microeconomics

Microeconomics studies how individual units such as individual businesses, market of a product, price of a product, etc. function and change in specific situations, while **macroeconomics** studies the economy as a whole such as the total production in the economy, aggregate consumption, general price level, etc.

Distinction between Macroeconomics and Microeconomics:-

Basis	Microeconomics	Macroeconomics
Meaning	It studies issues and problems at the level of an individual firm, an individual household etc.	It studies issues and problems at the level of the economy as a whole.
Concern	It is basically concerned with determination of output and price for an individual firm or industry.	It is basically concerned with determination of aggregate output and general price level in the economy as a whole.
Focus	Its focus is on maximisation of individual's gain .	Its focus is on maximisation of social welfare .
Scope	It has a narrow scope , i.e., an individual person, an individual market, etc.	It has a very wide scope , i.e., a state, or a country.

3 Factors of Production

3.1 Land

- Land is the **naturally occurring materials of the planet** that are used for the production of goods and services, including the **land** itself; the **minerals** and **nutrients** in the ground; the **water, wildlife, and vegetation** on the surface; and the **air** above.

3.2 Labour

- Labour is the **mental and physical efforts of humans** (excluding entrepreneurial organizations) used for the production of goods and services.
- Labour includes both the **physical effort of factory workers** and farmhands often associated with labor, as well as the **mental effort of executives and supervisors**.



3.3 Capital

- Capital is the **manufactured, artificial, or synthetic goods used in the production of other goods**, including **machinery, equipment, tools, buildings, and vehicles**. Capital is the produced factor of production.
- In economics, Capital as a factor of production, also **refers to the money that is used to purchase capital goods that are used to produce goods and services**. However, money is not a factor of production because it is not directly involved in producing a good or service. Instead, it enables entrepreneurs and company owners to purchase capital goods.



3.4 Entrepreneurship

- Entrepreneurship is the **special sort of human effort** that takes on the risk of **bringing labor, capital, and land together to produce goods**.
- A **key component of entrepreneurship is risk**. This resource takes the risk of organizing production before anything is produced and with no guarantee that production will be successful.

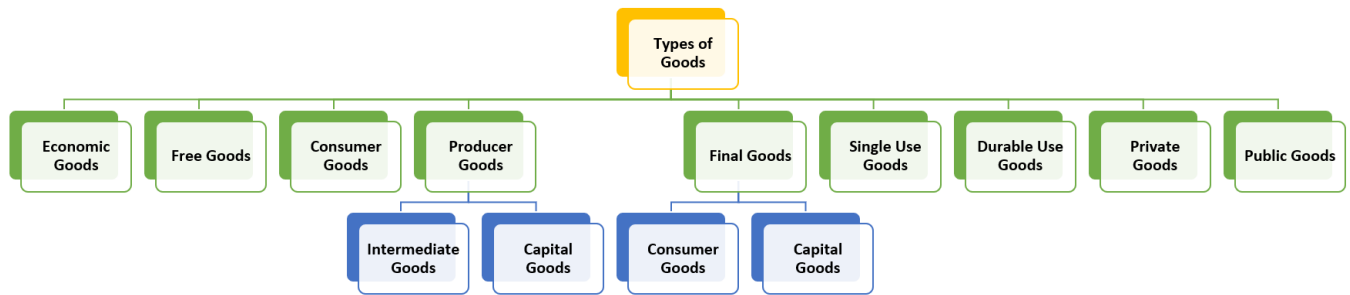


Factor Payments

Households are the ones in the economy that majorly provide the **factors of production for gaining Factor payments**. Thus, for each factor of production, there is a factor payment.

- Factor payments are frequently categorized according to the services of the productive resource.
 - Wages** are paid for the services of **labor**.
 - Interest** is the payment for the services of **capital**.
 - Rent** is the payment for the services of **land**.
 - Profit** is the factor payment to **entrepreneurship**.

4 Different Types of Goods



4.1 Economic Goods and Free Goods

Economic Goods

- Economic goods are those goods whose **demand is more than supply** (i.e., they are scarce). They **command a price** and they can be bought in the market.
- Example:** toothpaste, soap, shaving cream, footwear, bread, machines, buses, table, chair, books, fans, television etc.



Free Goods

- We can define free goods as goods which **possess utility**, but which are **not scarce**.
- Free goods are **free gifts of nature**. They are available in abundance i.e., in **unlimited quantity** and the supply is much more than the demand.
- Example:** Sand, clean air, water etc.



4.2 Consumer Goods and Producer Goods

Consumer Goods

- Consumer goods are those goods that **satisfy the wants of consumers directly**. They are goods which are **used for consumption**.
- Example:** bread, fruits, milk, clothes, etc.



Producer Goods

- Producer goods are those goods which **satisfy the wants of consumers indirectly**. As they **help in producing other goods**, they are known as producer goods.
- Example:** machinery, tools, raw materials, seeds, manure, tractor etc. are all examples of producer goods.
- There are 2 kinds of producer goods – Intermediate goods and capital goods – both of them are used in the production process.



4.2.1 Intermediate Goods

- An intermediate good is a product **used to produce another good (semi-finished or finished)**.
- These goods are also **called semi-finished products** because they are used as inputs to become part of another product.
- When they are used in the production process, they are **transformed into another state** such as cotton (intermediate good) is converted into yarn (another semi-finished good) which is further converted into cloth (finished good).

4.2.2 Capital Goods

- Capital goods**, on the other hand, are assets such as machinery, tools, equipment, factory, buildings etc. that are **used in the production process to produce other goods**.

- The key thing to note about capital goods is that they **don't transform or change shape in the production process**.

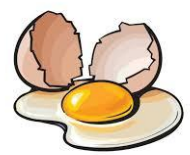
4.3 Final Goods: Consumer Goods and Capital Goods

- **Final goods** are products that are **not further transformed** in the production process. They can be categorized into two types: **Consumer Goods and Capital Goods**.
 - **Consumer goods** are items consumed\used **directly** by households, such as computers, fruits, and vegetables. They are purchased for personal use or satisfaction i.e., they are not used for the production process, and **thus are considered Final Goods**.
 - **Capital goods**, which are also a type of producer goods, are used **in the production process** but **do not undergo transformation** themselves. They are acquired as fixed assets by businesses and **thus are also considered Final Goods**.

4.4 Single-Use and Durable Use Goods

Single Use Goods

- Single-use goods are those goods which **can be used only once**. They are **finished in one use itself**.
- Example: **bread, butter, egg, milk, etc.** are single-use consumer goods as they are consumed immediately and once and for all.



Durable Use Goods

- Durable use goods are those goods that **can be used again and again for a long period of time**.
- For example: **cloth, furniture, television, scooter, etc.** Private Goods and Public Goods



Private Goods

- All goods that are **privately owned and are exclusively enjoyed by individuals** are called private goods. For example, all the goods owned by you are private goods.
- Examples: **watch, pen, scooter, books, table, chair, bed, clothes** etc. If you own a **factory** then its building, machinery; tools etc. are your private goods.



Public Goods

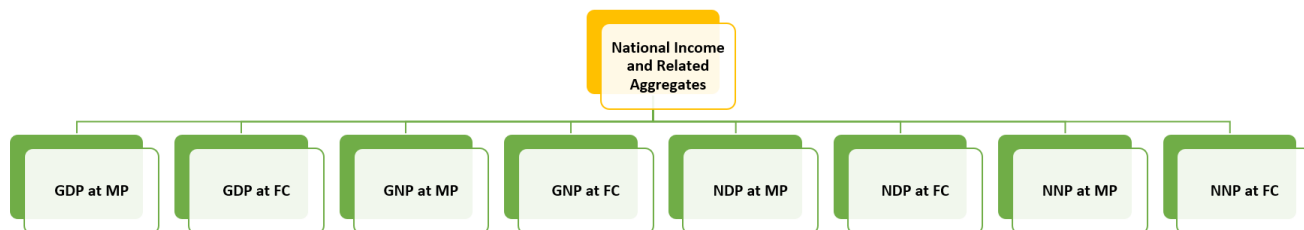
- Public goods are those goods which are **owned and enjoyed by the society as a whole**. They are **available to all people in a society without any discrimination**, i.e., no one is denied from the consumption of public goods. Example: **roads, bridges, parks, town halls, etc.** are all collectively owned.
- Economists refer to public goods as "**non-rivalrous**" and "**non-excludable**".
- Their **non-rivalry** refers to the fact that the **goods don't dwindle in supply as people consume them**; a country's **defenses**, for example, do not run out or diminish as its population grows.
- **Non-excludability** means that the **good is available to all and cannot be withheld**, even from people who do not contribute to its public funding.



5 National Income and Related Aggregates

The national income (NI) of a nation is a measure of economic activities carried out by the normal residents of that country—both domestically and while residing in a foreign country.

There are **8 measures to calculate economic activities that are known as NI and related aggregates**.



- **Gross Domestic Product (GDP) at Market Price** - Total value of all final goods and services produced in a year in the **domestic territory** of a country by the residents and non-residents.

With the definition of GDP at MP, we can see the definitions of related aggregates.

- **Gross Domestic Product (GDP) at Factor Cost** - Total value of all final goods and services produced in a year in the domestic territory of a country by the residents and non-residents **deducting net indirect taxes**. $\text{GDP at FC} = \text{GDP at MP} - \text{Net Indirect taxes}$

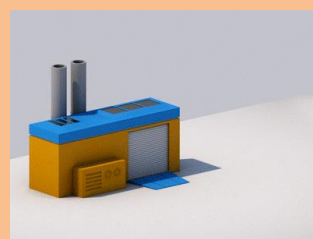
The **Market Price (MP)** is the price that consumers pay for the product in the **market** when they purchase it from the sellers and **includes indirect taxes and deduct the subsidies provided to producers**.

The **factor cost** refers to the cost of factors of production that is incurred by a firm when producing goods and services. Indirect Taxes are paid by the consumers in the market thus it is not included in factor cost. Subsidies provided to the producers are included in Factor Cost.

Market Price = Factor Cost + Indirect taxes – Subsidies

Factor Cost = Market Price – Indirect taxes + Subsidies

Net Indirect Taxes = Indirect taxes – Subsidies



- **Gross National Product (GNP) at MP** - Total value of all final goods and services produced in a year in the domestic territory of a country by the **normal residents** adding **net factor income from abroad**.
- **Gross National Product (GNP) at FC** - Total value of all final goods and services produced in a year in the domestic territory of a country by **the normal residents** adding **net factor income from abroad** deducting **net indirect taxes**.

Domestic Income includes the total value generated in the **domestic territory** by the residents or non-residents.

National Income includes the total value generated by the **normal residents** of a country around the world.

Difference between Domestic and National is seen through Net Factor Income from Abroad.

Net Factor Income from Abroad (NFIFA)

It refers to the difference between factor income received from the rest of the world and factor income paid to the rest of the world.

NFIFA = Factor income earned from abroad – Factor income paid abroad

“Normal resident of a country refers to an individual or an institution who is residing in the country and whose center of economic interest also lies in that country.”

National Income considers the total income earned and total value generated by the normal residents of a country in the Domestic area and abroad thus it includes NFIFA.

Domestic income does not include the NFIFA as it includes the total income earned and total value generated in the domestic territory only and not in abroad.

- **Domestic = National – NFIFA**
- **National = Domestic + NFIFA**

- **Net Domestic Product at MP** - Total value of all final goods and services produced in a year in the domestic territory of a country by the **residents and nonresidents** deducting the **consumption of fixed capital (depreciation)**.
- **Net Domestic Product at FC** - Total value of all final goods and services produced in a year in the domestic territory of a country by the **residents and nonresidents** deducting the **consumption of fixed capital (depreciation)** and **Net Indirect Taxes**.

Difference between Net and Gross is seen through Depreciation.

Depreciation means loss in the current value of fixed capital due to use, wear, and tear, or obsolescence which means the decrease in the value, at current prices, of durable fixed assets.

Gross Investment (Total Investment) = Net investment (New Investment to produce higher level of output) + Depreciation (Replacement Investment to produce the previous level of output)

Gross = Net + Depreciation

Net = Gross – Depreciation

- **Net National Product at Market Price** - Total value of all final goods and services produced in a year in the domestic territory of a country by the **normal residents** adding **net factor income from abroad** deducting depreciation.
 - Net National Product at Market Price = Gross Domestic Product at Market Price – Depreciation + Net Factor Income from Abroad
- **Net National Product at Factor Cost** - Total value of all final goods and services produced in a year in the domestic territory of a country by the **normal residents** adding **net factor income from abroad**. It does not include net indirect taxes and depreciation in it.
 - $NNP \text{ at FC} = GDP \text{ at MP} - \text{Depreciation} + \text{Net Factor Income from Abroad} - \text{Indirect taxes} + \text{Subsidies}$
 - National Income (NI) in India is measured at NNP at FC and thus NNP at FC is known as NI.

6 Measurement of National Income

Methods of calculating National Income are product method, expenditure method and income method. National income will be equal from all the methods of calculating national income as national income can be only one value for the whole of the nation.

6.1 Product or Value-added Method

Value added refers to the **addition of value to the intermediate goods** by a firm using the factors of production.

- Value Addition is calculated by Value of output – Intermediate consumption. Value addition shows the actual value generated at different levels of production.
- The **term that is used to denote the net contribution made by a firm is called its value added**. We have seen that the raw materials that a firm buy from another firm which are completely used up in the process of production are called intermediate goods. Therefore, the **value added of a firm = value of production of the firm – value of intermediate goods used by the firm**.
- The **value added of a firm is distributed among its four factors of production, namely, labour, capital, entrepreneurship, and land (natural resources)**. Therefore, wages, interest, profits and rents paid out by the firm must add up to the value added of the firm. Value added method gives us GVA at MP or GDP at MP.

Formula for Value added method –

Gross Value Added at MP = Value of Output – Intermediate Consumption

NNP at FC (National Income) = GVA at MP – Depreciation – Indirect taxes + Subsidies + Net factor Income from Abroad

6.2 Income Method

This method approaches national income from the **distribution side**. In other words, this method measures **national income at the phase of distribution and appears as income earned\generated by factors of production of the country**.

- This method assumes that there are four major factors of production in an economy and that all revenues must go to one of these four sources. That is, revenues earned by all the firms put together must be distributed among the factors of production as salaries, wages, profits, interest earnings and rents. Income method gives us NDP at FC.

NDP at FC = Compensation of Employees in Kind or Cash + Interest + Profits + Rent + Mixed Income of Self Employed.

NNP at FC (National Income) = NDP at FC + Net factor Income from Abroad

6.3 Expenditure Method

The expenditure method arrives at domestic income by adding up all expenditures made on goods and services produced in the domestic territory during a year.

GDP at MP = Private Final Consumption Expenditure (C) + Government Final Consumption Expenditure (G) + Gross Domestic Capital Formation (I) + Net Exports (NX).

GDP at MP = C + G + I + NX or GDP at MP = C + G + I + (X-M)

NX = Exports (X) – Imports (M)

From Domestic Income, GDP at MP we can derive National Income (NNP at FC)

NNP at FC (National Income) = GDP at MP – Depreciation – Indirect taxes + Subsidies + Net factor Income from Abroad

Precautions taken while measuring national income of a country –

- **Transfer Payments are not included in estimating national income** as national income only includes the earned income that is earned by providing your services or the goods provided.

- Transfer Payments are the Unilateral Payments such as the unemployment allowances, remittances from the relatives etc.
- **Imputed rent of self –occupied houses are included in national income.**
- **Illegal money** such as hawala money, money earned through smuggling etc. **are not included in national income.**
- **Windfall gains such as prizes and lotteries are also not included.**
- **Receipts from the sale of secondhand goods** should not be included.
- **Expenditure on Intermediate goods** should not be included.
- **Expenditure on the purchase of shares** from business enterprises and bonds from other people should not be included when estimating National Income.
- **The value of production for self-consumption is to be counted while measuring national income.**
- **Value of services of housewives are not included.**

7 Additional Concepts

7.1 Nominal GDP and Real GDP

Nominal GDP is the money value of all final goods and services produced in a year. This money value is obtained using the current year current prices of final goods and services produced.

Thus, **Nominal GDP is the Gross Domestic Product of a country in a given year, estimated on the basis of the current price of the goods and services of the same year.**

However, Nominal GDP does not truly indicate the real performance or economic growth of a country over time, if prices are changing.

To solve this problem, economists evaluate the output of final goods and services produced in a year using the market prices that prevailed in a certain chosen year, called as base year.

Real GDP is the Gross Domestic Product of a country for a given year, estimated on the basis of the price of the goods and services of a base year.

So, to calculate the real GDP, Quantities produced in the current year are multiplied with Market prices of base year.

The calculation of real GDP helps us to know whether the availability of real goods and services in the economy has increased over time.

Year	Bread (Units)	Price of Bread (Rs.)	Nominal GDP = Units * Current Prices	Real GDP = Units* Base Prices
2020	1000	10	1000 * 10 = 10000	1000 * 10 = 10000
2021	1000	20	1000* 20 = 20000	1000 * 10 = 10000
2022	1200	15	1200* 15 = 18000	1200 * 10 = 12000

In the above example, the Nominal GDP increases in 2021 from the 2020 level even when the output is same that is 1000 just because of the rise in the Prices from Rs. 10 to Rs. 15. So the Nominal GDP can increase even if the output is constant.

In the Above example Real GDP is constant in 2021 at the 2020 level that shows that the output is same at 1000 units. So, the Real GDP shows the real performance of the economy.

7.2 GDP Deflator

The **GDP deflator**, also called **implicit price deflator**, is a **measure of inflation**. It is the ratio of the value of goods and services an economy produces in a particular year at current prices to that of prices that prevailed during the base year.

The formula to find the GDP price deflator:

$$\text{GDP price deflator} = (\text{nominal GDP} \div \text{real GDP}) \times 100$$

7.3 Relationship between Basic Price, Factor Cost, and Market Price

$$\text{Basic Price} = \text{Factor Cost} + \text{Production Tax} - \text{Production Subsidies}$$

$$\text{Net Production Taxes} = \text{Production tax} - \text{Production Subsidies}$$

$$\text{Factor Cost} = \text{Basic Price} - \text{Production Tax} + \text{Production Subsidies}$$

$$\text{Market Price} = \text{Basic Price} + \text{Product tax} - \text{Product Subsidy}$$

$$\text{Net Product Taxes} = \text{Product tax} - \text{Product Subsidy}$$

$$\text{Basic Price} = \text{Market Price} - \text{Product tax} + \text{Product Subsidy}$$

7.4 Per capita Income

Per capita income (PCI) or average income measures the **average income earned per person in a given area (city, region, country, etc.) in a specified year.**

In Latin, the word "**Per Capita**" means "**by head.**"

PCI compares and assesses the economic situations of countries with varying population sizes. The measurement of a country's per capita income is done by dividing the total national income of a particular country or state by the population in that specific geographical region.



The diagram illustrates the formula for Per Capita Income. It features a calculator icon next to the text 'Per Capita Income Formula'. To the right, the formula is presented as: Total Income of Area divided by Total Population. Above the numerator is a bar chart icon, and below the denominator is a group of people icon.

$$\text{Per Capita Income Formula} = \frac{\text{Total Income of Area}}{\text{Total Population}}$$

8 Difference between Growth & Development

Basis	Development	Growth
Concept	Economic development is a much broader concept than economic growth. Economic development = Economic Growth + Standard of Living	Economic Growth is a narrower concept than economic development.
Scope	Economic Development is considered as a Multidimensional phenomenon because it focuses on the income of the people and on the improvement of the living standards of the people of the country.	Economic Growth is considered as a single dimensional in nature as it only focuses on the income of the people of the country.
Timeframe	Long term process	Short term process

Measurement	Both Qualitative & Quantitative Terms: HDI (Human Development Index), gender-related index, Human poverty index, infant mortality, literacy rate etc.	Quantitative Terms: Increases in real GDP.
Relevance	Economic Development is related to Underdeveloped and developing countries of the world.	Economic Growth is related to developed countries of the world.
Effect	Qualitative and Quantitative Impact on the Economy. Improvement in life expectancy rate, infant, literacy rate, poverty rates, and mortality rate.	Brings a quantitative impact on the economy. Increase in the indicators like per capita income and real GDP, etc.

8.1 Inclusive Growth

Economic growth was earlier seen as an **inclusive concept**, automatically supposed to be for all. 'Inclusive Growth' has thus emerged as a concept in Economics. This is reflected in **India's 11th Five-Year Plan (2007 – 2012)** had the theme '**towards faster and more inclusive growth**'.

The concept of Inclusive growth emphasizes that **equitable opportunities** for **economic participants** should be provided **during the very process of economic growth** with benefits being incurred by every section of society.

Inclusive growth can be defined in terms of **improving the delivery of core public services** & maintaining **rapid growth** while **spreading the benefits of this growth more widely**. Encouraging inclusive growth includes **revamping labor regulations, improving agricultural technology & infrastructure, helping lagging sections & regions catch up, & empowering the poor** through proactive policies that help them to take part in the market on fair and equitable terms.

9 Various Sectors of an Economy

9.1.1 Primary Sector

- The primary sector of the economy **extracts or harvests products from the earth** such as **raw materials and basic foods**.
- Activities associated with primary economic activity include **agriculture** (both subsistence and commercial), **mining, forestry, grazing, hunting and gathering, fishing, and quarrying**. The **packaging and processing of raw materials** are also considered to be part of this sector.

9.1.2 Secondary Sector

- The secondary sector of the economy **produces finished or semi-finished goods from the raw materials extracted by the primary sector**.
- All **manufacturing, processing, and construction jobs** lie within this sector.

9.1.3 Tertiary Sector

- The tertiary sector of the economy is **also known as the service industry**. This sector **sells the goods produced by the secondary sector** and provides **commercial services** to both the general population and businesses in all five economic sectors.
- Activities associated with this sector include **retail and wholesale sales, transportation and distribution, restaurants, clerical services, media, tourism, insurance, banking, health care, and law**.

9.1.4 Quaternary Sector

- The fourth sector of the economy, the quaternary sector, consists of **intellectual activities** often associated with **technological innovation**. It is sometimes called the **knowledge economy**.

- Activities associated with this sector include **government, culture, libraries, scientific research, education, and information technology.**

9.1.5 Quinary Sector

- Some economists further narrow the quaternary sector into the quinary sector, which includes the **highest levels of decision-making** in a society or economy.
- This sector includes **top executives or officials** in such fields as government, science, universities, nonprofits, health care, culture, and the media.

10 Economic Systems

10.1 Capitalism

- Capitalism, also called **market economy**, is a type of economy based on
 - **private ownership** of most resources, goods, and other stuff (private property).
 - **freedom** to use privately-owned resources, goods, and other stuff to get the most wages, rent, interest, and profit possible; and
 - a system of **relatively competitive markets**.

10.2 Socialism

- It is based on -
 - Ownership of the resources by the government rather than individuals.
 - resources allocated on the basis of need rather than on resource ownership or contribution to production.
- In a socialist society the **government decides what goods are to be produced** in accordance with the needs of society.

10.3 Mixed Economy

- While, in theory, we could have a pure capitalism or a pure socialism, **in the real world most of the economies are mixed**, relying on both markets and governments for allocation decisions.
- Markets allocate resources based on the demand of the consumers and supply of the producers that are the decisions of the private entities. Government forces allocation through taxes, laws, restrictions, and regulations. Both institutions play vital roles in an economy.

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