

# Public Versus Private Sector : Neglect of Lessons of Economics in Indian Policy Formulation

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## 1. Introduction

People derive satisfaction/welfare from consuming goods, services and leisure. Other things being equal, the more of any good/service a person has, the greater that person's welfare. The firms and enterprises produce goods and services and try to maximise their profits/surplus by selling them. In this world of welfare and surplus maximisers, if a set of prices of goods and factors of production emerges, such that each producer, with his given production technology, is unable to increase his profits/surplus at the prevailing set of prices and each consumer is unable, within his budget constraint, to increase his welfare, and provided that all markets are cleared in the sense that quantities demanded exactly equal the quantities supplied, then this set of prices, inputs and outputs constitutes a situation of *competitive equilibrium*. According to a basic theorem 1/ of neoclassical economics, a competitive equilibrium is a *Pareto Optimum*-a configuration in which it is *not possible* to find a reallocation of resources that makes at least one person better off without making anyone else worse off.

The first important thing to note is the "if-then" nature of the above mentioned statement of a competitive equilibrium. Strictly speaking, this formal characterisation only describes the properties of an equilibrium. It does not address the question whether the profit-maximising behaviour of producers and welfare-maximising behaviour of consumers, taking the prevailing set of prices as given, will somehow lead the economy to a competitive equilibrium. *Secondly*, a situation of Pareto optimality *does not imply* that it meets some ethical notion of distributive justice, except in the sense of a purely formalistic, distributional compatibility with production efficiency in the context of maximisation of a *Social Welfare Function*, embodying in it some considerations of a distributive justice.

In case a competitive equilibrium somehow comes into existence, the question of conditions under which it might be sustained has been investigated in the neoclassical literature. Another justly famous theorem of Welfare Economics, for instance, asserts that (under strong assumptions relating to technology, consumer preferences, absence of externalities, etc.) associated with any Pareto Optimum (that maximises social welfare) is a set of prices that will sustain it as a competitive equilibrium *provided appropriate redistribution of resource endowments or income through lump sum transfers is feasible*. This result presumes a complete set of smoothly functioning markets for commodities, factors of production and insurance and strict observance (enforceability) of trading contracts.

One must note that these two theorems have nothing to say about the virtues or vices of a free market economy 2/. As a formal description of the informationally efficient decentralisation of decisions

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\* Text of Rao Bahadur R.R. Kale Memorial Lecture delivered at the Gokhale Institute of Politics and Economics, Pune, on 27th April, 1991. The March issue is being printed in June 1991.