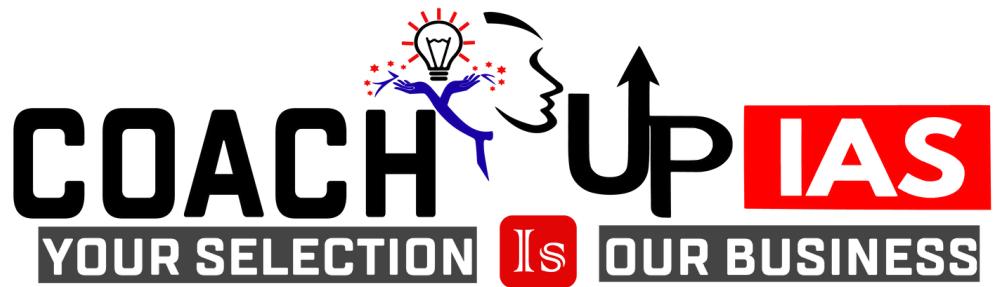


WHITE BOOK



LET US
DEMYSTIFY
NCERT
ECONOMY
*For civil
services
examination*



IAS COACH ASHUTOSH
SRIVASTAVA



IAS COACH MANISH
SHUKLA



8318600261 / 8009803231



LET US DEMYSTIFY INDIAN ECONOMY

**For UPSC & State Civil Services
Exams**

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PREFACE

Let us Demystify is an exclusive **White Book Series** of Coach Up IAS, Lucknow. White Book is the Magnum Opus of Gaurav Sir & Ashutosh Sir who have carefully curated this book series to cater the requirements of UPSC and State Civil Services Exams.

Let us demystify Indian Economy is divided into 23 chapters with a view to offer students an exhaustive coverage of all concepts which are of utmost importance. It would also quench the thirst of intellectuals who would like to know about the working of Indian economy.

This book demystifies entire NCERT Economy with lucid explanations and elaborative diagrams. It will help the students to build an insight into this subject. In the next release, a separate book will be released which will contain important MCQ based questions along with subjective questions with explanations.



1:1 MENTORSHIP BEYOND THE CLASSES

- **Diagnosis** of candidates based on background, level of preparation and task completed.
- **Customized solution** based on Diagnosis.
- One to One **Mentorship**.
- Personalized schedule **planning**.
- Regular **Progress tracking**.
- **One to One classes** for Needed subjects along with online access of all the subjects.
- Topic wise **Notes Making sessions**.
- One Pager (**1 Topic 1 page**) Notes session.
- **PYQ** (Previous year questions) Drafting session.
- **Thematic charts** Making session.
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Ashutosh Srivastava
(B.E., MBA, Gold Medalist)
Mentored 250+ Successful Aspirants over a period of 12+ years for Civil Services & Judicial Services Exams at both the Centre and state levels.



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Mentored 100+ Successful Aspirants over a period of 9+ years for Civil Services Exams at both the Centre and state levels.

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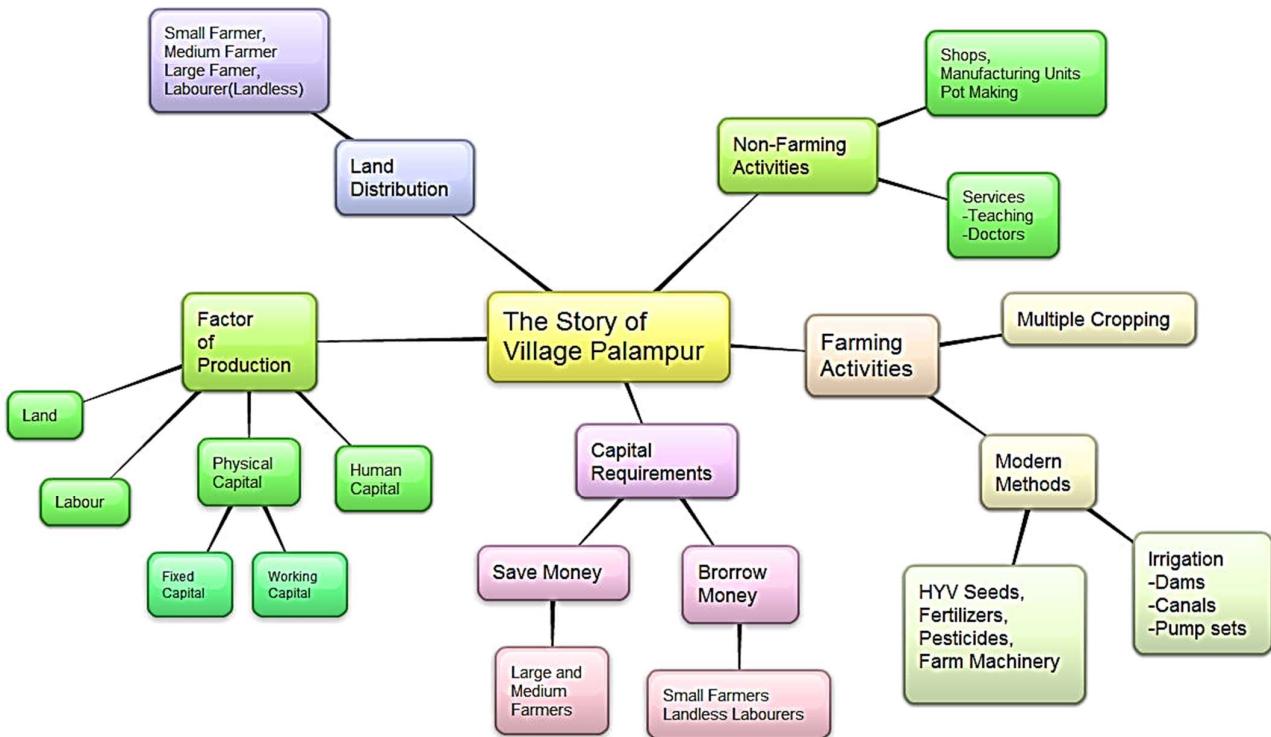
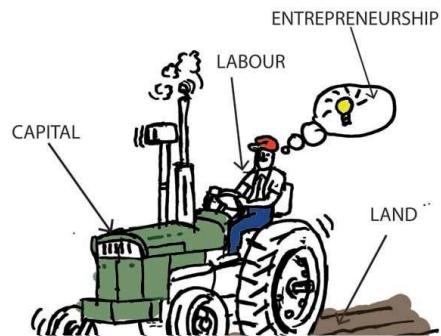
CHAPTER-1

This chapter will demystify the following concepts:

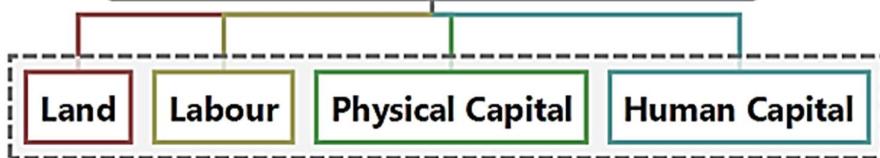
- ✓ Factor of Production
- ✓ Land Distribution
- ✓ Farming and Non-Farming Activities
- ✓ Capital Requirements

Here we will understand some basic concepts like- **Factor of Production**, **Land Distribution**, **Farming and Non-Farming Activities**, **Capital Requirements** through a hypothetical village called Palampur.

Palampur is fairly connected with nearby villages with a well-developed system of roads, transport, electricity, irrigation, schools and health centres. The story of Palampur takes us through the different types of production activities in the village. In India, farming is the main production activity



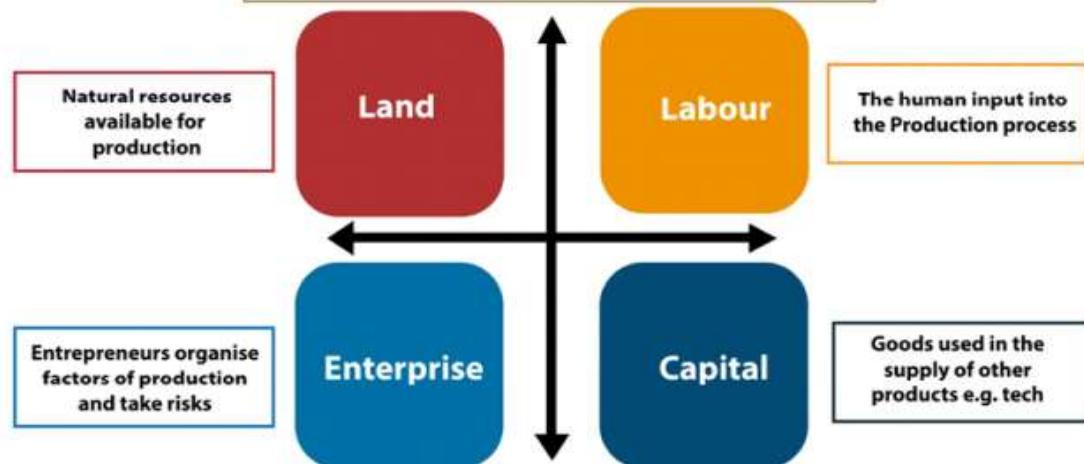
Requirements for production of goods and services



- The second requirement is **labour**, i.e. people who will do the work → (Mental Labour) Educated & (Physical Labour) Manual workers
- The third requirement is **physical capital**, i.e. the variety of inputs required at every stage during production
[PHYSICAL CAPITAL: Tools, machines, buildings, raw materials and money in hand]
- Fourth requirement is **human capital (entrepreneurship)**
[HUMAN CAPITAL: It denotes the monetary value of the knowledge, skills, and competencies of a person]

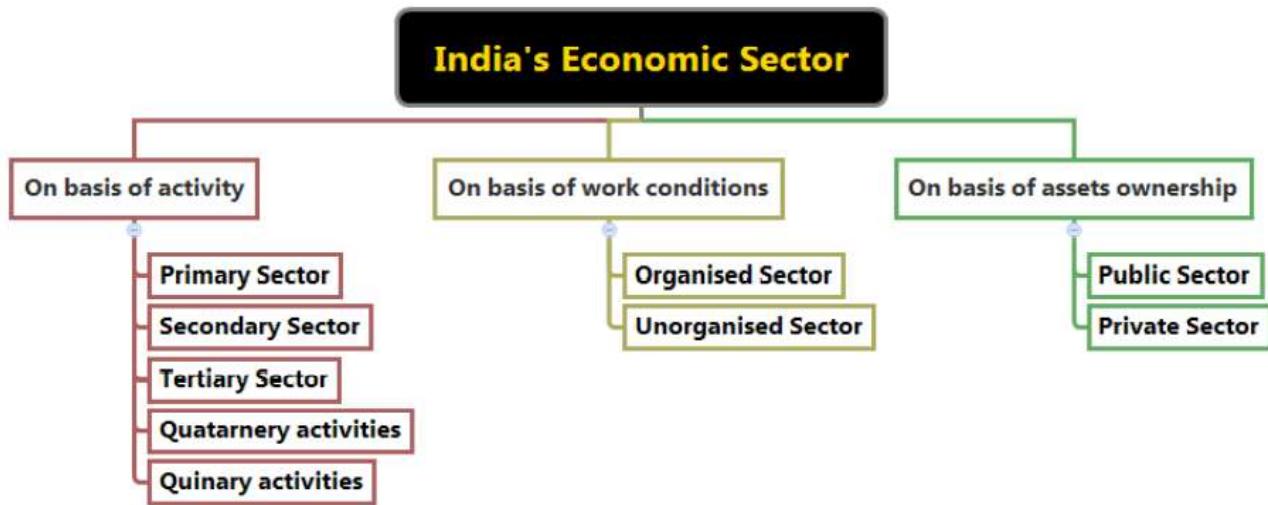
Factors of Production (Factor Inputs)

Factors of Production are the inputs available to supply goods and services in an economy.

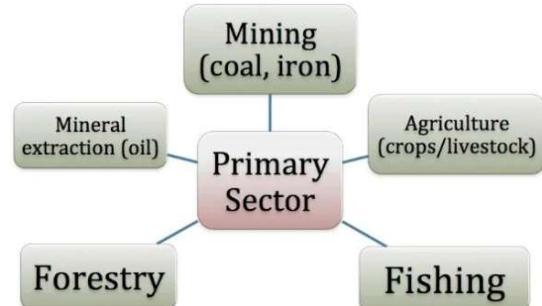


Factor	Characteristics	Examples	Rewards
Land	Land + Extracted Resources	Farm + Crops	Rent
Labour	Physical + Mental Input	Workforce	Wages
Capital	Fixed + Working Capital	Machinery	Interest
Entrepreneurship	Organisation of Factors	Manager	Profit

Now Let's understand sectors of Economy:



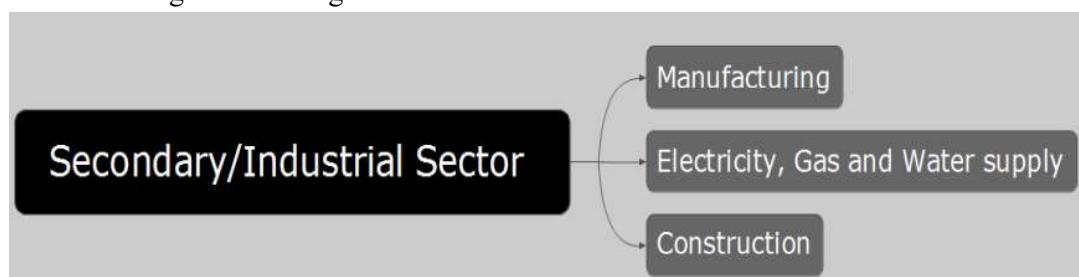
- It includes agriculture, forestry, fishing and mining.
- Amongst the primary sector, agriculture is the predominant occupation.
- The primary sector utilizes the natural resources and produces raw materials and basic goods which may be used by the industries or by the end-users.
- It can be said that the primary sector serves as a basic sector assisting the growth of the secondary and tertiary sectors.



Secondary Sector:

The secondary sector **covers activities in which natural products are changed into other forms through ways of manufacturing that we associate with industrial activity**. It is the next step after primary. The product is not produced by nature but has to be made and therefore some process of manufacturing is essential.

Hence Secondary sector consists of the ***Industrial sector***, engaged in construction activities and manufacturing of finished goods.



Tertiary Sector:

The **tertiary sector of the economy** is generally known as the **service sector**.

This sector consists of provision of services such as **education, medical, hotel, transport, finance, distribution and sale of goods from a producer to a consumer, as may happen in wholesaling and retailing, pest control or entertainment.**



Quaternary Activities:

- Involves the **research and development** needed to produce products from natural resources.
- These are **specialized tertiary activities in the 'Knowledge Sector'** which demands a separate classification
- The quaternary sector is the **intellectual aspect** of the economy.
- It is the process which **enables entrepreneurs to innovate and improve** the quality of services offered in the economy.
- **Elementary schools and university classrooms, hospitals and doctors' offices, theatres, accounting and brokerage firms all belong to this category of services**

Quinary Activities:

- The quinary sector is the **part of the economy where the top-level decisions are made**.
- This **includes the government** which passes legislation.
- It also **comprises the top decision-makers in industry, commerce and also the education sector**.
- Often referred to as '**gold collar**' **professions**, they represent another subdivision of the tertiary sector representing special and **highly paid skills of senior business executives, government officials, research scientists, financial and legal consultants, etc.**
- **The highest level of decision-makers or policymakers performs quinary activities.**
- **Quinary = Gold collar professions.**

On the basis of work Conditions:

Organized Sector & Unorganized Sector

The **Organized sector** comprises certain companies or workplaces in which the employment term is regular and employees are also guaranteed employment. They are authorized by the government and must comply with the laws and regulations set out in various laws, including the Minimum Wages Act, Factories Act etc.

The **Unorganised sector** comprises employees working in minor business concerns and units, often without any assurance of regularity. You can be said to be working in the unorganised sector if you are a farmhand, a domestic help, a salesman at a grocery shop etc.

Difference between organized and unorganised sectors

The difference between organized and unorganised sectors are tabulated below.

Organised sector	Unorganised sector
▪ It is a sector where the employment terms are fixed and regular, and the employees get assured work.	▪ The unorganised sector is characterised by small and scattered units, which are largely outside the control of the government.
▪ The job is regular and has fixed working hours. If people work more, they get paid for the overtime by the employer.	▪ Jobs are low-paid and often not regular.
▪ Workers enjoy the security of employment.	▪ Employment is not secure. People can be asked to leave without any reason.
▪ Employees will get medical and several other benefits.	▪ No benefits are available for the workers.
▪ Examples: Government employees, registered industrial workers, etc.	▪ Examples: Shop keeping, Farming, Domestic works, etc.

On basis of Asset Ownership:

Private Sector

- The private sector is the part of the economy that is ***run by individuals and companies for profit and is not controlled by government.***
- The private sector tends to make up a larger share of the economy ***in free market, capitalist-based societies.***
- Private sector businesses ***can also collaborate with government*** run agencies in arrangements called ***public-private partnerships.***

Public Sector:

- The Public Sector consists of ***businesses that are owned and controlled by the government of a country.***
- The ownership and control of the central or state governments in these organisations are either complete or partial. But ***government holds a majority stake and makes every single decision regarding running the entity.***
- These ***organisations include government agencies, state-owned enterprises, municipalities, local government authorities and other public service institutions.***
- Some of them can be ***non-profit organisations*** while others participate in ***commercial activities as well.***
- ***It generally focuses on providing goods and services to the general public at relatively cheaper rates than private companies.***
- ***Its main aim is to ensure the welfare of the general public within a country.***

Differences between Public and Private Sector

The main differences between Public and Private Sectors are as follows:

Public Sector	Private Sector
<ul style="list-style-type: none">▪ Definition: Public sector organisations are owned, controlled and managed by the government or other state-run bodies.	<ul style="list-style-type: none">▪ Private sector organisations are owned, controlled and managed by individuals, groups or business entities.
<ul style="list-style-type: none">▪ Ownership: The ownership of the public sector units can be by central, state or local government bodies, and this ownership is either full or partial.	<ul style="list-style-type: none">▪ The ownership of private sector units is by individuals or entities with zero interference from the government.
<ul style="list-style-type: none">▪ Motive: The main motive of public sector organisations is to engage in activities that serve the general public.	<ul style="list-style-type: none">▪ The main motive of the private sector is to earn profits from their business operations.
<ul style="list-style-type: none">▪ Source of Capital: The capital for public sector undertakings comes from tax collections, excise and other duties, bonds, treasury bills etc.	<ul style="list-style-type: none">▪ The capital for private sector entities comes either from its owners or through loans, issuing shares and debentures, etc.
<ul style="list-style-type: none">▪ Employment Benefits :▪ Public sector units provide several employment benefits like job security, housing facilities, allowances and retirement benefits.	<ul style="list-style-type: none">▪ Private sector units offer benefits like higher salary packages, better chances of promotion and recognition, competitive environment and greater incentives in terms of bonus and other benefits.
<ul style="list-style-type: none">▪ Stability: Jobs within the public sector are very stable since the chances of getting sacked due to non-performance are very low.	<ul style="list-style-type: none">▪ Jobs within the private sector are not very secure since non-performance can lead to sacking. Companies can also fire people in case of cost cutting or scaling down of operations.
<ul style="list-style-type: none">▪ Job Promotions: The criteria for promotion in the public sector units is generally based on the seniority of the employee.	<ul style="list-style-type: none">▪ The criteria for promotion in the private sector units is generally based on the merit and job performance of the employee.
<ul style="list-style-type: none">▪ Areas: Some of the main areas that come under the public sector are police, military, mining, manufacturing, healthcare, education, transport, banking, etc.	<ul style="list-style-type: none">▪ Some of the main areas that come under the private sector are information technology, finance, fast moving consumer goods, construction, hospitality, pharmaceuticals, etc.

Let's understand few other terms with reference to Palampur Village:

Multiple Cropping:

- To grow more than one crop on a piece of land during the year is known as multiple cropping.
- It is the most common way of increasing production on a given piece of land

Yield:

- Yield is measured as crop produced on a given piece of land during a single season

High yielding varieties (HYVs):

- Green Revolution in the late 1960s introduced the Indian farmer to cultivation of wheat and rice using high yielding varieties (HYVs) of seeds.
- Compared to the traditional seeds, the HYV seeds promised to produce much greater amounts of grain on a single plant.
- As a result, the same piece of land would now produce far larger quantities of food grains than was possible earlier.
- HYV seeds needed plenty of water and also chemical fertilizers and pesticides to produce best results.
- Higher yields were possible only from a combination of HYV seeds, irrigation, chemical fertilisers, pesticides etc.

Modern farming method:

- Farmers of **Punjab, Haryana and Western Uttar Pradesh** were the first to try out the modern farming method in India.
- The farmers in these regions set up tube wells for irrigation, and **made use of HYV seeds, chemical fertilizers and pesticides in farming.**
- They were rewarded with **high yields of wheat.**
- Scientific reports indicate that the modern farming methods have overused the natural resource base.
- Green Revolution is associated with the **loss of soil fertility due to increased use of chemical fertilizers.**
- **Continuous use of groundwater** for tube well irrigation **has reduced the water-table below the ground.**

Chemical fertilizers:

- Chemical fertilizers provide **minerals which dissolve in water and are immediately available to plants.**
- Chemical fertilizers **can also kill bacteria and other microorganisms in the soil.** This means some time after their use, the **soil will be less fertile than ever before.**
- The **continuous use** of chemical fertilizers has led to **degradation of soil health.**
- Farmers are now forced to use more and more chemical fertilizers and other inputs to achieve the same production level. This means **cost of cultivation is rising very fast.**

Lack of Surplus

- **Farmers retain a part of produce for self-consumption and sell the surplus** in the nearby market. That part of farm produce which is sold in the market is called **marketable surplus.**
- **Small farmers have little surplus output. It is the medium and big farmers only who have substantial surplus produce for selling in the market.**
- **Lack of surplus means that farmers are unable to obtain capital from their own savings, and have to borrow.**

CHAPTER-2

This chapter will demystify the following concepts:

- ✓ **Human capital**
- ✓ **The Role of Education & Health facilities**
- ✓ **Forms of Unemployment in India.**
- ✓ **Economic and Non-Economic Activities**
- ✓ **Market & Non-Market Activities**

Population → Asset for the economy rather than a liability



Human Capital:

- Human capital is the stock of skill and productive knowledge embodied in them.
- Population becomes human capital when there is investment made in the form of education, training and medical care

People as a resource →

It is a term that means how the population can be an asset and not a liability. It is a way of referring to the working class of society in terms of their existing productive skills and abilities. The population becomes human capital when an investment is done in the form of education and training. Education and health also help human beings to be an asset to the economy. Thus, people as a resource refers to the working population that results in the development of society.

Difference between Human Resource & Physical Resource

Human resources are different from other resources like land and physical capital because human beings can use other resources to give out productive output. However, resources like land and physical capital are dependent on human resource for their use and cannot give any productive output all by themselves.

Human Capital Formation

- When the existing human resource is further developed by spending on making the workforce more educated and healthier, it is called Human Capital Formation.

Role of education in human capital formation-

Education plays a very important role in human capital formation for the following reasons:

1. An educated human can be considered an asset for the economy and not a liability.
2. Education can help an individual make better use of economic opportunities. It helps in enhancing the national income, cultural richness and increases the efficiency of the Government.
3. It enhances individual productivity in terms of quality and quantity.
4. Because being educated can help the economic status of an individual, it also develops the consciousness towards society.
5. An educated person is also aware of health and hygiene, and it will ultimately result in better health of the people of a country.

Role of health in human capital formation-

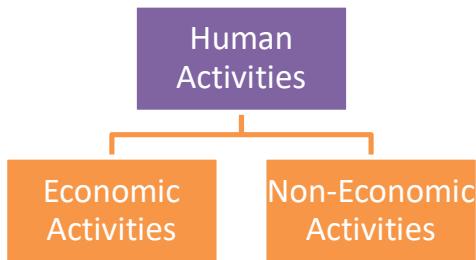
Health plays a very important role in human capital formation in the following ways:

1. If an individual is healthy, he or she may have better immunity to fight illness.

- Being healthy will also increase the overall outcome of an individual. The efficiency of a healthy person is higher than that of an unhealthy person.
- The health of an individual is directly proportional to the work he does. A healthy person can spend more time working in comparison to an unhealthy person. Thus better health will increase efficiency.

The above-mentioned points prove that if better health care measures are taken up due to which an individual in a country becomes healthier, the human capital and productivity will also increase.

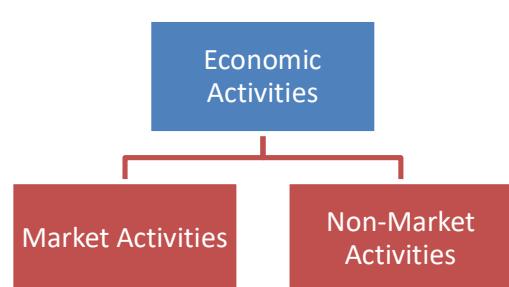
Note: Human beings perform many activities which can be grouped into economic and non-economic.



Economic Activities: Economic activities refer to those activities of human which are undertaken for a monetary gain or to satisfy his/her wants. The activities of workers, farmers, shopkeepers, manufacturers, doctors, lawyers, taxi drivers, etc. fall under this category.

Non-economic activities are ones that are not undertaken for any monetary gain. These are also called unpaid activities. The domestic chores done by housewives are example of non-economic activities.

Economic activities have two parts: market activities and non-market activities



Market activities: Market activities involve remuneration to anyone who performs i.e., activity performed for pay or profit. These include production of goods or services including government service.

Non-market activities: non-market activities are the production for self-consumption

Major determinants of the earning of any individual:

- Education and skill are the major determinants of the earning of any individual in the market.
- A majority of the women have meagre education and low skill formation.
- Women are paid low compared to men.

Quality of Population:

- The quality of population depends upon the literacy rate, health of a person indicated by life expectancy and skill formation acquired by the people of the country.
- The quality of the population ultimately decides the growth rate of the country.
- Illiterate and unhealthy population are a liability for the economy.
- Literate and healthy population are an asset

Unemployment:

- Unemployment is said to exist when people who are willing to work at the going wages cannot find jobs.
- Unemployment leads to wastage of manpower resource. People who are an asset for the economy turn into a liability.

- When we talk of unemployed people, we refer to those in the age group of 15-59 years. Children below 15 years of age and the old people above 60 are not considered while counting the number of unemployed
- Unemployment tends to increase economic overload. The dependence of the unemployed on the working population increases.
- Increase in unemployment is an indicator of a depressed economy.
- **Rural Areas:** *seasonal and disguised unemployment*
- **Urban Areas:** *educated unemployment*

Note: Workforce population includes people from 15 years to 59 years.

Difference between disguised unemployment and seasonal unemployment

- Rural areas have cases of both seasonal and disguised unemployment. Seasonal unemployment is when a person is unable to find jobs during a few months of the year. This mostly happens for farmers who

Market activities	Non-market activities
Market activities are those activities which are performed for getting some remuneration.	Non-market activities are those activities which are performed for self-consumption.
These activities provide some profit.	These activities do not provide any profit.
These activities include the production of goods and services which are sold in the market for money.	These activities include the production of goods and services which are consumed by the producer or his family.
For example, An industrialist who runs a factory of steel and sells it in the market and earns some profit.	For example, A small farmer which cultivate various vegetables in a small plot like a garden for self-consumption.

- are unemployed for a part of the year when no crops are grown.
- Disguised unemployment is when people appear to be employed. When the number of people working on agricultural land is higher than the number of people actually required to work, this is considered as an example of disguised unemployment. If a piece of land requires only three people to work on it, but rather five are working on it, the two extra people are an example of disguised unemployment.

Educated unemployment

Educated unemployment has become a common phenomenon in India. Youths with matriculation, graduation and post-graduation degrees are unable to get jobs in India. This is because the education system in India labels anyone above the age of 18 years eligible to work. This leaves the youth unskilled and ultimately, unemployed. It is important that an individual does not only have a degree but must also be skilled enough to get a job.

Consequences of Unemployment:

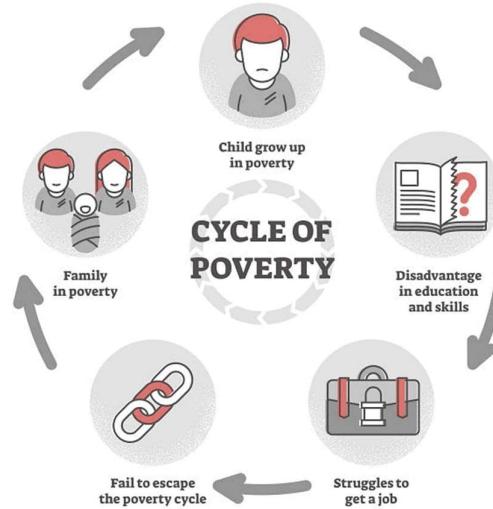
- Unemployment leads to wastage of manpower resource.
- Unemployment tends to increase the economic overload that is the dependence of the unemployed on the working population.
- Unemployment may lead to an increase in social unrest and tension.

CHAPTER 3

This chapter will demystify the following concepts:

- ✓ **Understanding Poverty**
- ✓ **Poverty Line**
- ✓ **Poverty Analysis**
- ✓ **Social Exclusion**
- ✓ **Vulnerability**
- ✓ **Causes of Poverty**
- ✓ **Poverty Mitigation Program**

- Poverty is the most difficult challenge faced by independent India. Poverty is a condition in which a person lacks the financial resources and essentials things to enjoy minimum standards of life.
- Poor people can be landless labourers in villages, jhuggi and slum dwellers in cities and towns, daily wage workers at construction sites, child, workers in dhabas or even beggars.
- According to facts, in India every fourth person is poor. Mahatma Gandhi always insisted that India would be truly independent only when the poorest of its people become free of human suffering.



Poverty Line

- The poverty line is a **method to measure poverty** based on income or consumption levels. Poverty line varies according to time and place.
- Poverty line refers to that line which expresses per capita average monthly expenditure that is essentially required by the people **to satisfy** their **minimum needs**.
- A person is considered poor if his or her income or consumption level falls below a m given "minimum level" necessary to fulfil basic needs.
- In India, the poverty line is determined through a minimum level of food requirement, clothing, footwear, fuel and light, educational and medical requirement, etc.
- These physical quantities are multiplied by their prices in rupees. In India poverty is calculated on the basis of the desired calorie requirement.
- The accepted average calorie requirement in India is 2400 calories per person per day in rural areas and 2100 calories per person per day in urban areas.
- On the basis of these calculations, for the year 2011–12, the poverty line for a person was fixed at Rs 816 per month for rural areas and Rs 1000 for urban areas.
- The Poverty Line is estimated periodically (normally every five years) by conducting sample surveys carried out by the National Sample Survey Organisation (NSSO). It is an organisation under the Ministry of Statistics and Programme Implementation of the Government of India.

Poverty Analysis

- Usually the indicators used relate to the levels of income and consumption. But now poverty is looked through other social indicators prescribed by social scientists.

- Social scientists study all aspects of society from past events and achievements to human behaviour and relationships among groups.
- Social scientists, analyse poverty from many aspects besides levels of income and consumption.

These aspects are -

- Poor level of literacy
- Malnutrition leading to poor resistance to disease
- Lack of access to healthcare
- Lack of job opportunities
- Lack of access to sanitation and safe drinking water and so on

Social Exclusion:

- It is a process through which individuals or groups are excluded from facilities, benefits and opportunities that others (their “bettters”) enjoy.
- A typical example is the working of the caste system in India in which people belonging to certain castes are excluded from equal opportunities. This caused more poverty than the lower income.

Vulnerability:

- Vulnerability to poverty is a measure, which describes the greater probability of certain communities (say, members of a backward caste, or tribal) or individuals (such as a widow or a physically handicapped person) of becoming, or remaining, poor in the coming years.
- Vulnerability is determined by various options available to different communities in terms of assets, education, job, health, etc. and analyse their ability to face various risks like natural disasters. The group which face greater risk at the time of natural calamity are called vulnerable groups.

Vulnerable Groups:

- Social groups which are most vulnerable to poverty are scheduled caste and scheduled tribe households.
- Among the economic groups, the most vulnerable groups are the rural agricultural labour households and the urban casual labour households.
- The double disadvantage, of being a landless casual wage labour household in the socially disadvantaged social groups of the scheduled caste or the scheduled tribe population highlights the seriousness of the problem.

International Poverty Line:

- The international poverty line is a monetary threshold under which an individual is considered to be living in poverty.
- It is calculated by taking the poverty threshold from each country—given the value of the goods needed to sustain one adult—and converting it into dollars.
- Current international poverty line is \$1.90 per day.

Causes of Poverty in India

1. **Low level of economic development under the British colonial administration:** Policies of the colonial government ruined traditional handicrafts and discouraged development of industries like textiles.
2. **Low Rate of Growth until 1980s:**
 - This resulted in less job opportunities and low growth rate of incomes.
 - This was accompanied by a high growth rate of population.
 - The two combined to make the growth rate of per capita income very low.
 - The failure at both the fronts: promotion of economic growth and population control perpetuated the cycle of poverty
3. **Irrigation and Green Revolution:**
 - With the spread of irrigation and the Green revolution, many job opportunities were created in the agriculture sector.
 - But the effects were limited to some parts of India
4. **Industries:**
 - The industries, both in the public and the private sector, did provide some jobs. But these were not enough to absorb all the job seekers.
 - Unable to find proper jobs in cities, many people started working as rickshaw pullers, vendors, construction workers, domestic servants etc.
 - With irregular small incomes, these people could not afford expensive housing.
 - They started living in slums on the outskirts of the cities and the problems of poverty, largely a rural phenomenon also became the feature of the urban sector.
5. **Income inequalities:**
 - Another feature of high poverty rates has been the huge income inequalities.
 - One of the major reasons for this is the unequal distribution of land and other resources.
 - Land reforms have not been properly implemented and lack of adequate land resources is also a reason for many people to be poor.
 - Small farmers borrow money for seeds, fertilisers and pesticides, etc. and later on fail to pay landing in debt trap. This high level of indebtedness is both the cause and effect of poverty.
 - Since lack of land resources has been one of the major causes of poverty in India, proper implementation of policy could have improved the life of millions of rural poor.

Anti-Poverty Measures

Removal of poverty has been one of the major objectives of Indian developmental strategy. The current anti-poverty strategy of the government is based on the following two objectives

(i) Promotion of Economic Growth :

- The government has promoted economic growth during the last few years. Economic growth was low till the 1980s but has increased significantly since then, causing significant poverty reduction.
- The high economic growth helps in a significant reduction of poverty. There is strong linkage between economic growth and poverty reduction.
- Economic growth widens opportunities and provides the resources needed to invest in human development.
- High economic growth encourages people to send their children (including the girl child) to school with hope of better economic returns from investing in education.

- But still, the rural poor may not take direct advantage of economic growth. Due to lack of growth in the agricultural sector, the large number of people remain poor in rural areas

(ii) Targeted Anti-Poverty Programmes:

▪ **Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA)-**

The Act provides 100 days assured employment every year to every rural household. One-third of the proposed jobs would be reserved for women. The central government will also establish National Employment Guarantee Funds.

Similarly, state governments will establish State Employment Guarantee Funds for implementation of the scheme. Under the programme, if an applicant is not provided employment within 15 days s/he will be entitled to a daily unemployment allowance

▪ **Public Distribution System (PDS)**

(PDS) which evolved as a system of management for food and distribution of food grains plays a major role in poverty alleviation. This programme is operated jointly by the Central Government and the State Government of India. The responsibilities include:

- Allocations of commodities such as rice, wheat, kerosene, and sugar to the States and Union Territories.
- Issue of Ration Cards for the people below the poverty line.
- Identification of families living below the poverty line.
- Management of food scarcity and distribution of food grains.

PDS was later launched as Targeted Public Distribution System (TPDS) in June 1997 and is controlled by the Ministry of Consumer Affairs, Government of India. TPDS plays a major role in the implementation and identification of the poor for proper arrangement and delivery of food grains. Therefore, the Targeted Public Distribution System (TPDS) under the Government of India plays the same role as the PDS but adds a special focus on the people below the poverty line.

▪ **National Rural Livelihood Mission (NRLM)**

- It was launched in 2011 by the Ministry of Rural Development and aided by the World Bank. NRLM aims to create an efficient and effective system for the rural poor to access financial services.
- Self Help groups are formed at the village level to help the needy.
- To that end, the objective is to create sustainable opportunities by empowering and enabling the poor to increase their household income. In addition to income-generated assets to the poor — they would also be facilitated to achieve increased access to rights, entitlements and public services, diversified risk and better social indicators of empowerment.
- The mission aims at harnessing the innate capabilities of the poor and complements them with providing them the capacity to participate in the growing economy of the country. In 2015, the program was renamed to Deendayal Antyodaya Yojana (DAY-NRLM).

▪ **National Urban Livelihood Mission**

- It was launched in 2013 by the Ministry of Housing and Urban Affairs.
- It focuses on organizing urban poor in Self Help Groups, creating opportunities for skill development leading to market-based employment and helping them to set up self-employment ventures by ensuring easy access to credit

- **Pradhan Mantri Jan Dhan Yojana**
 - It was launched in 2014 by the Ministry of Finance.
 - It aimed at direct benefit transfer of subsidy, pension, insurance etc. and attained the target of opening 1.5 crore bank accounts. The scheme particularly targets the unbanked poor.
- **Pradhan Mantri Awas Yojana**
 - It was launched in 2015 by the Ministry of Housing and Urban Affairs
 - The Housing for All scheme was an initiative of the Indian government to establish housing facilities for slum dwellers. It was introduced by the Indian government's Ministry of Housing and urban poverty Alleviation. This is also known as the Pradhan Mantri Awas Yojana. It is for both people residing in urban and rural areas that fulfil certain criteria.
 - The aim is to provide solid and permanent housing with all the basic amenities including toilet, LPG connection, electricity connection and drinking water.
- **Pradhan Mantri Ujjwala Yojana (PMUY)**
 - It was launched in 2016 by Ministry of Petroleum and Natural Gas.
 - It envisages the distribution of 50 million LPG connections to women below the poverty line
- **National Nutrition Mission (NNM), Poshan Abhiyan**
 - It was launched in 2018 by Ministry of Women and Child Development.
 - To reduce the level of under-nutrition and also enhance the nutritional status of children in the country. Also, to improve the nutritional outcomes of adolescents, children, pregnant women and lactating mothers.
- **Pradhan Mantri Shram Yogi Maan-Dhan (PM-SYM)**
 - It was launched in 2019 by Ministry of Labour and Employment
 - It is a central government scheme that is introduced for old age protection and social security of Unorganised Workers (UW)
- **Prime Minister Street Vendor's AtmaNirbhar Nidhi – PM SVanidhi**
 - It was launched in 2020 by the Ministry of Housing and Urban Affairs.
 - It aims to provide micro-credit facilities to street vendors affected due to COVID-19 pandemic

CHAPTER 4

This chapter will demystify the following concepts:

- ✓ **Food Security**
- ✓ **Hunger**
- ✓ **Buffer Stock**
- ✓ **Public Distribution System (PDS)**
- ✓ **Ration Cards**
- ✓ **Poverty Alleviation Schemes**
- ✓ **Integrated Child Development Scheme (ICDS)**



What is Food Security?

Food security means availability, accessibility and affordability of food to all people at all times. The poor people are more vulnerable to food insecurity.

Food security depends on the Public Distribution System (PDS) and government vigilance and action at times, when this security is threatened.

Dimensions of Food Security

- **Availability of food:** It means food production within the country, food imports and the previous year's stock stored in government granaries.
- **Accessibility:** It means food is within the accessible to all.
- **Affordability:** It means Food is affordable to all & an individual can buy enough food to fulfil his dietary needs.

How food security is ensured in a country?

Food security can be ensured a country by:

- Enough availability of food for all.
- Food should be of acceptable quality and all persons should have the capacity to buy it.
- No barrier should be there on the accessibility of food.

How is food security affected during a calamity?

- Due to a natural calamity, say drought, total production of food grains decreases. It creates a shortage of food in the affected areas.
- Due to shortage of food, the prices go up.
- At the high prices, some people cannot afford to buy food.
- If such calamity happens in a very wide spread area or is stretched over a longer time period, it may cause a situation of starvation.
- A massive starvation might take a turn of famine

What is a Famine?

A famine is a widespread scarcity of food, caused by several factors including war, inflation, crop failure, population imbalance, or government policies. This phenomenon is usually accompanied or followed by regional malnutrition, starvation, epidemic, and increased mortality.

FAMINE of 1943 in Bengal was the most devastating famine of India.

No. of Deaths: 30 Lakhs in Bengal Province

Who are 'food-insecure'?

- A large number of people suffer from food insecurity in India, the worst affected groups are landless people with little or no land to depend upon, traditional artisans, and providers of traditional services, petty self-employed workers and beggars.
- In Urban areas affected workers are those who are employed in ill- paid jobs.
- The social composition along with the inability to buy food also plays a role in food insecurity.
- The SCs, STs and some sections of the OBCs (lower castes among them) who have either poor land-base or very low land productivity are prone to food insecurity.

A high incidence of malnutrition prevails among women. This is a matter of serious concern as it puts even the unborn baby at the risk of malnutrition.

Food Security in India

- After the Green Revolution the country has avoided famine even during adverse weather conditions.
- India has become self-sufficient in food grains during the last 30 years because of a variety of crops grown all over the country.
- Availability of food grain in the adverse weather condition has also been ensured with a proper food security system.

Hunger:

- Hunger is another aspect indicating food insecurity.
- The attainment of food security therefore involves eliminating current hunger and reducing the risks of future hunger.
- Hunger has chronic and seasonal dimensions.

Chronic Hunger

- Chronic hunger is a consequence of diets persistently inadequate in terms of quantity and/or quality.
- Poor people suffer from chronic hunger because of their very low income and in turn inability to buy food even for survival.

Seasonal Hunger

- Seasonal hunger is related to cycles of food growing and harvesting.
- This is prevalent in rural areas because of the seasonal nature of agricultural activities and in urban areas because of the casual labour, e.g., there is less work for casual construction labour during the rainy season.
- This type of hunger exists when a person is unable to get work for the entire year.

Buffer Stock-

- It is a stock of food grains procured by the government through the **Food Corporation of India (FCI)**.
- FCI purchases wheat and rice from the farmers where surplus production is there and they pay a pre announced price.
- This pre announced price is known as **Minimum Support Price**.

- MSP is declared every year before the sowing season to provide incentives to farmers for raising the production of these crops.

Why this buffer stock is created by the government?

- This is done to distribute food-grains in the deficit areas and among the poorer strata of the society at a price lower than the market price also known as **Issue Price**.
- This also helps resolve the problem of shortage of food during adverse weather conditions or during the periods of calamity.

Programmes For Food Security In India

In mid-1970s, National Sample Survey Organisation (NSSO) reported the high incidence of poverty level. Due to this, three important food intervention programmes were introduced. They are

- Public Distribution System (PDS) for food grains
- Integrated Child Development Services (ICDS)

Public Distribution System-

The food procured by the FCI is distributed through government regulated ration shops among the poorer section of the society. This is called the Public Distribution System (PDS).

The Ration shops are now present in most localities, villages, towns and cities. These shops are also, known as **Fair Price Shops**. Food grains, Sugar, Oil for cooking are sold at these shops at the cheaper rates than the market. Any family with ration card can buy these essentials

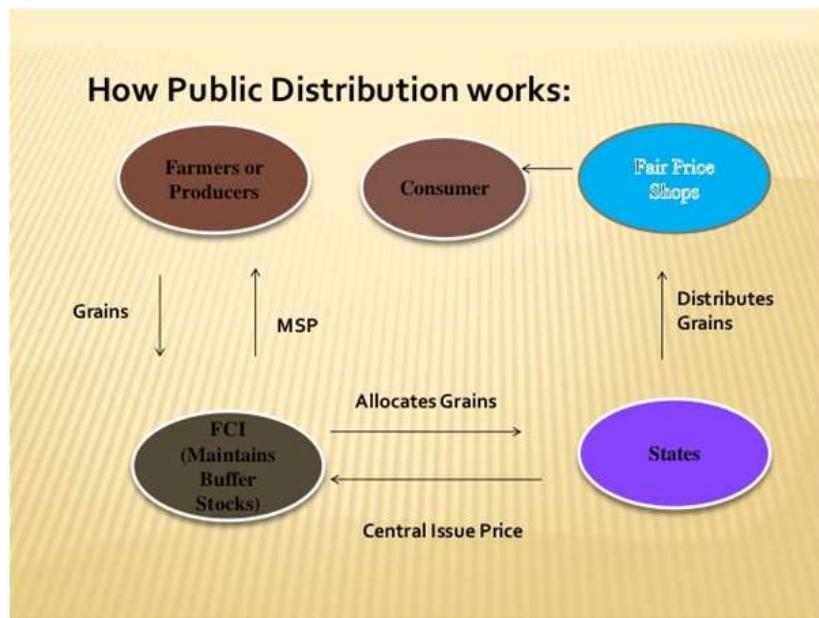
- Nodal Ministry – **Ministry of Consumer Affairs, Food, and Public Distribution**.
- PDS is operated under the joint responsibility of the Central and the State Governments.
 - Central Govt. via FCI = Procurement + Storage + Transportation + Allocation of food grains to the State Governments
 - **State Governments**= Operational responsibilities+ State allocation+ Identification of eligible families + Issue of Ration Cards + supervision of the functioning of Fair Price Shops (FPSs)
- Commodities covered (Vary state to state) – **wheat, rice, sugar and kerosene**, pulses, edible oils, iodized salt, spices, etc.

Modus Operandi of PDS

- The Central and State Governments share responsibilities in order to provide food grains to the identified beneficiaries.
- The centre procures food grains from farmers at a **minimum support price (MSP)** and sells it to states at **central issue prices**. It is responsible for transporting the grains to godowns in each state.
- States bear the responsibility of transporting food grains from these godowns to each fair price shop (ration shop), where the **beneficiary buys the food grains at the lower central issue price**. Many states further subsidise the price of food grains before selling it to beneficiaries.

Importance of PDS

- Ensuring Food and Nutritional Security of the nation by strengthening Pillars of Food security
- Stabilising food prices
- Maintain the buffer stock of food
- Redistribution of grains— Surplus regions of the country to deficient regions.
- Stabilizing Farmers Income



Issues Associated with PDS System in India

- **Identification of beneficiaries:** Studies have shown that targeting mechanisms such as TPDS are prone to **large inclusion and exclusion errors**. For example According to the estimation of an expert group set up in 2009, PDS suffers from nearly 61% error of exclusion and 25% inclusion of beneficiaries, i.e. the misclassification of the poor as non-poor and vice versa.
- **Leakage of food grains:** (Transportation leakages + Black Marketing by FPS owners) TPDS suffers from large leakages of food grains during transportation to and from ration shops into the open market. In an evaluation of TPDS, the erstwhile Planning Commission found 36% leakage of PDS rice and wheat at the all-India level.
- Poor Access to Public Services – **Inefficiency**
- Indifference, Apathy – **Non-Responsiveness**
- Rampant corruption, Extortion by 'Agents & Middlemen' - **Weak Accountability**
- Loose Systems & Weak Integrity – **Abuse of Discretion**
- Weak Civil Society – **Low Demand for Good Governance**
- **Issue with procurement:** Open-ended Procurement i.e., all incoming grains accepted even if buffer stock is filled, creates a shortage in the open market.
- **Issues with storage:** A performance audit by the CAG has revealed a serious **shortfall in the government's storage capacity**. Given the increasing procurement and incidents of **rotting food grains**, the lack of adequate covered storage is bound to be a cause for concern.
- **Poor quality of food grains**
- The provision of **minimum support price (MSP)** has encouraged farmers to divert land from production of coarse grains that are consumed by the poor, to rice and wheat and thus, **discourages crop diversification**.
- **Environmental issues:** The over-emphasis on attaining self-sufficiency and a surplus in food grains, which are water-intensive, has been found to be **environmentally unsustainable**. Procuring states such as Punjab and Haryana are under environmental stress,

including **rapid groundwater depletion, deteriorating soil and water conditions from overuse of fertilisers**

Types of Ration Card

There are three kinds of ration cards:

1. **Antyodaya cards** for the poorest of the poor
2. **BPL cards** for those below poverty line
3. **APL cards** for all others.

Antyodaya Anna Yojana (AYY)

AAY was launched in December 2000. One crore of the poorest among the BPL families covered under the targeted public distribution system were identified. Poor families were identified by the respective state rural development departments through a Below Poverty Line (BPL) survey.

Twenty-five kilograms of food grains were made available to each eligible family at a highly subsidised rate of Rs 2 per kg for wheat and Rs 3 per kg for rice, with 35 kg qty. The scheme has been further expanded twice by additional 50 lakh BPL families in June 2003 and in August 2004.

National Food Security Mission (NFSM) was launched in 2007-08 to increase the production of rice, wheat and pulses through (i) area expansion and productivity enhancement, (ii) restoring soil fertility and productivity, (iii) Creating employment opportunities and (iv) enhancing farm level economy. Coarse cereals were also included in the Mission from 2014-15 under NFSM. The interventions covered under NFSM include cluster demonstrations on improved package of practices, demonstrations on cropping system, Seed distribution of high yielding varieties, farm machineries/resources conservation machineries/tools, efficient water application tools, plant protection measures, nutrient management/soil ameliorants, cropping system-based trainings to the farmers etc.

The National Food Security Act (NFSA), 2013

Government enacted that **National Food Security Act, 2013 (NFSA) in July 2013** with an intended coverage of upto 75% of rural population and upto 50% of urban population for receiving highly subsidized foodgrains under Targeted Public Distribution System. One of the guiding principles of the Act is its life cycle approach wherein special provisions for supplementary nutrition have been made for pregnant women and lactating mothers and children in the age group of **6 months to 14 years**.

- Every pregnant woman and lactating mother are entitled to meal, free of charge, during pregnancy and six months after the child birth, through the local anganwadi.
- Every child in the age group of six months to six years, is entitled to age-appropriate meal, free of charge, through the local anganwadi.
- In the case of children, up to class VIII or within the age group of six to fourteen years, whichever is applicable, one mid-day meal, free of charge is provided every day except on school holidays, in all schools run by local bodies, Government and Government aided schools.
- State Government through the local anganwadi, also identify and provide meals, free of charge, to children who suffer from malnutrition.

Anganwadi is a type of rural child care centre in India. They were started by the Indian government in 1975 as part of the Integrated Child Development Services program to combat child hunger and malnutrition. *Anganwadi* means "courtyard shelter" in Hindi.

Currently, ration cardholders can avail their entitlement of subsidised foodgrains under the National Food Security Act, only from the designated Fair price shop (FPS) within the concerned state. To address the grim state of food security in the country and combat the problem of hunger, the government has started the '**One Nation, One Ration Card**'

Integrated Child Development Scheme (ICDS)

The ICDS is a government programme in India which provides food, preschool education, primary healthcare, immunization, health check-up and referral services to children under 6 years of age and their mothers. ICDS is linked with Anganwadi Centre to provide these services.



Role of cooperatives in food security:

- The role played by cooperatives in food security of India is important especially in the Southern and Western parts of the country.
- The cooperative societies set-up shops to sell low priced goods to poor people. For example, out of all fair price shops running in Tamil Nadu, around 94% are being run by the cooperatives.
- The examples shown below are success stories of cooperatives in order to contribute in food security of India. In Delhi, Mother Dairy is making progress in the provision of milk and vegetables to the consumers at a controlled rate decided by the Government of Delhi.
- Amul is another success story of cooperatives in milk and milk products from Gujarat. It has brought about the White Revolution in the country.

Points to Remember:

- The availability, accessibility and affordability of food to all people at all times is called food security.
- When there is problems in food production or distribution, poor household has to suffer the most.
- The food security in India depends on the Public Distribution System (PDS) and vigilant and timely action of the government.
- Food is an essential item for the survival of human being. Food security of a nation is ensured if all of its citizens have enough nutritious food available (availability), all person having the capacity to buy food and there is no barrier on access to food (accessibility).
- The poorest strata of society are mostly food insecure and the better off might face food insecurity during national disaster and calamity.

- During natural calamity there is decrease in foodgrain production, which causes shortage of foodgrain. The increased price ultimately leads to starvation and famine.
- Epidemics during famine is caused by forced use of contaminated water or decaying food and loss of body resistance due to weakening from starvation.
- Landless people, traditional artisans, petty self-employed workers and destitute Including beggars are worst affected groups from food and nutrition insecurity.
- Workers of ill-paid occupations and casual labourer are the most food insecure people in urban areas.
- Agriculture is seasonal and low paying activity. Besides the inability to buy food, the social composition (like SCs, STc, OBCs etc) also has role in food insecurity.
- Economically backward states, with high incidence of poverty, tribal and rural areas, regions prone to natural disaster has largest number of food insecure people.
- Poverty and hunger are dimensions of food insecurity.
- Hunger can be chronic or seasonal. The chronic hunger is the consequence of a diet regularly deficient in quantity and quality due to lack of income.
- The seasonal hunger is the consequence of seasonal nature of food production and harvesting which affects landless agricultural labourers the most.
- Through Green Revolution, India attained self-sufficiency in foodgrain production.
- The food security system of government consists of component of buffer stock and public distribution system.
- Buffer stock is the stock of foodgrains (wheat and Rice) procured by government (through FCI) from surplus producing state for distribution (through PDS) to deficit states and the poorest section of society.
- The pre-announced price, paid by government to farmers is called Minimum Support Price (MSP).
- The price at which foodgrains is distributed to poorer section of people is called issue price.
- It is lower than market price. The system of distribution of food procured by the FCI among the poorer section of society is called the Public Distribution System (PDS).
- Ration shops (also known as fair price shops), keep stocks of foodgrains, sugar, kerosene etc to be sold to people at a price lower than market price.
- In addition to PDS, the other poverty alleviation programme comprising component of food security are :
- Integrated Child Development Service (ICDS); Food For Work (FFW), mid day meals, Antyodaya Anna Yojana (AAY) etc. Various cooperatives, NGOs are also working intensively along with government to ensure food security of India. Mother Dairy, Amul, Grain banks are regarded as successful and innovation food security intervention

CHAPTER 5

This chapter will demystify the following concepts:

- ✓ **Understanding Development**
- ✓ **Development Comparison**
- ✓ **Per capital income**
- ✓ **Human development**
- ✓ **Sustainable development**



Developmental Economics

- Developmental economics is a branch of economics that deals with- improving the economic, social and monetary conditions of people, regions and countries.
- It studies the transformation of poor countries into rich and prosperous ones.
- While studying and measuring this level of development it uses factors such as health, literacy, working conditions, domestic & international policies and market conditions with a focus on improving conditions in the world's poorest countries.
- The application of development economics is complex and varied as the cultural, social, and economic frameworks of every nation is different.

Development Means Different Things for Different People

- Different people have different notions of development because life situations of persons are different and therefore their aspirations and desires and goals.
- Development for a person in rural area will be different than development for a person in urban areas. However these desires, needs may also be conflicting.
- That is in achieving the development objectives of one person - the desires of other may have to be compromised.
- Development of a Dam may be useful for generation of electricity but it will be destructive for the tribals whose villages will get submerged.

WHAT MAY BE DEVELOPMENT FOR ONE, MAY NOT BE DEVELOPMENT FOR OTHER.

Goals of Development

Development seeks to improve the overall quality of life or a person and it has to meet more than just monetary (income) goals. To measure this we need some indicators that help us measure:

- Income
- Health
- Education
- Equality
- Security
- Respect

➤ Some of these factors can be measured, while others can't be. This does not mean they are not important indicators of development. Such as how would you measure the notion of security? It may be different for people of different strength!!

- When taking decisions, it is expected of you to weigh all your options.
- For example, when changing a school you will look at not just the quality of education but also the environment and other facilities such as sports, extra-curricular activities, discipline etc.
- Similarly, when measuring development we have to do it by considering an appropriate mix of all goals.
- When a woman works, she becomes an active part of economy and thus her status and respect in the family also increases. Every person desires, not just an increase in their disposable income but other benefits that come with it such as quality life.

What should be the development goals for India?

- ✓ Are there poor people in India? - Income Equality (Purchasing Power)
- ✓ Are all people in India educated? - Literacy
- ✓ Are all people in India healthy? - Life Expectancy
- ✓ Is the environment pollution free? - Use of Clean Energy
- ✓ Are all social groups treated equally? - Reservation for SCs, STs, Women & disabled
- ✓ Is India safe for Women? - Gender Equality

There can be several other goals and different people will have different notions and their priority of these goals can also vary.

Development comparison-

- If Different Countries/Regions/People have Different Development Goals and Definitions, then how do we compare them?
- What does it mean when we say a country is developed, developing or under developed?
- We categorize these countries by whose perspective?
- ❖ In a class for example, a student who is good in studies may not be good in sports, or one who is very social may not be great in studies. Different student will have different qualities and talents, but there are students who are able to balance all their goals and are said to have overall development.
- ❖ There are some characteristics that are considered more important than others and we base our comparison based on these characteristics. This applies to measurement of development too.

What factors do we consider for measurement of Development and what indicators are used to measure them?

- **Income** - Average Income, Per Capita Income and Purchasing Power Parity
- **Health** - Infant Mortality Rate, Life Expectancy and Body Mass Index (BMI)
- **Education** - Literacy Rate, Net Attendance Ratio

Should we use Total National Income or Average Income as an indicator for Income?

- ❖ For measuring income levels, it is desirable to take average income of a region than the gross income as it helps in finding the purchasing power of an average person.
- ❖ For example; Singapore being small country has a GDP of \$350 Billion and India has a GDP of close to \$3 Trillion. In absolute terms the GDP of India is greater than GDP of

Singapore, but the population of Singapore is much less than population of India and therefore the average income is much higher in Singapore.

- ❖ Therefore, for comparison between countries, total income is not such an useful measure. Since, countries have different populations, comparing total income will not tell us what an average person is likely to earn.
- ❖ Hence, we compare the **average income** which is the total income of the country divided by its total population. The average income is also called **per capita income**
- ❖ In **World Development Reports**, brought out by the **World Bank**, this criterion is used in classifying countries.
- ❖ **As per 2022-**
Low-income economies are defined as those with a per capita income (here- GNI per capita) of \$1,045 or less in 2020;
Lower middle-income economies are those with a GNI per capita between \$1,046 and \$4,095; <**INDIA IS CURRENTLY IN THIS CATEGORY**>
Upper middle-income economies are those with a GNI per capita between \$4,096 and \$12,695;
High-income economies are those with a GNI per capita of \$12,696 or more.

Understanding some key terms associated with Human development

Average Income or Per Capita Income

- It is the total income of the country divided by its total population.
- The average income is also called per capita income.
- Per Capita Income is calculated in dollars for all countries so that it can be compared.

Infant Mortality Rate

- Infant Mortality Rate (or IMR) indicates the number of children that die before the age of one year as a proportion of 1000 live children born in that particular year

Literacy Rate

- Literacy Rate measures the proportion of literate population in the 7 and above age group.

Net Attendance Ratio

- Net Attendance Ratio is the total number of children of age group 6-10 attending school as a percentage of total number of children in the same age group.

Human Development Report

- Human Development Report published by UNDP compares countries based on the educational levels of the people, their health status and per capita income

Gross Enrolment Ratio

- Gross Enrolment Ratio for three levels means enrolment ratio for primary school, secondary school and higher education beyond secondary school.

Body Mass Index (BMI)

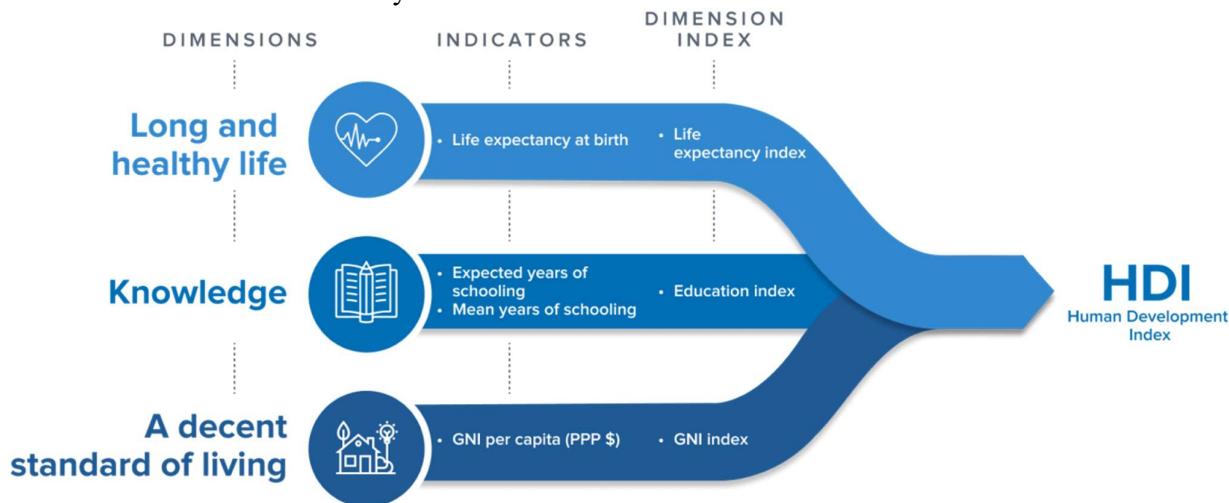
- Calculating one's body mass index is one approach to determine if an adult is malnourished.
- It is calculated by dividing a person's weight (in kilograms) by the square of their height (in metres), expressed in units of kg/m^2 , resulting from mass in kilograms and height in metres
- If this number is less than 18.5 then the individual is regarded to be malnourished. If this BMI is greater than 25, the individual is considered overweight.

Human Development Report

Human Development Report is published by the **United Nations Development Programme (UNDP)**. The first HDR was launched in 1990 by the Pakistani economist **Mahbub ul Haq** and Indian Nobel laureate **Amartya Sen**.

Each report also presents an updated set of indices like-

1. Human Development Index
2. Inequality-adjusted Human Development Index
3. Gender Development Index
4. Gender Inequality Index
5. Multidimensional Poverty Index



The Human Development Index (HDI) is a summary measure of average achievement in key dimensions of human development: a long and healthy life, being knowledgeable and have a decent standard of living. The HDI is the geometric mean of normalized indices for each of the three dimensions.

The health dimension is assessed by life expectancy at birth, the education dimension is measured by mean of years of schooling for adults aged 25 years and more and expected years of schooling for children of school entering age. The standard of living dimension is measured by gross national income per capita.

Sustainable Development

It means development without hampering the Environment. It is the process of development that satisfies the present needs without compromising the needs of the future generation.

Environmental Sustainability:

- It prevents nature from being used as an inexhaustible source of resources and ensures its **protection and rational use**.
- Aspects such as **environmental conservation**, investment in **renewable energy**, **saving water**, supporting **sustainable mobility**, and innovation in **sustainable construction and architecture**, contribute to achieving environmental sustainability on several fronts.

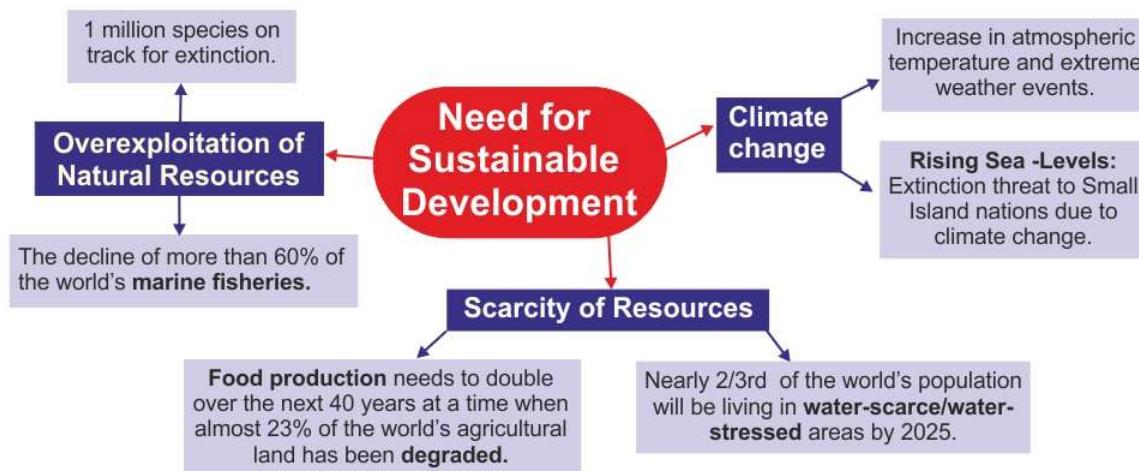


Social Sustainability:

- It can foster **gender equality**, **development of people, communities and cultures** to help achieve a reasonable and **fairly-distributed quality of life**, healthcare and education across the Globe.

Economic Sustainability:

- Focuses on **equal economic growth** that generates **wealth for all**, without harming the environment.
- **Investment and equal distribution of economic resources**.
- Eradicating poverty in all its forms and dimensions.



CHAPTER- 6

This chapter will demystify the following concepts:

- ✓ Money & Credit
- ✓ Double Coincidence of wants
- ✓ Barter System
- ✓ Loan Activities of Banks
- ✓ Formal & Informal Sector of Credit
- ✓ Self Help Groups (SHGs)



What is Money?

Money is a medium of exchange. Anyone having money can use it to exchange for goods and services they may need or want.

What is barter system?

When money in its present form wasn't there people used to exchange goods and services with each other. This system is called the barter system. The buyer and seller have to agree to exchange the goods both of them have. This creates a problem of **double coincidence of wants**.

What a person desires to sell is exactly what the other wishes to buy. In a barter system where goods are directly exchanged without the use of money, double coincidence of wants is an essential feature



Why money is called a medium of exchange?

Money eliminates the double coincidence of wants by providing a uniform medium of exchange that is acceptable by everyone. It acts as an intermediate in the process of exchange and hence is called a medium of exchange.

Types and Forms of Money

- Earlier cattle and grain was used as a medium of money. As humans discovered metals and found better means of extracting and processing metals, we started using them as Money. Up until 100 years back, metals coins such as silver coins, gold coins, copper coins were used as a medium.
- Lately we have seen emergence of cashless economy dominated by digital transactions through credit cards, debit cards, bank transfers etc. where no tangible asset is exchanged.
- With the loss of trust in government system, we are even seeing adoption of crypto currencies such as Bitcoin, Ripple, Ethereum etc.

What is a Currency?

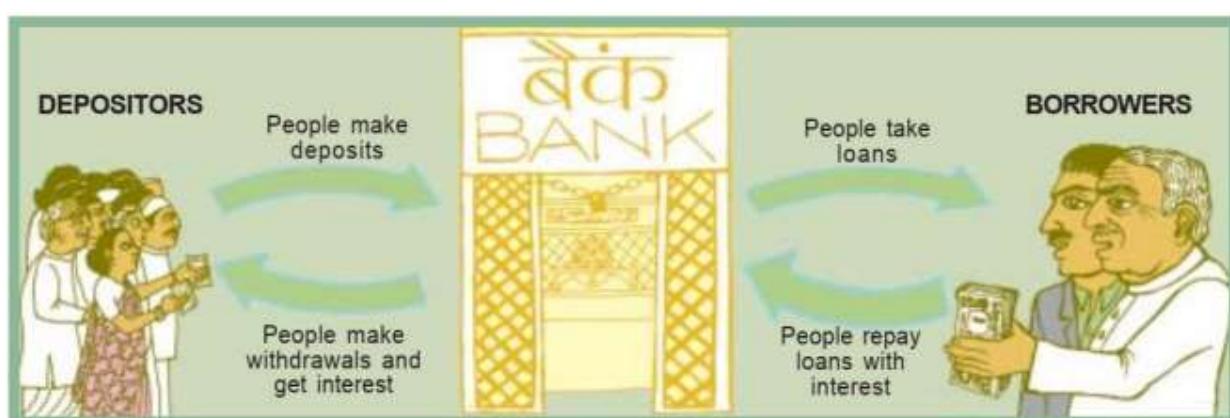
- Currency - Modern currency is not made up of precious metals. It does not have any use of its own unlike cattle and grains.
- It is accepted by everyone because it is authorized by the government. It cannot be refused as a medium of payment as per the law. Such currency is called as legal tender or fiat money.
- In India RBI issue the currency notes and the coins are issued by the Government of India. You can see the sign of the RBI governor on all currency notes except for Re. 1 note which is signed by the Finance Secretary.
- All coins on the other hand are minted by the Government of India

Why do people deposit money with banks?

We do not need money all the time and we cannot carry it with us at all times. After meeting our requirements we save the extra money. This money can be saved by us in our homes or in a bank.

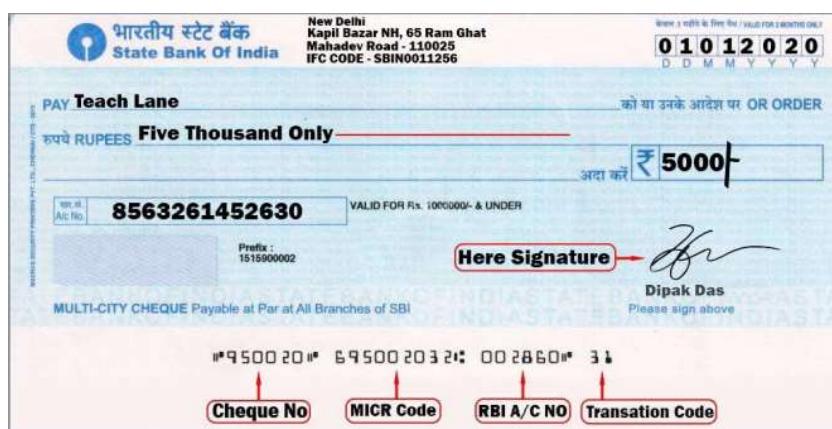
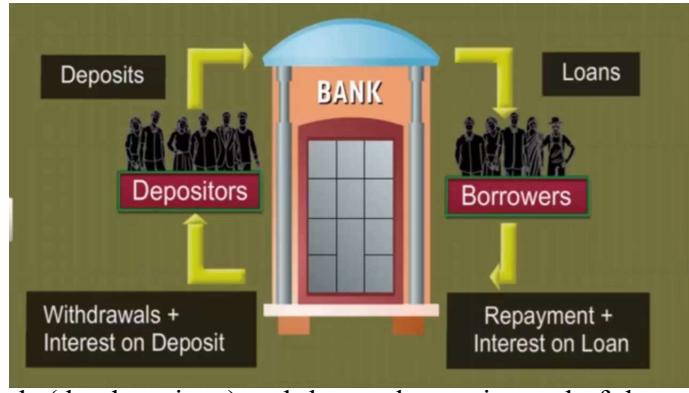
A bank provides interest on the savings and as well as security to the deposits from burglary, theft etc.

Since the deposits in the bank accounts can be withdrawn on demand, these deposits are called demand deposits



Loan Activities of Banks:

- Banks keep only a small proportion of their deposits as cash with themselves.
- Banks use the major portion of the deposits to extend loans.
- There is a huge demand for loans for various economic activities.
- Banks make use of the deposits to meet the loan requirements of the people. In this way, banks mediate between those who have surplus funds (the depositors) and those who are in need of these funds (the borrowers).
- Banks charge a higher interest rate on loans than what they offer on deposits.
- The difference between what is charged from borrowers and what is paid to depositors is their main source of income



What are Time Deposits?

There is some money that people save in schemes, such as provident fund, insurances, recurring deposits and the money cannot be withdrawn before specified time. These are called Time Deposits. We should know that the Interest on Time Deposits > Interest on Demand Deposits.

What is Credit?

When money/goods/services are loaned under an agreement by the lender to the borrower in return of promise of future repayment is called credit.

The agreement normally has **terms of credit** which list out how much money is being loaned, for what time, what will be the interest and provision in case of non-repayment.

What are terms of credit?

Interest rate, collateral and documentation requirement, and the mode of repayment together comprise what is called the terms of credit. The terms of credit can vary depending on nature of lender or borrower.

Credit can play a positive and negative role depending on its usage and terms of credit.

Cheque:

- A cheque is a paper instructing the bank to pay a specific amount from the person's account to the person in whose name the cheque has been made.

- It helps in settling the transaction without use of cash.

Positive Role of Credit

When an entrepreneur or businessman borrows money on credit, he/she may use it for meeting the capital requirements for buying new machinery, raw materials or goods which can help in increasing his production.

He can use the money from his profits to repay the loan. In this case, credit plays a positive and vital role in development.

Negative Role of Credit

When a farmer borrows money for seeds, irrigation and harvest and is not able to get the necessary output from farming, he/she fails to repay the loan and might have to sell their land for repayment of loan.

In this case, rather than helping the farmer, credit played a negative role and pushed him/her further in situation from where recovery is difficult.

Collateral

- Collateral is an asset that the borrower owns (such as land, building, vehicle, livestock, deposits with banks) and uses this as a guarantee to a lender until the loan is repaid.
- If the borrower fails to repay the loan, the lender has the right to sell the asset or collateral to obtain payment.
- Property such as land titles, deposits with banks, livestock are some common examples of collateral used for borrowing.

Terms of Credit:

Interest rate, collateral and documentation requirement, and the mode of repayment together comprise what is called the terms of credit.

The terms of credit vary substantially from one credit arrangement to another.

They may vary depending on the nature of the lender and the borrower

Formal Sector of Credit

- Loans are availed from Banks and Cooperatives
- Credit activity is monitored by RBI
- No unfair means of repayment of loan
- Interest Rate is Lower - thereby making borrowing cheaper
- As a result, borrowers have more income left after repayment of interest
- Borrowers can easily pay off debt

Informal Sector of Credit

- Loans are availed through moneylenders, relatives, traders, friends etc
- Credit activity is not monitored by RBI or any other agency
- Unfair means of repayment of loan may be employed such as loan sharks
- Interest Rate is high- thereby making borrowing expensive
- As a result, borrowers have less or no income left after repayment of interest
- Borrowers can get into a debt trap

It is therefore necessary that banks and cooperatives increase their lending particularly in the rural areas, so that the dependence on informal sources of credit reduces.

Due to benefits of the formal sector, we need more of banks and cooperatives. They provide cheap credit which is crucial for country's development

What are Self Help Groups?

- National Bank of Agriculture and Rural Development (**NABARD**) defines Self-Help Groups as 'a homogenous group of rural poor voluntarily formed to save whatever amount they can conveniently save out of their earnings and mutually agree to contribute and emergent credit needs'.
- A Self-Help Group is defined as a "**self-governed, peer-controlled information group of people with similar socio-economic background and having a desire to collectively perform common purpose**".
- SHG is a **mini voluntary agency for self-help at the micro level** has been focused on the weaker section particularly women for their social defence. So basically, the concept of SHGs serves the principle "**by the women, of the women and for the women**".
- Self-Help Groups are **informal associations of people** who choose to come together to find ways to improve their living conditions. They help to build Social Capital among the poor, especially women.

The most important functions of a Self-Help Groups are:

- To encourage and motivate its members to save,
- To persuade them to make a collective plan for generation of additional income, and
- To act as a conduit for formal banking services to reach them.
- Such groups **work as a collective guarantee system** for members who propose to borrow from organised sources. Consequently, Self-Help Groups have **emerged as the most effective mechanism for delivery of micro-finance services to the poor**. The range of financial services may include products such as deposits, loans, money transfer and insurance.
- The SHGs **comprise very poor people who do not have access to formal financial institutions**. They **act as the forum** for the members to provide space and support to each other. It also enables the members to learn to cooperate and work in a group environment.
- The SHGs **provide a savings mechanism**, which suits the needs of the members. It also provides a cost-effective delivery mechanism for small credit to its members.
- The SHGs **significantly contribute to the empowerment of poor women** by involving them in some productive activity which in turn will yield something to overcome their poverty.



Objectives of SHG

The main objectives of SHG is to inculcate the habit of thrift savings, banking culture, that is, availing the loan and repaying the same over a given period of time and in the process, again economic prosperity through credit. SHGs are mostly informal groups whose members pool their savings and relent within the group on a rotational or need basis.

Origin and Evolution of SHGs:

- SHGs originated in the year 1975 at Bangladesh by Mohammed Yunus of Chittagong University. It is a programme related to the eradication of poverty in general, rural development through women empowerment in particular.
- Its initiation-credit in India in 1986-87 goes to National Bank for Agriculture and Rural Development (NABARD). But the real effort was taken after 1991-92 from the linkages of SHGs with banks.
- The first organised initiative in this direction was taken in Gujarat in 1954 when the Textile Labour Association (TLA) of Ahmedabad formed its women's wing to organise the women belonging to households of mill workers in order to train them in primary skills like sewing, knitting embroidery, typesetting and stenography etc.
- In 1972, it was given a more systematized structure when Self Employed Women's Association (SEWA) was formed as a Trade Union under the leadership of Ela Bhatt. She organised women workers such as hawkers, vendors, home based operators like weavers, potters, papad / agarbatti makers, manual labourers, service providers and small producers like cattle rearers, salt workers, gum collectors, cooks and vendors with the primary objective of:
 - Increasing their income and assets;
 - Enhancing their food and nutritional standards; and
 - Increasing their organisational and leadership strength.
 - The overall intention was to organise women for full employment.
- In the 1980s, MYRADA – a Karnataka based non-governmental organisation, promoted several locally formed groups to enable the members to secure credit collectively and use it along with their own savings for activities which could provide them economically gainful employment.
- Today, around 44% of the total Bank-linked SHGs of the country are in the four southern States of Andhra Pradesh, Tamil Nadu, Karnataka and Kerala.
- NABARD-Bank Linkage Programme: 40.95 million families and 204.75 million people having been covered under this programme and the cumulative loan figure standing at 18040 crores as on 31-03-2007.

Major Functions of an SHG

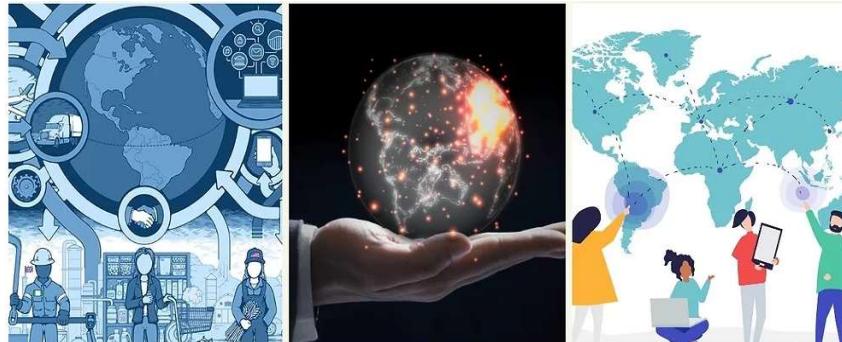
- **Freedom from exploitative debt** – In rural India, people are still dependent on informal moneylenders. These moneylenders exploit these poor people by entering into false agreements, writing wrong amounts on papers, charging excessive interest rates and confiscating property on failing to repay the loan. SHGs free these people from clutches of moneylenders.
- **Collective guarantee system** – for members who propose to borrow from organised sources. The poor collect their savings and save it in banks. In return they receive easy access to loans with a small rate of interest to start their micro unit enterprise.

- **Leadership development:** SHGs provide organisational platform to rural people to act as leader for their respective activities. SHGs provide dynamic leadership as every person gets a chance to lead according to the skill sets. Example: In Andhra Pradesh alone, 1,40,000 women leaders were created.
- **Social integrity** –SHGs encourages collective efforts for combating practices like dowry, alcoholism etc.
- **Gender Equity** –SHGs empowers women and inculcates leadership skill among them. Empowered women participate more actively in gram sabha and elections.
- **Pressure Groups** –their participation in governance process enables them to highlight issues such as dowry, alcoholism, the menace of open defecation, primary health care etc and impact policy decision.
- **Voice to marginalized section**– Most of the beneficiaries of government schemes have been from weaker and marginalized communities and hence their participation through SHGs ensures social justice.
- **Savings** – All SHG members regularly save a small amount. The amount may be small, but savings have to be a regular and continuous habit with all the members.
- **“Savings first – Credit later”** should be the motto of every SHG member.
- **Internal lending** – The SHG should **use the savings amount for giving loans** to members. The purpose, amount, rate of interest, schedule of repayment etc., are to be decided by the group itself.
- **Financial inclusion** – SHGs have mobilised millions of people across the country especially women. 40.95 million families and 204.75 million people having been covered under NABARD-Bank Linkage programme and the cumulative loan figure standing at 18040 crores as on 31-03-2007
- **Impact on Housing & Health** –The financial inclusion attained through SHGs has led to reduced child mortality, improved maternal health and the ability of the poor to combat disease through better nutrition, housing and health – especially among women and children.
- **Banking literacy** –It encourages and motivates its members to save and act as a conduit for formal banking services to reach them.

CHAPTER 7

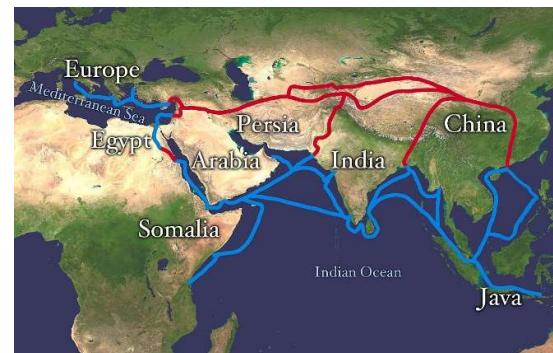
This chapter will demystify the following concepts:

- ✓ Foreign Trade
- ✓ Joint Ventures
- ✓ Multinational Corporations (MNCs)
- ✓ Globalisation
- ✓ Advantages & Disadvantages of Globalisation



Foreign trade

- Foreign trade has been the main channel connecting countries. Trade routes connected India and South Asia to markets both in the East and West such as the Silk Route.
- Trading interests attracted various trading companies such as the East India Company to India.
- Foreign trade creates an opportunity for the producers to reach beyond the domestic markets
- For the buyers, import of goods produced in another country is one way of expanding the choice of goods beyond what is domestically produced.
- The opening of trade allows goods to travel from one market to another.
- Choice of goods in the markets rises. Prices of similar goods in the two markets tend to become equal.
- Foreign trade thus results in connecting the markets or integration of markets in different countries.
- More and more goods and services, investments and technology are moving between countries.
- There is movement of people between countries in search of better income, better jobs or better education.



Multinational corporations (MNCs):

- A MNC is a company that owns or controls production in more than one nation.
- MNCs set up offices and factories for production in regions where they can get cheap labour and other resources.
- This is done so that the cost of production is low and the MNCs can earn greater profits.
- Investment made by MNCs is called foreign investment.

Why do MNCs decentralise their production?

- MNCs set up offices and factories for production in regions where they can get cheap labour and other resources. This is done so that the cost of production is low and the MNCs can earn greater profits.
- Production is organised in increasingly complex ways. The MNCs not only sell the finished products globally, but also produce goods and services globally.
- Production process is divided into small parts and spread out across the globe.
- Companies set up units across countries depending upon the strength of particular nations.
- Example, China & Vietnam provides advantage of being a cheap labour market for production while India has the advantage of an educated and skilled English speaking youth.
- In general, MNCs set up production where it is close to the markets; where there is skilled and unskilled labour available at low costs; and where the availability of other factors of production is assured.
- MNCs might look for government policies that look after their interests.
- Large MNCs in developed countries place orders for production with small producers. The products are supplied to the MNCs, which then sell these under their own brand names to the customers.
- The money that is spent to buy assets such as land, building, machines and other equipment is called investment. Many of the top MNCs have wealth exceeding the entire budgets of the developing country governments.
- Investment made by MNCs is called foreign investment.
- MNCs can spread their production in following ways: By setting up partnerships with local companies, by using the local companies for supplies, by closely competing with the local companies or buying them up, MNCs are exerting a strong influence on production at these distant locations.
- As a result, production in these widely dispersed locations is getting interlinked.

Joint Venture

Sometimes, MNCs set up production jointly with some of the local companies of these countries.

Benefits to local company:

- MNCs can provide money for additional investments, like buying new machines for faster production.
- MNCs might bring with them the latest technology for production.

Benefits to foreign company:

Most common route for MNC investments is to buy up local companies and then to expand production.

Example: Flipkart being acquired by Walmart

Globalisation:

- Globalisation is this process of rapid integration or interconnection between countries. It refers to the integration of the domestic economy with the economies of the world.
- MNCs are playing a major role in the globalisation process.
- More and more goods and services, investments and technology are moving between countries.

- In the last few decades our world has changed drastically. Changes in technology has made transportation and communication much more efficient, thereby allowing us to connect with anyone anywhere.
- Until the middle of the twentieth century, production was largely organised within countries.
- Colonies such as India exported raw materials and food stuff and imported finished goods. Trade was the main channel connecting distant countries.

Reasons why India imposed barriers on Foreign Trade initially

1. The Indian government after independence had put barriers to foreign trade and investment. This was done to protect the producers within the country from foreign competition. Industries were just coming up in the 1950s and 1960s and competition from imports at that stage would not have allowed these industries to develop and grow. Imports of only essential items such as machinery, fertilizers, petroleum etc. was allowed.
2. To protect the Indian economy from foreign infiltration in industries affecting the economic growth of the country as planned. India wanted to move faster to catch up with the main industries in the world market and therefore had to keep an extra watch on its progress in international trade and give incentives to the more rapidly growing industries through fiscal tariff and other means. Around 1991, some changes were made in policy by the Indian government as it was decided that the time had come for the Indian producers to compete with foreign producers

Factors that enabled Globalisation

1. Technology

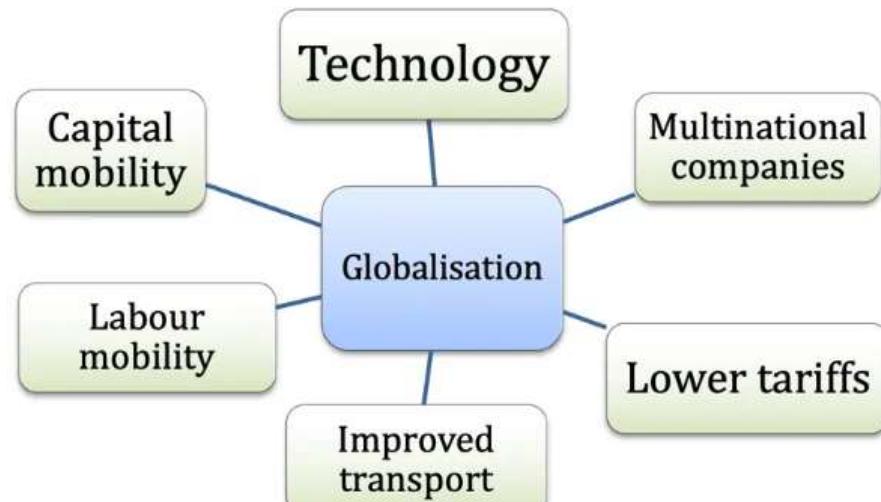
- The past fifty years have seen several improvements in transportation technology. This has made much faster delivery of goods across long distances possible at lower costs.
- Developments in information and communication technology has allowed people to contact one another around the world, to access information instantly, and to communicate from remote areas.
- This has been facilitated by satellite communication devices.
- Information technology has also played an important role in spreading out production of services across countries. Teleconferences help in saving frequent long trips across the globe. Orders are placed and payments are transferred through internet.

2. Liberalisation of foreign trade and foreign investment policy

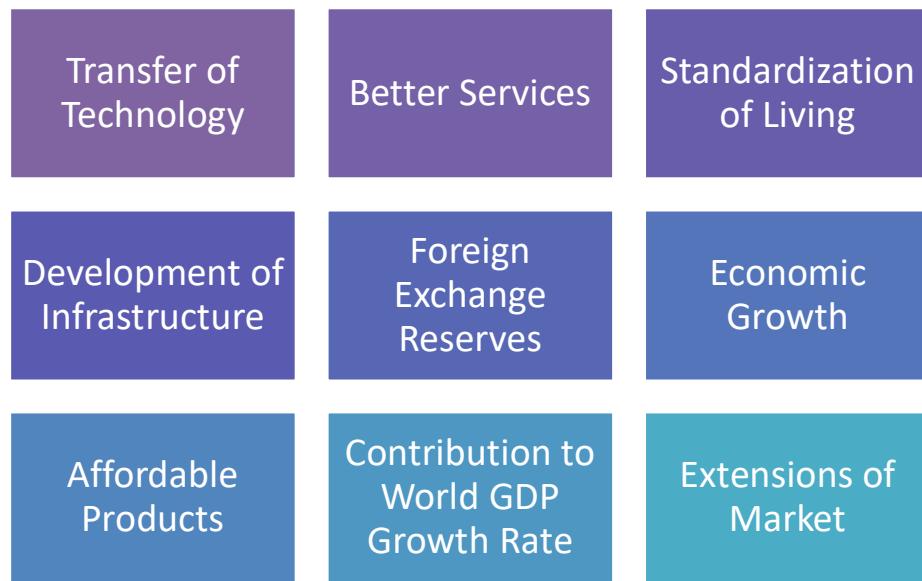
- Governments can use trade barriers to increase or decrease (regulate) foreign trade and to decide what kinds of goods and how much of each, should come into the country.
- The Indian government, after Independence, had put barriers to foreign trade and foreign investment.
- This was considered necessary to protect the producers within the country from foreign competition.
- Competition from imports at that stage would not have allowed these industries to come up.
- India allowed imports of only essential items such as machinery, fertilisers, petroleum etc.
- In 1991, post the economic crisis barriers on foreign trade and foreign investment were removed to a large extent.

- This meant that goods could be imported and exported easily and also foreign companies could set up factories and offices here.
- Removing barriers or restrictions set by the government is what is known as liberalisation.
- The government now imposes much less restrictions than before and is therefore said to be more liberal.

Main reasons that have caused globalisation



Advantages of Globalization



1. Transfer of Technology

Transfer of technology throughout the globe is good for us. Any country can borrow the technology through the agreement and can implement it in their country for their overall development. We can communicate each other easily from any part of the globe by using advance technology at minimal cost, time and efforts.

2. Better Services

Globalization always provides us better services. Through the technological advancement our services like water supply, mobile networking, internet, electricity supply and any other services have been easier and better than before. By the way, easy access to the internet throughout the globe is also the result of the globalization.

3. Standardization of Living

The integration of economies as the key process of globalization enables countries to fight against poverty and improve the standard of living of the people.

Many researchers have stated that when a country open up their trade to the globe, their rate of economic growth is faster and living standards tend to increase.

4. Development of Infrastructure

Due to the technological advancement and its transfer throughout the globe helps to improve country's infrastructure. Countries are more enabling to deliver their services to the people. Development of infrastructure means overall development of respective countries. Here it is necessary to say that economic growth and development of infrastructure are compatible with each other.

5. Foreign Exchange Reserves

Through globalization countries can build foreign exchange reserves owing to international financial flows.

6. Economic Growth

Globalization entails to optimum utilization of resources wherein deficit resources are procured and surplus resources are exported to other countries. This ensures overall economic growth.

7. Affordable Products

With the access to the latest technology, the countries can provide products to its countrymen at affordable prices. Globalization promotes competition in domestic economies and their endeavour to compete against competition, companies reduce product price or follow penetration pricing strategy.

8. Contribution to World GDP Growth Rate

Globalization ensures contribution of every country to the world GDP growth.

9. Extensions of Market

Above all, Globalization promotes extension of market. It provides an opportunity to the domestic companies in going global. For instance, domestically, companies can witness saturation in the demand for their products or services but through globalization the domestic companies can sustain and satisfy the growing demands of foreign customers.

Disadvantages of globalisation:

1. Increasing of the Unemployment rate

It may lead to outsourcing of jobs from a native country due to availability of cheap labour in another country. Globalization demands for higher-skilled work with cheaper price. But countries where Institutions are relatively weak are not capable of producing highly skilled workers. As a result, the unemployment rate is increasing in those countries.

2. Trade Imbalance

The balance of trade refers to the balance of values between a country's export and import's goods and services. As the result of globalization, any country can trade to any part of the globe. That is why, in some cases developing countries are so much dependent on the developed countries in terms of import goods but their export capabilities are lower than import.

3. Growing Inequality

Globalization can increase inequality throughout the world by increasing specialization and trade. Although specialization and trade boost the per-capita income it may cause relative poverty.

To illustrate this we will take an example. All dominated MNCs in the world are located in the United States. All these companies are buying cheaper labour from developing or underdeveloped countries for their product manufacturing or assembling. China, India and Africa are prime examples of this. It increases the employment of such countries but they are lagging behind relatively developed countries. It will result in an increase in emission of greenhouse gases that will have a direct impact on the environment.

4. Environmental Concerns

The pace of industrialization is increasing as the result of globalization. Industrialization boosts the economic growth but it harms environment as well. Deforestation and loss of biodiversity is caused by infrastructure development

Greenhouse gas emissions and other forms of pollution caused by increased transportation of goods

Let's try to understand with an example. Coca-Cola is the world's leading soft drink company. This company consume huge amount of water for making soft drinks. In a state of northern India, Uttar Pradesh, a Coca-Cola bottle plant was closed by the government order because of too much usage of water claimed by local farmers.

CHAPTER 8

This chapter will demystify the following concepts:

- ✓ **Consumer Rights**
- ✓ **Consumer International (CI)**
- ✓ **World Consumer Rights Day**
- ✓ **Consumer Protection Act**

Consumer is a person who buys and uses a good or service from the market after making a payment.

Some common ways by which consumers may be exploited by manufacturers and traders:

- **Underweight and under-measurement:** Goods sold in the market are sometimes not measured or weighed correctly.
- **High prices:** Very often the traders charge a price higher than the prescribed retail price.
- **Sub-standard quality:** The goods sold are sometimes of sub-standard quality, e.g., selling medicines beyond their date of expiry, selling deficient or defective home appliances.
- **Duplicate articles:** In the name of genuine parts or goods, fake or duplicate items are sold.
- **Adulteration and impurity:** In costly edible items like oil, ghee and spices, adulteration is common in order to earn more profit. This causes heavy loss to the consumers.
- **Lack of safety devices:** Fake or inferior electronic goods, electrical devices or other appliances, produced locally lack the required in-built safety measures. This may cause accidents.
- **Artificial scarcity:** Some unscrupulous businessmen create artificial scarcity by hoarding. They sell their goods for a higher price by creating panic among consumers.
- **False and incomplete information** is provided by sellers which can easily mislead consumers.
- **Unsatisfactory after-sale service:** The suppliers do not provide the satisfactory after-sale service despite the necessary payments on items such as electronics, automobiles, etc.

Consumers International: It is an international association of consumer advocacy groups that promotes the rights and interests of consumers. It was founded on 1 April 1960 and currently has more than 240 member organizations (various agencies & NGOs) from over 220 countries.



CI provides 8 basic consumer rights:

1. The right to protection from unsafe products
2. The right to product information
3. The right to a range of product choices
4. The right to representation in government policy
5. The right to products that satisfy basic needs
6. The right to redress for grievances concerning unsatisfactory products
7. The right to consumer education, and

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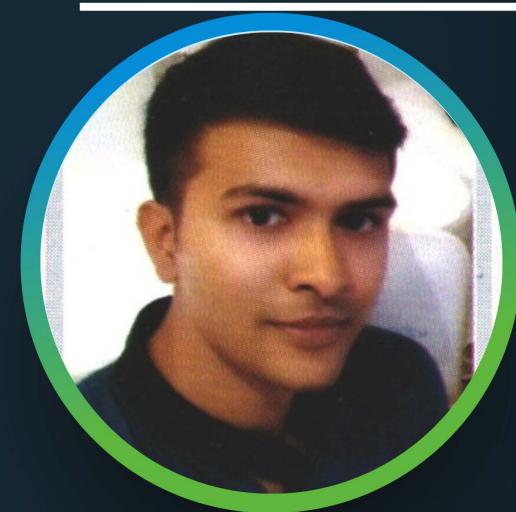
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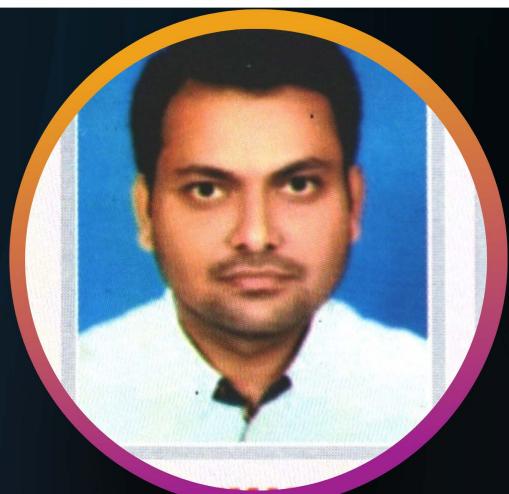
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8. The right to an environment that is not threatening to human well-being.

CI acts through its member organizations to influence local and international policies that affect consumers, and it campaigns to promote corporate accountability and to protect consumers from deceptive marketing practices.

To raise consumer awareness, the group also publishes research on product-safety issues and abuses in the marketplace.

World Consumer Rights Day is celebrated on **15 March of every year**. This day was inspired by a speech **John F. Kennedy** (former US President) gave on consumer rights on **15 March 1962** while speaking at the US Congress. **He was the first world leader to recognize Consumer Rights.**

Anwar Fazal, a worker for Consumers International, later proposed this day as World Consumer Rights Day.

However, **India celebrates 24th December as National Consumer Day every year**. It is observed to highlight the **importance of the consumer movement** and the need to make every consumer **more aware of their rights and responsibilities**.

As on this day the **Consumer Protection Act (COPRA), 1986** had received the assent of the President and came into effect.

The **Consumer Protection Act 2019** was passed by the Parliament in August 2019 *to replace the 3 decades old Consumer Protection Act, 1986*.

Need for the new act:

- The Digital Age has ushered in a new era of commerce and digital branding, as well as a new set of customer expectations. Digitization has provided easy access, a large variety of choices, convenient payment mechanisms, improved services and shopping as per convenience. However, there are also associated challenges related to consumer protection.
- To help address the new set of challenges faced by consumers in the digital age, the Indian Parliament passed the landmark Consumer Protection Act, 2019 which aims to provide timely and effective administration and settlement of consumer disputes.

Salient Provisions of the 2019 Consumer Protection Act

New definition of consumer:

- The new Act has widened the definition of 'consumer'.

Definition of consumer:

- As per the Act, a person is called a consumer who avails the services and buys any good for self-use. Worth to mention that if a person buys any good or avails any service for resale or commercial purposes, he/she is not considered a consumer. This definition covers all types of transactions i.e. offline and online through teleshopping, direct selling or multi-level marketing.

Central Consumer Protection Authority (CCPA)

- The Act proposes the establishment of the Central Consumer Protection Authority (CCPA) as a regulatory authority.

- The CCPA will protect, promote and enforce the rights of consumers and regulate cases related to unfair trade practices, misleading advertisements, and violation of consumer rights.
- CCPA is given wide-ranging powers:
 - The CCPA will have the right to take suo-moto actions, recall products, order reimbursement of the price of goods/services, cancel licenses, impose penalties and file class-action suits.
 - The CCPA will have an investigation wing to conduct independent inquiry or investigation into consumer law violations.

Consumer Disputes Redressal Commission:

The Act has the provision of the establishment of Consumer Disputes Redressal Commissions (CDRCs) or Forums at the national, state and district levels to entertain consumer complaints.

As per the notified rules, the State Commissions will furnish information to the Central Government on a quarterly basis on vacancies, disposal, the pendency of cases and other matters.

The CDRCs will entertain complaints related to:

- Overcharging or deceptive charging
- Unfair or restrictive trade practices
- Sale of hazardous goods and services which may be hazardous to life.
- Sale of defective goods or services

E-Filing of Complaints:

- The new Act provides flexibility to the consumer to file complaints with the jurisdictional consumer forum located at the place of residence or work of the consumer.
- To facilitate consumers in filing their complaint online, the Central Government has set up the **E-Daakhil Portal**.
- This is unlike the earlier condition where the consumer had to file a complaint at the place of purchase or where the seller has its registered office address.
- The new Act also contains enabling provisions for consumers to file complaints electronically and for hearing and/or examining parties through video-conferencing.
- Consumers will also not need to hire a lawyer to represent their cases.

Product Liability & Penal Consequences:

- The Act has introduced the concept of product liability.
 - A manufacturer or product service provider or product seller will now be responsible to compensate for injury or damage caused by defective products or deficiency in services.
- This provision brings within its scope, the product manufacturer, product service provider and product seller, for any claim for compensation. The term 'product seller' would also include e-commerce platforms.

Penalties for Misleading Advertisement:

- The CCPA may impose a penalty on a manufacturer or an endorser, for a false or misleading advertisement. The CCPA may also sentence them to imprisonment.

Provision for Alternate Dispute Resolution:

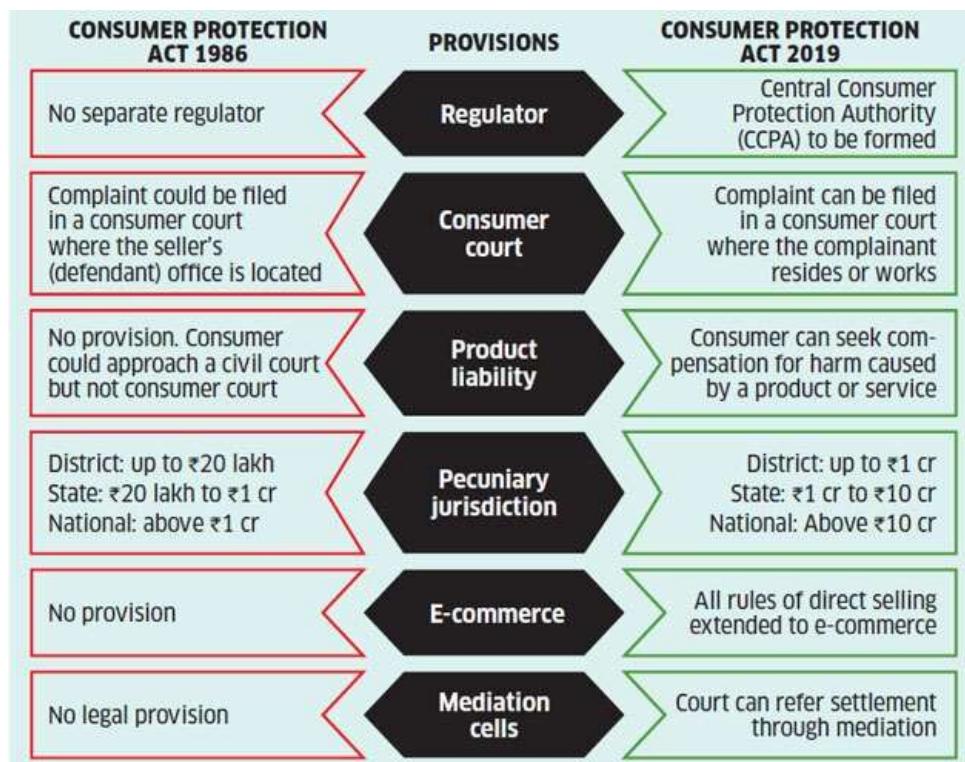
- The new Act provides for mediation as an Alternate Dispute Resolution mechanism. For mediation, there will be a strict timeline fixed in the rules.
- As per the recently notified rules, a complaint will be referred by a Consumer Commission for mediation, wherever scope for early settlement exists and parties agree for it. The mediation will be held in the Mediation Cells to be established under the aegis of the Consumer Commissions. There will be no appeal against settlement through mediation.
- This will not only save time and money of the parties involved in litigating the dispute, but will also aid in reducing overall pendency of cases.

Unfair Trade Practices:

- The new Act has armed the authorities to take action against unfair trade practices too.
- The Act introduces a broad definition of Unfair Trade Practices, which also includes the sharing of personal information given by the consumer in confidence unless such disclosure is made in accordance with the provisions of any other law.

Time-bound redressal:

- A large number of pending consumer complaints in consumer courts have been common across the country. The new Act by simplifying the resolution process can help solve the consumer grievances speedily.
- A main feature of the Act is that under this, the cases are decided in a limited time period.



ISI Mark (Indian Standards Institution)

It is an industrial goods certification mark for industrial products in India. It acts as an **authentication of good quality for the products**



AGMARK

It is a **certification mark to assure the quality of agricultural products in India**. AGMARK acts as a guarantee for the agricultural products that are produced and consumed in India.



Hallmark

An official mark struck on items made of precious metals like gold silver platinum etc. to attest their purity.



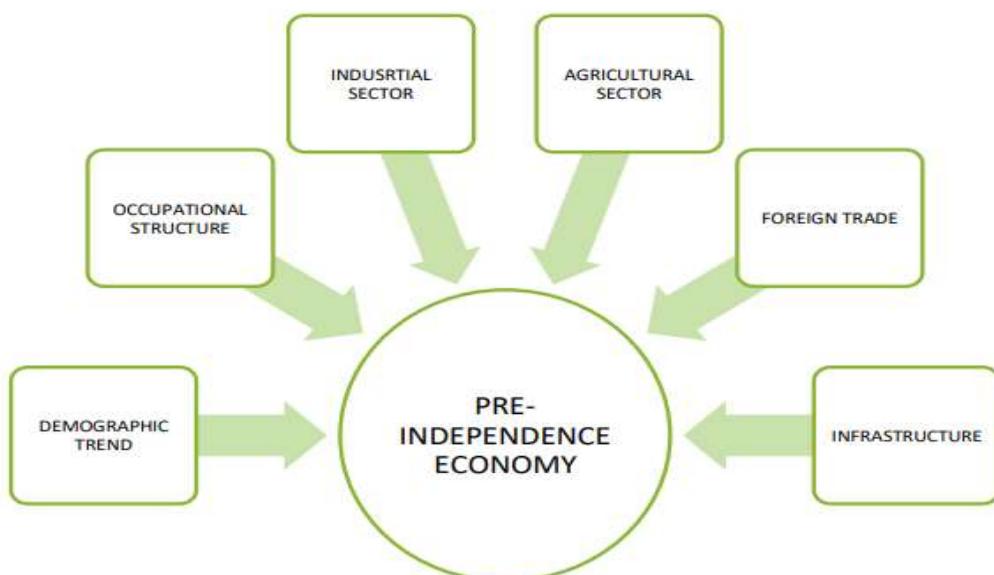
Duties of consumers while shopping

- A consumer must check for a certification of quality such as ISI mark, AGMARK or Hallmark.
- Consumers must ensure that they receive a valid bill or cash memo and warranty on purchase of items especially electronic goods such as TV, laptop, mobile phones etc.
- The consumer should not allow a salesman to force him/her to buy a particular brand and
- A consumer should inform concerned authorities if a shopkeeper is selling defective goods

CHAPTER- 9

This chapter will demystify the following concepts:

- ✓ **Understanding Pre-Independence Indian Economy**
- ✓ **Agriculture Sector before Independence**
- ✓ **Infrastructure before Independence**
- ✓ **Industrial Sector before Independence**
- India had an **independent economy** before the advent of British rule.
- India was particularly well known for its **handicraft industries** in the fields of cotton and silk textiles, metal and precious stone works, etc.
- **Aim of the British colonial rule in India** – To convert India into a **feeder economy** for Britain's own rapidly expanding modern industrialization.
- **British Economic policies** were concerned more with the **protection** and **promotion** of the economic interests of Britain than with the development of the Indian economy.
- **A fundamental change in the structure of the Indian economy** – India was transformed into a **net supplier of raw materials** and **consumer of finished industrial products** from Britain.
- The colonial government **never made any sincere attempt** to estimate national and per capita income of India.



Economic Policies of Colonial Govt.

- Promoted Economic interests of British Govt.
- No development in Indian Economy
- Converted India into supplier of raw materials
- India --> Big market for finished goods from British
- Never estimated our National and Per Capita Income

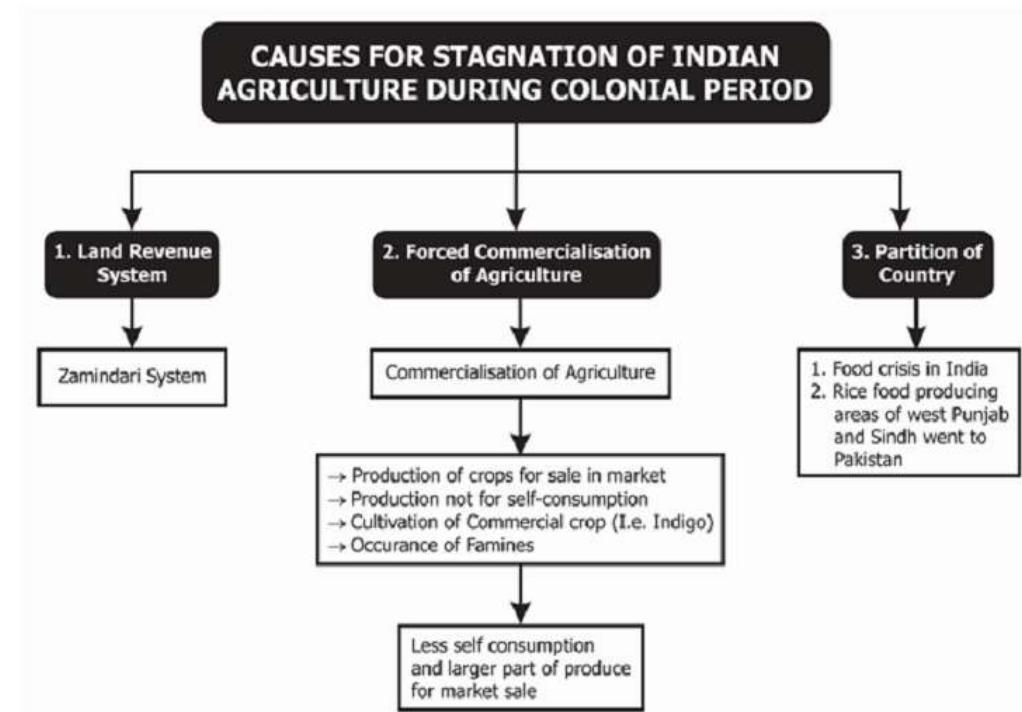
India before colonial rule

- Independent economy
- Main Source: Agriculture
- World Famous for Handicrafts
 - Reason: High Quality Material and Craftsmanship
 - Best Example: Textile industry in Bengal

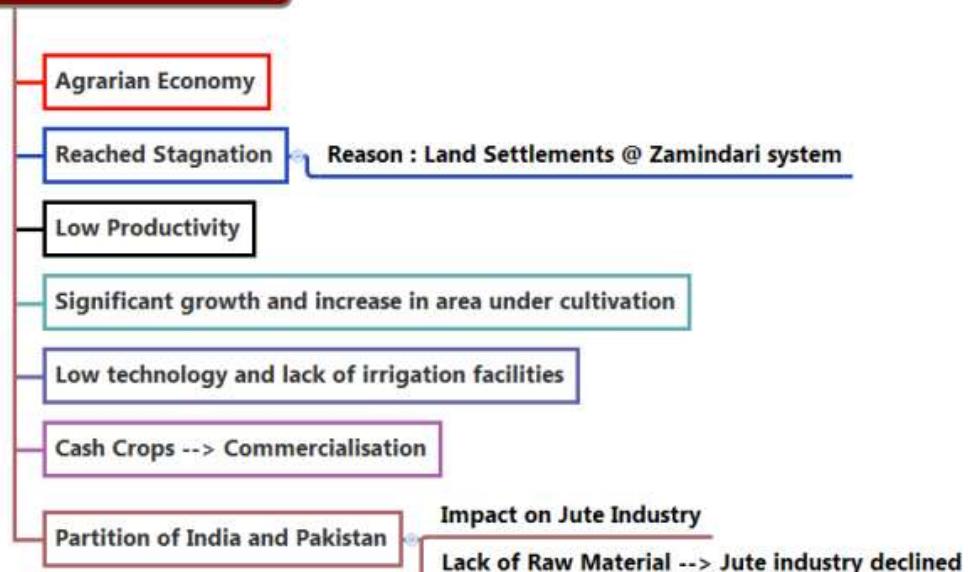
AGRICULTURE SECTOR

- Agrarian Economy** – Indian economy under the British rule was fundamentally **agrarian**. About 85 per cent of the country's population lived **mostly in villages** and derived **livelihood directly or indirectly from agriculture**.
- Stagnated agriculture sector** – Reason being **over-crowded** with involvement of maximum population leading to a **very low agricultural productivity**.
- Due to systems of land settlement, the profit accruing out of the agriculture sector went to the **zamindars** instead of the cultivators. No zamindar initiated to strive for the development of agriculture.
- Lack of agricultural inputs** – Low levels of technology, lack of irrigation facilities and negligible use of fertilisers resulted in a **dismal level of agricultural productivity and efficiency**.
- India's agriculture was starved of investment in terracing, flood-control, drainage and desalination of soil.

- **The commercialisation of agriculture** – could hardly help farmers in improving their economic condition as they were producing cash crops which were to be ultimately used by British industries back home. This further led to shortage of Food Crops.
- **Partition of the country**: A sizeable portion of the undivided country's **highly irrigated and fertile land went to Pakistan** leading to an adverse impact upon India's output from the agriculture sector especially, Jute industry (the whole of the area went away to East Pakistan (Present Bangladesh))



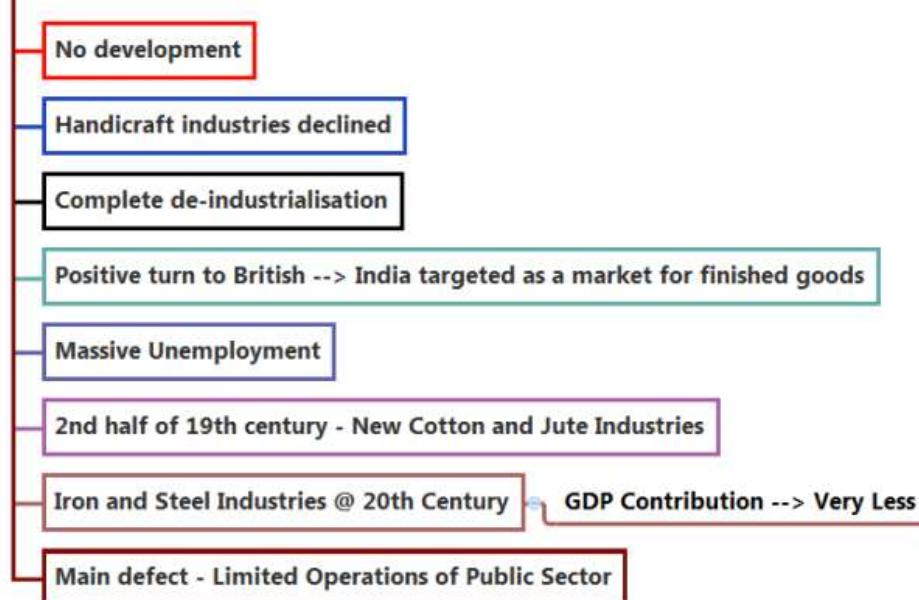
Downfall of Agricultural Sector



INDUSTRIAL SECTOR

- India **could not develop an efficient industrial base** even while carrying the legacy of producing the best handicraft stuff in the world. Indian industry declined rapidly and no corresponding modern industrial base was allowed to take its place.
- **British Policy of systematic deindustrialisation** – To reduce India to the **status of a mere exporter of important raw materials (Feeder Economy)** for the upcoming modern industries in Britain.
- To turn India into a **market for the finished products** of Britain's industries so that their continued expansion could be ensured.
- **Decline of the Indian handicraft** industries created huge **unemployment** and **rural distress** in India.
- **Cotton and jute textile mills** were mainly concentrated in the **western parts** of the country – Maharashtra and Gujarat (Indians).
- During the second half of the nineteenth century, modern industry began to take root in India but its progress remained very **slow and stagnant**.
- **Iron and steel industries began to rise up** – The Tata Iron and Steel Company (TISCO) was incorporated in **1907**. Other industries like sugar, cement, paper etc. came up after the Second World War.
- **Capital goods industry** – Though necessary to help promote further industrialisation, this industry did not bloom. **Note: Capital goods industry – means industries which can produce machine tools which are, in turn, used for manufacturing products for consumption.**
- Growth rate of the new industrial sector and its contribution to the Gross Domestic Product (GDP) remained dismal and piecemeal (unsystematic).
- The Indian Industrial sector thus, was **deprived of modernisation, diversification, capacity building and public investment**.

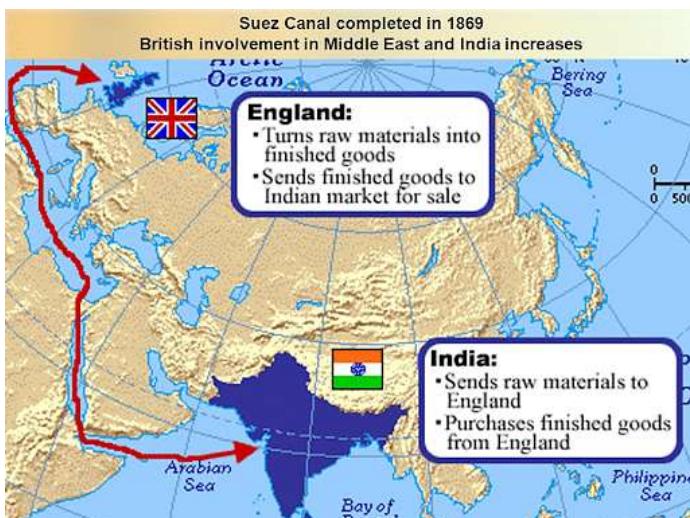
Industrial Sector



FOREIGN TRADE

- India has been an **important trading nation since ancient times**.
- **British Restrictive policies** of goods production, trade and tariff made India an exporter of primary products (raw silk, cotton, wool, sugar, indigo, jute etc.) and an importer of finished consumer goods (cotton, silk and woollen clothes and capital goods like light machinery) produced in the factories of Britain.
- Britain maintained a **monopoly** control over India's exports and imports, leading to **more than half of India's foreign trade to be restricted to Britain** while the rest was allowed with a few other countries like China, Ceylon (Sri Lanka) and Persia (Iran).
- The **opening of the Suez Canal** further intensified British control over India's foreign trade.
- The **expenses incurred by an office (India Office)**, set up by the colonial government in Britain and **expenses on war fought by the British government** were utilised from revenue generated from India.

Note: The **India Office** was a **British** government department established **in London in 1858** to oversee the **administration, through** a Viceroy and other officials, of the Provinces of **British India**.



Foreign Trade



DEMOGRAPHIC TREND

Demography-the statistical characteristics of human population like Age, Ethnicity, gender, employment, education, income, marriage rates, birth and death rates etc.

- First documentation of the population of British India was conducted through the 1881 (**decennial**) census. This census revealed the **unevenness** in India's population growth.
- **Overall literacy level:** less than 16 per cent; (the female literacy level was at about seven per cent)
- **Public health facilities:** either unavailable to the larger population or, when available, were grossly inadequate.
- Rampant occurrence of **water and air-borne diseases** taking a huge toll on life
- The overall **mortality rate was very high** and the infant mortality rate was quite alarming – about 218:1000
- Life expectancy was also very low – 32 years
- **Extensive poverty** prevailed in India during the colonial period which contributed to the worsening profile of India's population of the time.

Demographic Conditions

First Census @ 1881

Unevenness in population growth

before and after 1921 - Changes

Social development indicators - not upto the mark

Literacy rate < 16%

Female literacy < 7%

lack of public facilities - water and air borne diseases

Result: high mortality rate

IMR - too high

Life Expectancy - 32 yrs

Extensive poverty

OCCUPATIONAL STRUCTURE

- Occupational structure denotes the distribution of working persons across different industries and sectors
- **Very little signs of changes** in occupational structure witnessed during the colonial period.
- **Largest share of the workforce** (about 70-75 %) witnessed in **agriculture**.
- Manufacturing and the services sectors accounted only 10 and 15-20 % growth in regional variation respectively.
- The parts of the then **Madras Presidency, Maharashtra and West Bengal** witnessed a **decline in the dependence of the workforce on the agricultural sector** with some increase in the manufacturing and the services sectors
- **Orissa, Rajasthan and Punjab** experienced an increase in the share of workforce in agriculture during the same time.

Occupational Structure (Labour Distribution %) 1950/51

Agriculture	72.3
Industry (Total)	10.7
Trade and Transport	7.7
Services	9.3

for

INFRASTRUCTURE

- To sub-serve various colonial interests (not to provide basic amenities to the people), development of basic infrastructure (railways, ports, water transport, posts and telegraphs) took place in India.

Roads—

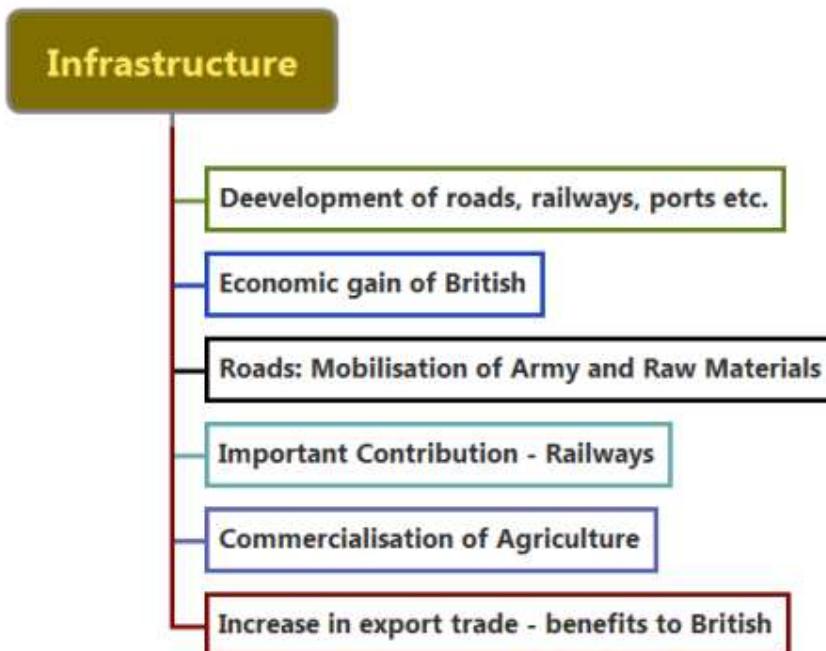
- To mobilize the **army** within India
- To draw out **raw materials** from the countryside to the nearest railway station or to the ports to send them far away England
- To **reach out to the rural areas** during the rainy season.

Railways—

- Introduced in 1850s by **Lord Dalhousie**
- Enabled people to undertake long distance travel thereby **breaking geographical and cultural barriers**
- **facilitated commercialisation** of Indian agriculture which adversely affected the comparative self-sufficiency of the village economies in India
- Volume of India's export trade expanded with benefits rarely being accrued to the Indian people
- Social benefits outweighed the country's huge economic loss with the railways needing further upgradation and expansion.

Electric telegraph served the purpose of maintaining law and order in remotest parts.

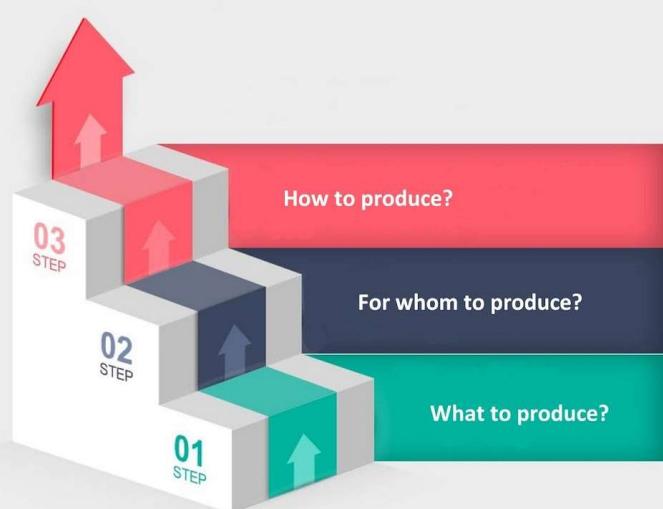
Postal services were useful but remained inadequate.



CLASS - 10

This chapter will demystify the following concepts:

- ✓ Different types of economic systems- Capitalist, Socialist, Mixed
- ✓ Indian Economy Post Independence (1950 – 1990)
- ✓ Land Reforms
- ✓ Subsidies
- ✓ Industry & Trade Policies
- ✓ Nehru- Mahalanobis Model of Growth
- ✓ Rao-Manmohan Model of Growth



Economic System deals with 3 type of Questions:

1. **What to produce ?**
2. **For whom to produce ?**
3. **How to produce ?**

What to Produce relates to-

- Selection of goods to be produced
- According to Market Analysis
- As Per Consumer's demand

For whom to produce relates to- Part of the society for whom goods are to be produced:

- According to the distribution of Income
- According to the availability of resources

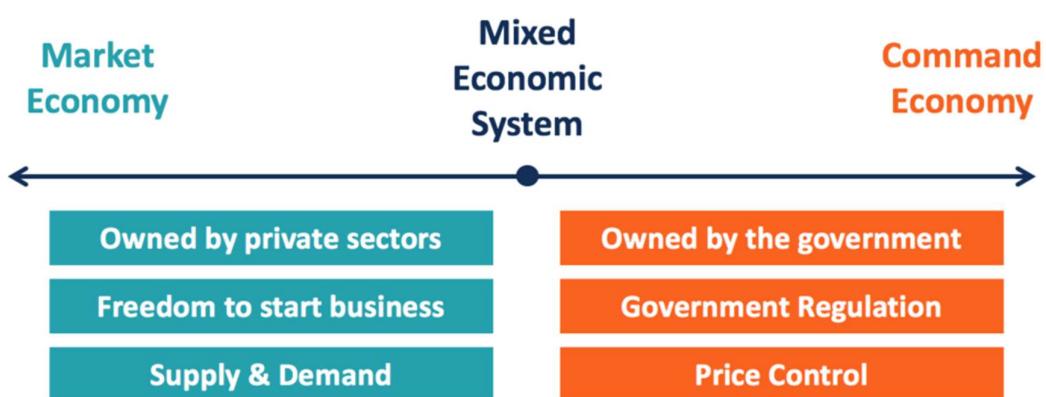
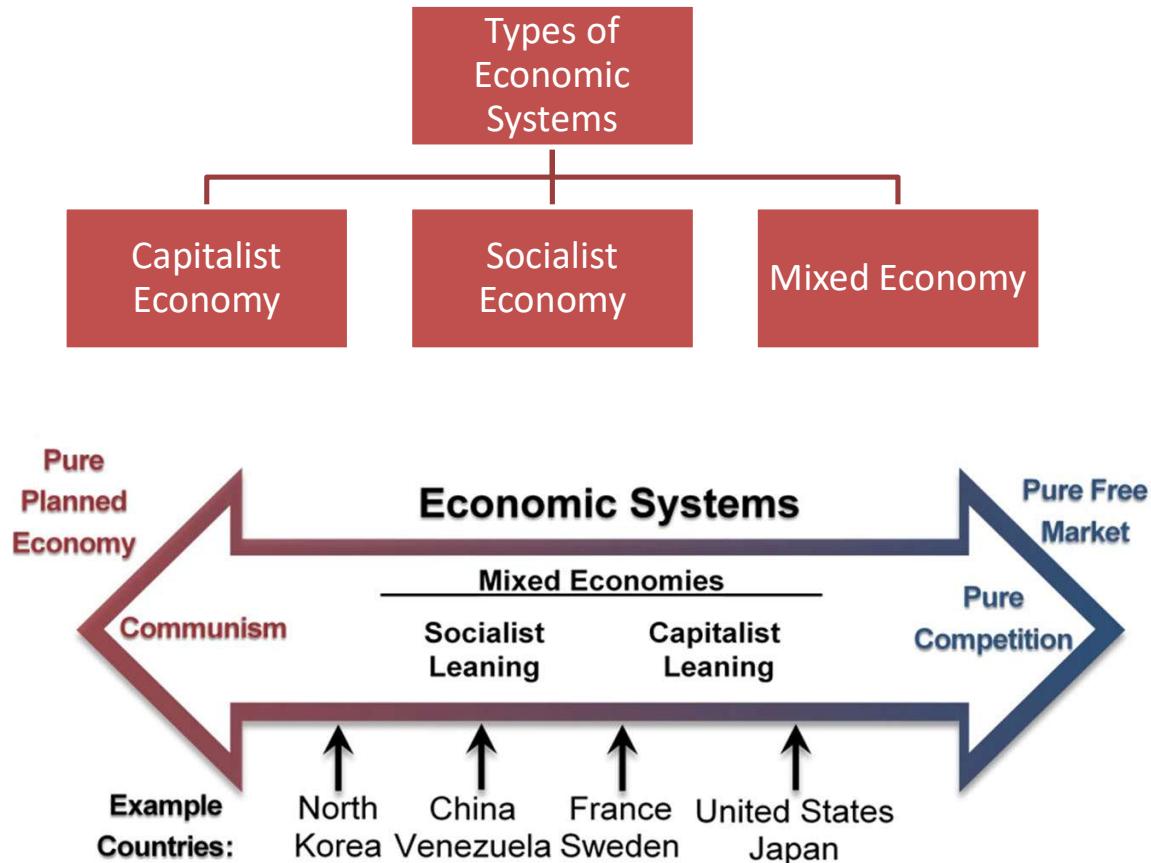
How to produce relates with - Selection of the technique of Production:

1. **Labour Intensive Technique**
 - Use of more Labour than Capital
 - Labour>Capital

2. Capital Intensive Technique

- Use of more Capital than Labour
- Capital > Labour

Economic Systems may be broadly classified into 3 categories-



CAPITALIST (MARKET) ECONOMY SYSTEM

- In a capitalist system, the products manufactured are divided among people not according to what people want but on the **foundation of Purchasing Power (PP)** – which is the ability to buy products and services.
- Which means an individual needs to have the money with him to buy the goods and services.
- **Example** – The affordable housing for the underprivileged is much required but will not include demand in the market because the needy do not have the buying power to back the demand.
- Therefore, the commodity will not be manufactured and provided as per **market forces**.

FEATURES	MERITS	DEMERITS
Freedom of Enterprise- every individual is free to make his own economic choices	Increase in production	Leads to monopoly
Right to Private Property – Every individual can acquire any amount of property	Flexible system	Inequalities
Freedom of choice to the consumers	Optimum use of resources	Depression and unemployment
Competition among producers and sellers	Progress and prosperity	Insufficient production
More scope for innovation	Quality products at low costs	Class conflict

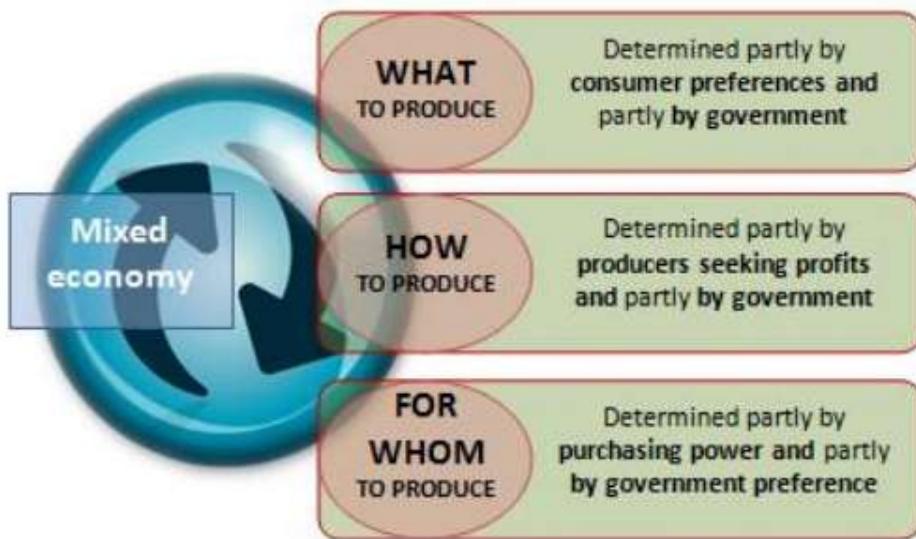
SOCIALIST ECONOMIC SYSTEM

- In a socialist society, the **government determines what products are to be manufactured** in accordance with the requirements of society.
- It is believed that the **government understands what is appropriate for the citizens** of the country, therefore, the passions of individual buyers are not given much attention.
- The government concludes how products are to be created and how the product should be disposed of.
- In principle, **sharing under socialism is assumed to be based on what an individual needs** and not what they can buy.
- Better allocation of the resources and equitable distribution of wealth & social justice.
- Existence of economic planning
- Planned and definite economic role of government ensures that all citizens have the means to achieve a minimum living standard.
- Consumers do not have absolute freedom of choice.
- Inefficient Public sector. Breeding ground for corruption, red-Tapism, and favouritism. Socialism does not promote hard work or any creativity in its citizens.

Note: Red tapism denotes the practice of requiring excessive paperwork and tedious procedures before official action can be considered or completed

MIXED ECONOMIC SYSTEM

- It is a golden **combination** of a command (Socialist) economy and a market (Capitalist) economy.
- For this purpose, the mixed economic systems are also called **dual economic systems**.
- However, there is **no sincere method to determine a mixed system**, sometimes the word represents a market system beneath the strict administrative control in certain sections of the economy.



GOALS AND POLICIES OF MIXED ECONOMIC SYSTEM

FEATURES	MERITS	DEMERITS
Combination of a command economy and a market economy.	Healthy competition in the market.	The public sector gets maximum benefits whereas the private sector remains controlled.
Coexistence of All Sectors- In a mixed economy all three sectors coexist in harmony	Enjoys the advantages of central economic planning	Inefficient Planning – large sectors of the economy remain outside the control of the government.
Social Welfare- aims to reduce the wealth gap in the country and fight the inequalities.	Economic freedom to ownership of property and choice of goods and services.	Ineffectiveness of Sectors- private sector does not get full freedom, hence it becomes ineffective. This leads to ineffectiveness among the public sector.
Economic Planning – General guideline for economic growth and prosperity of the nation.	Existence of price mechanism. So the allocation of resources is more scientific and beneficial to the economy.	Constant fear of nationalisation of the private sector.

DIFFERENCE BETWEEN CAPITALIST, SOCIALIST AND MIXED ECONOMIC MODELS

PARAMETER	CAPITALIST	SOCIALIST	MIXED
Ownership of Property	Private	Public	Both public and private
Price Determination	determined by the market forces of demand and supply	Determined by the central planning authority.	Determined by central planning authority and demand & supply.
Motive of Production	Profit motive	Social welfare	The profit motive in the private sector and welfare motive in the public sector
Role of Government	No role	Complete role	Full role in the public sector and limited role in the private sector
Competition	Exists	No competition	Exist only in the private sector
Distribution of income	Very Unequal	Quite Equal	Considerable inequalities exist.

WHAT TYPE OF ECONOMY IS INDIA?

- India has a **mixed economy**. Nearly half of India's working population is engaged in **agriculture**, the signature of a traditional economy.
- **One-third of its workers** are employed by the **services industry**, which contributes two-third of India's output.
- The productivity of this segment is made possible by India's shift towards a market economy.
- Since the 1990s, India has **deregulated** several industries. It has **privatized** many state-owned enterprises, and **opened doors** to foreign direct investment.

REASONS FOR ADOPTION OF MIXED ECONOMY

- To maintains a **healthy balance** between the public and the private sector. This ensures cooperation and competition between them which is conducive to attain high growth targets.
- Through its pricing mechanisms as well as freedoms of production, consumption, occupation and the presence of a profit motive, it ensures that there is an **efficient allocation of resources** in the economy.
- By working towards **minimizing the inequalities** of income, wealth etc.
- Eliminating **unemployment and poverty**.
- Mixed economy maximizes social welfare. It has all the main features of a welfare state.

Indian Economy 1950 – 1990

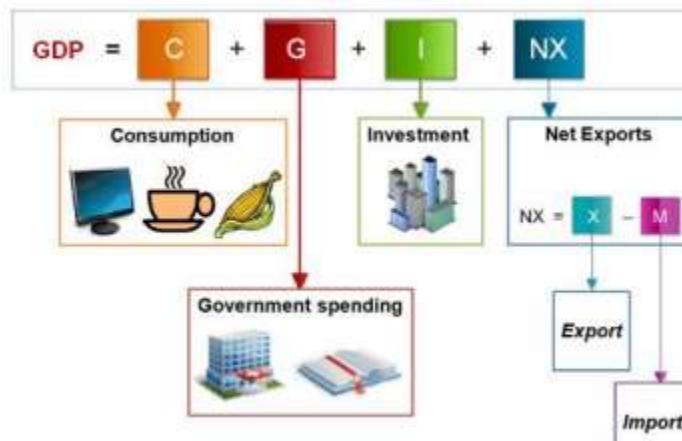
POST-INDEPENDENCE ERA IN INDIAN ECONOMY

MEANING OF PLAN

- A plan spells out how the resources of a nation should be put to use. It should have some **general goals** as well as **specific objectives** which are to be achieved within a **specified period of time**;
- In India plans are of **five years duration** and are called **five-year plans** (we borrowed this from the former Soviet Union).
- Our plan documents **specify the objectives to be attained in the five years of a plan** and what is to be achieved over a **period of twenty years** (called as perspective plan)
- In 1950, the **Planning Commission** was set up with the Prime Minister as its Chairperson and the era of five-year plans had begun.

POST INDEPENDENCE PLANNING

- **Economic Programme Committee (EPC)** – formed by All India Congress Committee (AICC) with Nehru as its chairman. The aim of this committee was to make a plan which could **balance private and public partnership and urban and rural economies**. The EPC recommended in 1948 to form a **permanent Planning Commission** in India.
- In March 1950 in pursuance of declared objectives of the Government, the **Planning Commission was set up by a Resolution** (Hence Executive body which is neither constitutional nor statutory), with **Jawaharlal Nehru as the first Chairman** of the Planning Commission.
- The Planning Commission was charged with the responsibility of **making assessment of all resources** of the country, **augmenting deficient resources**, **formulating plans** for the most effective and **balanced utilization of resources** and determining priorities.



Democratic Socialism: Nehru was greatly influenced by the achievements of Soviet Planning; The philosophy was to not only check the growth of monopolistic tendencies of the private sector but also provide freedom to the private sector to play for main objective of social gain rather than economic gain.

Central planning distributes common goods, such as mass transit, housing, and energy, while the free market is allowed to distribute consumer goods.

THE GOALS OF FIVE YEAR PLANS



GROWTH

- Growth refers to an increase **in the country's capacity** to produce the output of goods and services within the country.
- Good indicator of economic growth is the **steady increase in the country's Gross Domestic Product (GDP)** – the market value of all the goods and services produced in the country during a year.
- The GDP of a country is **derived from the different sectors** (Primary, Secondary and Tertiary) of the economy – the contribution made by each of these sectors makes up the structural composition of the economy.

MODERNIZATION

- Steps taken by a factory to increase output by using a new type of machine and technology is called modernization.
- Modernisation also leads to changes in social outlook such as the recognition that women should have the same rights as men.

SELF RELIANCE

- A nation can promote economic growth and modernisation by using its own resources or by using resources imported from other nations.
- The **first seven five-year plans** gave **importance to self-reliance** which means avoiding imports of those goods which could be produced in India itself, **in order to reduce our dependence** on foreign countries, especially for food.
- There was a fear that dependence on imported food supplies, foreign technology and foreign capital may make **India's sovereignty vulnerable to foreign interference** in our policies.
- Recently, PM stressed for a self-reliant **India (Atma Nirbhar Bharat)** in the backdrop of the Covid-19 outbreak.

EQUITY

To ensure that **the benefits of economic prosperity reach the poor sections** as well instead of being enjoyed only by the rich – **every Indian should be able to meet his or her basic needs** such as food, a decent house, education and health care; and reducing inequality in the distribution of wealth.

Addressing Agricultural Needs

Agriculture refers to all those activities which are related to the cultivation of land for the production of crops; food crops and non-food crops.

Importance of Agriculture in the Indian Economy:

- Contribution to GDP
- Supply of consumption goods

- Employment
- Industrial raw material
- Contribution to international trade
- Contribution to domestic trade
- Wealth of the nation

Problems of Indian Agriculture:

- Lack of permanent means of irrigation
- Deficiency of finance
- Conventional techniques
- Small and scattered holding

Reforms in Indian Agriculture:

- Technical Reforms
- Use of HYV seeds
- Use of chemical fertilisers
- Scientific farm management practices
- Mechanised means of cultivation

Land Reforms

- The term ‘land reforms’ specifically refers to land tenure reforms. The word tenure, derived from the Latin word “teneo”, means ‘to hold’. Therefore, land tenure is used to refer to the **conditions under which land is held**.
- Land reforms are visualized as an **instrument of social justice** as they seek to do away with exploitative relationships characterized by sharp inequalities between rich landowners and impoverished peasants with no security of tenure.
- It is a **step against the concentration of landholdings in the hands** of a few absentee/non-cultivating owners, through the imposition of ceilings on the size of holdings, which can be owned by a family.
- **Abolition of Zamindari:** It was successful in states like West Bengal and Kerala due to political will and strong rural mass social base; but failed in other states due to lack of political will, bureaucratic apathy, corruption and zamindar's influence the implementation process.
- **Tenancy rights:**
 - The subsequent land reforms recognized the rights of tenants. According to the **Second Five Year Plan**, abolition of intermediary tenures and bringing the tenants into direct relations with the state would give the tiller of the soil his rightful place in the agrarian system and provide him with full incentives for increasing agricultural production.
- **Land ceiling:**
 - The term ‘ceiling on land holdings’ refers to the legally stipulated maximum size beyond which no individual farmer or farm household can hold any land. Like all other land reforms measures, the objective of such a ceiling is to promote economic growth with social justice.

- **Bhoodan and Gramdaan Movements**
- The Bhoodan movement was launched in 1951, immediately after the peasant uprising in Telengana region of Andhra Pradesh, and after some years, another movement known as Gramdan came into being in 1957.
 - The objective was to **persuade landowners and leaseholders** in each concerned village to **renounce their land rights**, after which all the lands would become the property of a village association for the egalitarian redistribution and for purpose of joint cultivation.
 - **Vinoba Bhave** hoped to eliminate private ownership of land through Bhoodan and Gramdan and maintained that the movement would go a long way to ensure the just redistribution of land, the consolidation of holding and their joint cultivation.
 - However, the movement **failed to achieve its targeted objectives** and the degree of success in respect of both land acquisition and land distribution was very limited.
 - In most cases, the village landlords donated only those pieces of land which were either **unfit for cultivation** or were in dispute with tenants or government

But there still were cases wherein:

The zamindars continued to own large areas of land (usage of loopholes in legislation) Tenants were evicted and the landowners claimed to be self-cultivators (the actual tillers)

Hurdles faced by the land ceiling legislation

- The big landlords challenged the legislation in the courts delayed its implementation
- Used this delay to register their lands in the name of close relatives to escape from the legislation

Success of Land reforms witnessed: Kerala and West Bengal had governments committed to the policy of land to the tiller

Green Revolution

During independence:

- About 75% of the country's population dependent on agriculture
- Suffered low productivity → use of old technology + absence of required infrastructure
- India's agriculture → dependent upon monsoon; and if the monsoon fell short the farmers were in trouble (if no access to irrigation facilities)

1st phase of the green revolution (approximately mid 1960s up to mid-1970s)

- The use of HYV seeds was restricted to the more affluent states such as Punjab, Andhra Pradesh and Tamil Nadu.
- Use of HYV seeds proved beneficial for the wheat-growing regions only

2nd Phase of the green revolution (mid-1970s to mid-1980s):

- Spread of the HYV technology to a larger number of states and this benefited more variety of crops thus, enabling India to achieve self-sufficiency in food grains
- To increase growth in agricultural output & contribute to the country's economy—it is important to keep a substantial amount of agricultural produce to be sold in the market (and not consumed by the farmers himself)
- The portion of agricultural produce which is sold in the market by the farmers is called marketed surplus

Marketable Surplus: It refers to surplus of farmer's output over and above his own farm consumption. Thus, Marketable surplus of wheat = Output of wheat – On farm consumption of wheat.

A good proportion of the rice and wheat produced during the green revolution period (available as marketed surplus) was sold by the farmers in the market which led to decline in the price of food grains.

Low-income groups - Benefited from this decline in relative prices (spend a large percentage of their income on food)

Risks involving technology:

- Possibility of increase in the disparities between small and big farmers—since only the big farmers could afford the required inputs, thereby reaping most of the benefits of the green revolution
- HYV crops were more prone to attack by pests

Fears remained 'fears'— because of the steps taken by the government:

- Provided loans at a low interest rate to small farmers
- Subsidised fertilisers so that small farmers could also have access to the needed inputs; since the small farmers could obtain the required inputs, the output on small farms equalled the output on large farms in the course of time benefited the small as well as rich farmers
- Risks due to pest attack were minimised with the services rendered by research institutes established by the government

Subsidies

Need of Subsidies

- Necessary to use subsidies to provide an incentive for adoption of the new HYV technology by small farmers in particular—to encourage farmers to test the new technology

Case against continuing subsidies—

- Once the technology is found profitable and is widely adopted, subsidies should be phased out since their purpose has been served—meant to benefit the farmers but a substantial amount of fertiliser subsidy also benefits the fertiliser industry; and among farmers, the subsidy largely benefits the farmers in the more prosperous regions
- Ends up not providing benefit to the target group and it is a huge burden on the government's finances

Need to continue with agricultural subsidies—

Farming in India continues to be a risky business as most of the farmers are very poor and they will not be able to afford the required inputs without subsidies will increase the inequality between rich and poor farmers and violate the goal of equity

Correct way forward:

Ensure that only the poor farmers enjoy the benefits

Observation: As a nation becomes more prosperous, the proportion of GDP contributed by agriculture as well as the proportion of population working in the sector declines considerably.

Between 1950 and 1990: The proportion of GDP contributed by agriculture declined significantly but not the population depending on it (67.5 per cent in 1950 to 64.9 per cent by 1990)—the industrial sector and the service sector did not absorb the people working in the agricultural sector.

Industry & Trade

Poor nations can progress only if they have a good industrial sector as industry provides employment which is more stable than the employment in agriculture

Industrial sector promotes modernisation and overall prosperity → Hence, India gave more emphasis on growth of Industrial Sector in the Five Year Plans.

Post-Independence: Need to expand the industrial base with a variety of industries if the economy was to grow.

Market and Role of State in Indian Industrial Development:

- At the time of independence—lack of capital to undertake investment in industrial ventures required for the development of our economy; small market being unable to encourage industrialists to undertake major projects → state had to play an extensive role in promoting the industrial sector
- Development of the economy on socialist lines: Policy of the state controlling the commanding heights of the economy—the state would have complete control of those industries that were vital for the economy
- Policies of the private sector needed to be complimentary to those of the public sector, with the public sector leading the way

Industrial Policy Resolution 1956 (IPR 1956):

Formed the basis of the Second Five Year Plan—to build the basis for a socialist pattern of the society Classification of Industries—three categories:

1. 1st: Industries which would be exclusively owned by the state
2. 2nd: Industries in which the private sector could supplement the efforts of the state sector, with the state taking the sole responsibility for starting new units
3. 3rd: The remaining industries which were to be in the private sector; was kept under state control through a system of licenses

- Only with the issuance of license could any industry be established—to promote industry in backward regions → it was easier to obtain a license if the industrial unit was established in an economically backward area
- Industries Were given certain concessions such as tax benefits and electricity at a lower tariff → To promote regional equality
- Even an existing industry had to obtain a license for expanding output or for diversifying production (producing a new variety of goods) → to ensure that the quantity of goods produced was not more than what the economy required
- License to expand production was given only if the government was convinced that the economy required the larger quantity of goods.

Trade Policy—Import Substitution

The industrial policy that we adopted was closely related to the trade policy

first seven FYPs: Trade was characterised by an inward-looking trade strategy → Import substitution; aiming at replacing or substituting imports with domestic production

Protection from imports took two forms: Tariffs and Quotas

Tariffs: Tax on imported goods; they make imported goods more expensive and discourage their use.

Quotas: Specify the quantity of goods which can be imported. Both restrict imports and, therefore, protect the domestic firms from foreign competition.

Policy of protection

- Based on the notion that industries of developing countries are not in a position to compete against the goods produced by more developed economies—assumed that if the domestic industries are protected, they will learn to compete in the course of time
- Feared the possibility of foreign exchange being spent on import of luxury goods if no restrictions were placed on imports

OBJECTIVES OF PLANNING

- **Economic and social planning** and ensuring pattern of the ‘welfare state’.
- Sustainable economic growth.
- Poverty alleviation
- **Employment generation** and self-employment
- **Modernising** the traditional economy was set as a foremost objective of planning especially the agriculture sector
- Accord due place and weightage to all the **aspirations of the Preamble**, the **Fundamental Duties**, the **Fundamental Rights** and the **Directive Principles of the State Policy** – adequate means of livelihood, opportunities for employment and a socio-economic order based on justice and equality.
- **Self-reliance** – an effort to strike against a subordinate position in the world economy.
- Ensuring **economic equality**

FINANCIAL RESOURCES FOR PLANNING

- Central budget and state budgets – revenue and capital receipt side
- Public Sector Enterprises (PSEs)
- Domestic private sector
- **Gross Budgetary Support** – This is an amount from the central budget which goes to fund the planned investment during the plan period.
- **Foreign Direct Investment (FDI)** in India

PRIME MOVING FORCE – AGRICULTURE VS. INDUSTRY

- The government of the time **opted for industry** to be India’s prime moving force of the economy.
- Given the available resource base it seems an **illogical decision as India lacked all those prerequisites** which could suggest the declaration of industry as its prime mover –
- Almost no presence in the infrastructure sector.
- Lack of robust infrastructure industries, i.e., iron and steel, cement, coal, crude oil, oil refining and electricity.
- Lack of availability of investible capital – either by the government or the private sector.
- Absence of required technology to support the process of industrialisation and lack of research and development.
- Lack of skilled and semi-skilled manpower.

- Lack of entrepreneurship spirit among the people.
- Lack of a market for industrial goods.
- Many other socio-psychological factors which acted as negative forces for the proper industrialisation of the economy.

The obvious choice for India would have been the agriculture sector as the prime moving force of the economy because:

- The country was having the natural resource of fertile land which was fit for cultivation.
- Human capital did not require any kind of higher training.
- Higher population in rural areas with involvement in agriculture
- Just by organising our land ownership, irrigation and other inputs to agriculture, India could have gone for better prospects of development.
- Once the masses were able to achieve a level of purchasing capacity through remunerative income from agriculture, India could have gone for the expansion of industries.

Following developments were in favour of industrialisation –

- By choosing industry as the prime moving force, India opted to industrialise the economy as well as modernise the traditional mode of farming.
- The dominant ideology around the world as well as in the WB (World Bank) and the IMF (International Monetary Fund) was in favour of industrialisation as a means to faster growth and development.
- The Second World War had proved the supremacy of defence power – which needs support not just of science and technology, but also of a robust industrial base.
- India also required a powerful defence base for herself as a deterrent force.
- By the time of independence, the might of industrialisation was already proven and there were no doubts regarding its efficacy.
- A major shift took place in the Indian economic landscape, when the government announced in **2002** that from now onwards, in place of industry, **agriculture will be the prime moving force of the economy**.
- According to the Planning Commission such a policy shift will **solve the following major challenges** faced by the economy:
 - Economy will be able to **achieve food security** with the increase in agricultural production.
 - The agricultural surplus will **generate exports in the globalising world** economy benefiting out of the WTO (World Trade Organisation) regime.
 - The challenge of **poverty alleviation** will be solved to a great extent as the emphasis will make agriculture a **remunerative occupation** and induce **growth in the rural economy** by generating more gainful employment.

PLANNED AND MIXED ECONOMY FOR INDIA

- Post-independence, India was **declared to be a planned and a mixed economy**.
- India was not only facing **regional disparities** at the level of resources, but **inter-regional disparities** were also prevalent, since centuries.
- Deeply entrenched **mass poverty** could only be remedied once the government started the process of economic planning.
- The **abject poverty of the masses** made the government go for planning so that it could play an **active role in the allocation of resources** and mobilise them for **equitable growth and development**.

- Although, India was declared a Quasi-federal country, but in the process of planning, the authority of regulation, directing and undertaking economic activities got more and more centralised in the Union government.

Following factors made pressing points to opt for planned and mixed economy –

- Great Depression (1929) and the reconstruction challenges after the second world War favoured a state intervention in the economy
- In the **1950s and 1960s**, the dominant view among policymakers around the world was in favour of an active role of the state in the economy – **Soviet Union** and the **East European countries** were notable examples.
- A dominant role of the State in the economy to **neutralise market failure situations**
- The dominant force behind planning in India, was **Nehru** himself who had **strong socialist leanings**.

WHY EMPHASIS ON PUBLIC SECTOR ?

- The state was to be given an **active and dominant role** in the economy, it was very much decided by the time India became independent.
- Naturally, there was going to be a giant structure of the government-controlled enterprises to be known as the **PSUs**.

The reason behind the ambitious expansion of the PSUs was in the face of the following major requirements:

- Infrastructural Needs
- Industrial Needs
- Employment Generation
- Development of the Social Sector
- Emergence of the Private Sector

NEHRU – MAHALANOBIS MODEL OF GROWTH

- The turning point in India's planning strategy came with the **second five-year (1956- 61) plan**.
- The model adopted for the plan is known as the **Nehru-Mahalanobis strategy** of development as it was **articulated by Jawahar Lal Nehru's vision** and P.C. Mahalanobis was its chief architect.
- P C Mahalanobis an Indian scientist and statistician. He was one of the members of the first Planning Commission of free India
- The **Mahalanobis model of growth** was based on the **predominance of the basic goods** (Capital goods or investment goods that are used to make further goods).
- Its theme was that- If industrialization is to be rapid enough, the **country must aim at developing basic industries and industries which make machines to make the machines needed for further development**.
- It was based on the premise that **it would attract all round investment and result in a higher rate of growth of output**.
- That will **develop a small scale and ancillary industry** to boost employment generation, poverty alleviation, exports etc.

Other elements of the model were –

- **Import substitution** – Protective barriers against foreign competition to enable Indian companies to develop domestically produced alternatives for imported goods and to reduce India's reliance on foreign capital.
- **Public sector active in vital areas** of the economy including atomic energy and rail transport.
- **A vibrant small-scale private sector** driving consumer goods production for dispersed and equitable growth and producing entrepreneurs.

Outcomes of the model –

- In terms of the core objective of rising up the **rate of growth of industrial production**, the strategy was successful.
- Rate of growth of overall industrial production picked up.
- The strategy laid the **foundation for a well-diversified industrial structure** within a reasonably short period and this was a major achievement.
- It gave the **base for self-reliance**.

Criticism –

- **Visible imbalances** between the growth of the heavy industry sector and other spheres like agriculture and consumer goods etc.
- It **heavily relied on trickle-down effect** benefits of growth will flow to all sections in course of time.
- Eradication of poverty was slow and incremental.

RAO-MANMOHAN SINGH MODEL OF GROWTH

Economic reforms since 1991 are based upon Rao-Manmohan model (Narsimha Rao – PM and Manmohan Singh – Finance minister)

Features of model

- Selectively dismantle controls and permits in order to permit the private sector to invest liberally.
- Reorient the role of state in economic management. State should refocus on social and infrastructural development.
- External sector liberalisation in order to integrate the Indian economy with the global economy to benefit from the resource flow and competition.
- Open up the economy and create competition for PSEs – for better profitability, productivity and efficiency.
- **Forex reserves accumulation** thus alleviating the **Balance of Payment pressures** and the foreign flows – **FDI and FII increased**. Indian economy became competitive.
- Its success is seen in the more than 6.5% average annual rate of growth of the economy during the 8th Plan (1992-1997). **Forex reserves accumulated leaving the BOP crisis in history**.

CHAPTER -11

This chapter will demystify the following concepts:

- ✓ **Economic Crisis**
- ✓ **Economic Reforms**
- ✓ **Liberalization, Privatization & Globalization**
- ✓ **License Raj**
- ✓ **Navaratnas, Maharatnas & Miniratnas**



- In 1991, India met with an economic crisis relating to its external debt — the government was not able to make repayments on its borrowings from abroad.
- When expenditure is more than income, the government borrows to finance the deficit from banks and also from people within the country and from international financial institutions.
- Foreign exchange reserves, which we generally maintain to import petrol and other important items, dropped to levels that were not sufficient for even a fortnight.
- When we import goods like petroleum, we pay in dollars which we earn from our exports.
- The crisis was further compounded by rising prices of essential goods.
- The origin of the financial crisis can be traced from the **inefficient management of the Indian economy** in the 1980s. Government's expenditure was more than its income.

Development Policies

- Development policies required that even though the revenues were very low, the government had to overshoot its revenue to meet problems like unemployment, poverty and population explosion.
- The continued spending on development programmes of the government did not generate additional revenue.
- Govt. was not able to generate sufficiently from internal sources such as taxation.
- The income from public sector undertakings was also not very high to meet the growing expenditure.

ECONOMIC CRISIS OF 1980s

- **Government expenditure began to exceed its revenue** by such large margins that meeting the expenditure through borrowings became unsustainable.
- There was a sharp **rise in the prices** of many essential goods.
- **Imports grew at a very high rate** without matching growth of exports.
- **Foreign exchange reserves declined** to a level that was not adequate to finance imports for more than two weeks.
- **No sufficient foreign exchange** to pay the interest to international lenders.

Support from IBRD and IMF

- India approached the International Bank for Reconstruction and Development (IBRD), popularly known as World Bank and the International Monetary Fund (IMF), and received \$7 billion as loan to manage the crisis.

- For availing the loan, these international agencies expected India to liberalise and open up the economy by removing restrictions on the private sector, reduce the role of the government in many areas and remove trade restrictions.
- India agreed to the conditionalities of World Bank and IMF and announced the New Economic Policy (NEP).
- To avert and mitigate the crisis, India approached the International Bank for Reconstruction and Development (IBRD) (World Bank) and the International Monetary Fund (IMF) and received **\$7 billion** as loan to manage the crisis.

Measures to avail the loan from IMF and World Bank

1. Liberalisation – Removing restrictions on the private sector
2. Privatisation – Reducing the role of the government in many areas
3. Globalisation - Removing trade restrictions

CONDITIONS OF IMF FOR INDIA

- Devaluation of the rupee by 22 percent.
- Drastic reduction in the peak import tariff from the prevailing level of 130 per cent to 30 per cent.
- Excise duties to be hiked by 20 percent to neutralize the revenue shortfalls due to the custom cut.
- All government expenditure to be cut down by 10 per cent, annually.
- India agreed to the conditionalities of World Bank and IMF – announced the **New Economic Policy (NEP)** – which consisted of following economic reforms:
 1. Creating a more competitive environment in the economy by removing the barriers to entry and growth of firms;
 2. Introduced liberalization with a view to integrate the Indian economy with the world economy;
 3. To remove restrictions on FDI as also to free the domestic entrepreneur from the restrictions of Monopolies and Restrictive Trade Practices (MRTP) Act;
 4. To unleash the Indian industrial economy from the web of unnecessary bureaucratic controls;
 5. To reduce the load of public sector enterprises which have shown a very low rate of return or which were incurring losses over the years.

REASONS FOR ECONOMIC REFORMS

- **Rise in Prices** – Inflation surged from **7% to 16.7%**
- **Rise in Fiscal Deficit** – Due to increase in **non- development expenditure** fiscal deficit of the Government had been increasing. This was accompanied by **rise in public debt and resultant interest**.
- **Adverse Balance of Payments**: When foreign exchange falls short for payment or total imports exceeds total exports, problems of adverse balance of payments arise.
- **Iraq-Kuwait War 1990-91** – This led to **rise in petrol prices**. The **flow of remittances from Gulf countries stopped**.

- **Dismal performance of the PSUs** – These were not performing well **due to political interference** and became a big liability for the Government.
- **Fall in Foreign Exchange Reserves** – Indians foreign exchange reserve fell to **lowest in 1990-91** and it was **insufficient to pay for an import bill for 2 weeks**

Balance of Payments of a country is the record of all economic transactions between the residents of the country and the rest of world in a particular period.

Import cover – measures the number of months of imports that can be covered with foreign exchange reserves (FOREX) available with the central bank of the country.

REFORM MEASURES

1. Macroeconomic Stabilisation Measures

- These include all those economic policies which intend to **boost the aggregate demand** in the economy – be it domestic or external.
- For enhancing domestic demand, **increasing the purchasing power** of the masses is essential, which connotes an **emphasis on the creation of gainful and quality employment**

2. Structural Reform Measures

- Measures that include **all the policy reforms** which have been initiated by the government **to boost the aggregate supply of goods and services** in the economy.
- It naturally **entails unshackling the economy** so that it may search for its own potential of enhanced productivity.
- For the purchasing capacity of the people to be increased, the **economy needs increased income**, which comes from increased levels of activities.
- Income so increased is later **distributed among the people** whose purchasing power has to be increased.
- This will take place by properly initiating a suitable set of macroeconomic policies.

LPG FRAMEWORK OF THE REFORMS

The process of reforms in India had to be completed via a roadmap of three processes – **liberalisation, privatisation and globalisation (LPG)**.

LIBERALIZATION

- The term “liberalization” in this context implies **economic liberalization**.
- This policy connotes that **greater freedom is to be given to the entrepreneur of any industry, trade or business** and that **governmental control on the same be reduced to the minimum**.
- Liberalisation was introduced to **put an end to regulations and restrictions** and **open up various sectors** of the economy.
- Only key **issues of welfare** and other regulatory mechanisms are left with the state.

License Raj

License Raj refers to regulations and accompanying bureaucracy that were required to set up and run Indian businesses in India between 1951 and 1991. The Government resorted to licensing system so that it can maintain control over industries as per the Industries Development and Regulation Act, 1951.

What is a License?

A license refers to a written permission granted by government to a firm which mentions what product can be manufactured by the firm. Further, license also includes various other particulars such as the place where factory is to be located; what products to be produced; what is maximum quantity that can be produced; what are conditions about expansion of production etc.

Example: India's automobile sector is most suitable to recall the heydays of license raj. In those days, only a few brands such as Bajaj, Rajdoot (of Escorts), Vespa (of Bajaj later), Chetak (of Baja), Lambretta etc. existed. Bajaj was market leader and its Chetak brand was so popular that people used to book it and wait for months to get it delivered. The reason was that the Industrial License stipulated what quantity of scooter they could produce and also that they could produce only up to 25 per cent in excess of its licensed capacity. If they wanted to expand beyond this, they needed prior permission.

What was compulsion for licensing?

The licensing policy made it necessary to obtain licensing in the following conditions:

- The existing industrial units (prior enactment of IDR act 1951) needed to obtain registration under the act.
- For new industrial units to be set up in category of licensed industries. If the industry is not covered under compulsory licensing but the investment was above Rs. 10 crore; the firm was required to file a memorandum of information with the department of industries.
- If any article is reserved for small scale industries and a firm wanted to manufacture these items, it needed a license.
- If a firm wants to increase its production capacity beyond 25%, it needed to obtain prior approval.
- An industrial license was needed to set up a manufacturing unit in metro city. Prior approval was needed to change the location of the manufacturing unit.

To obtain the license, the entrepreneur had to file an application with the government. After receiving application, government would make necessary investigation, and if government found that industrial unit is not against public interest, then it will grant licence. The license could be revoked if the industrial unit was not complying with provisions of Industrial Licensing Policy.

The bureaucratic red tape imposed substantial administrative burden and there was no certainty that an application for a license would be approved within or in what timeframe. More than one third applications were rejected which meant a loss of investments. This was a big hurdle in rapid industrialization. The issues created by License Raj are:

- The entrepreneurs needed to run from pillar to post to obtain industrial license. They needed to deal with various government departments and officers; and spent more time in Delhi than their factories.
- The licensing policy was a conflict of objectives. The stated objective was to increase industrial production but on ground it restricted expansion, production of new articles etc. Similarly, the stated objective of was to check the concentration of economic power in few hands, but actually it did the same. New licenses were granted to big houses thanks to all pervasive corruption. They were also allowed to grow at cost of new players. Bribery was a culture in license raj

IMPORTANT MEASURES UNDER LIBERALISATION

1. Removal of Industrial Licensing:

- All industrial licensing was **abolished except a shortlist of 18 industries** related to security and strategic concerns, social reasons, hazardous chemicals and overriding environmental reasons.
- Subsequently, all industries **except for a small group of five industries** (alcohol, cigarettes, hazardous chemicals, industrial explosives, electronics, aerospace and drugs and pharmaceuticals), **industrial licensing requirements have been done away with**.
- **Reservations for the Public sector** for defence equipment, atomic energy generation and railway transport.
- **Market mechanism** to determine the prices. In many industries, the market has been allowed to determine the prices

2. Financial Sector Reforms:

- Financial sector reforms led to the establishment of private sector banks, both Indian as well as foreign.
- Financial sector includes financial institutions such as commercial banks, investment banks, stock exchange operations and foreign exchange market.
- The financial sector in India is controlled by the Reserve Bank of India (RBI).
- All the banks and other financial institutions in India are controlled through various norms and regulations of the RBI.
- The RBI decides the amount of money that the banks can keep with themselves, fixes interest rates, nature of lending to various sectors etc.
- One of the major aims of financial sector reforms is to reduce the role of RBI from regulator to facilitator of financial sector.
- This means that the financial sector may be allowed to take decisions on many matters without consulting the RBI.

3. Liberalization of Foreign Investment:

- Earlier, prior approval was required by foreign companies, now automatic approvals were given for FDI to flow into the country.
- A high-priority and investment-intensive industries were **de-licensed** and could now **invite up to 100% FDI** including sectors such as hotel and tourism, infrastructure, software development etc.
- **Use of foreign brand name or trademark** was permitted for sale of goods.

4. Public Sector Reforms:

Greater autonomy was accorded to the PSUs in-order to **restrict interference** of the government officials and allow their management **greater freedom in decision-making**.

5. MRTP Act:

- The **Industrial Policy 1991** restructured **the Monopolies and Restrictive Trade Practices Act. (Now replaced by Competition Commission of India CCI)**
- The Act became obsolete in the present world of throat cutting competition. The MRTP Act prevent the expansion of the companies whose assets was 100 crores, because these companies need to take government permission to expand their business
- Regulations relating to concentration of economic power, pre-entry restrictions for setting up new enterprises, expansion of existing businesses, mergers and acquisitions etc. have been **abolished**.

6. Tax Reforms:

- Tax reforms are concerned with the reforms in government's taxation and public expenditure policies which are collectively known as its fiscal policy.
- There are two types of taxes: direct and indirect.
- Direct taxes consist of taxes on incomes of individuals as well as profits of business enterprises.
- Since 1991, there has been a continuous reduction in the taxes on individual incomes as it was felt that high rates of income tax were an important reason for tax evasion. It is now widely accepted that moderate rates of income tax encourage savings and voluntary disclosure of income.
- The rate of corporation tax, which was very high earlier, has been gradually reduced. Efforts have also been made to reform the indirect taxes, taxes levied on commodities, in order to facilitate the establishment of a common national market for goods and commodities.

PRIVATISATION

- The policies through which the '**roll back**' of the state was done included deregulation, privatization and introduction of market reforms in public services.
- Privatization at that time was used as a process under which the **state assets were transferred to the private sector**.
- Government companies can be converted into private companies in two ways
 - (i) By withdrawal of the government from ownership and management of public sector
 - (ii) By outright sale of public sector companies
- Another variant of privatization is **disinvestment**.
- Disinvestment is de-nationalization of **less than 100 per cent-ownership transfer** from the state to the private sector.
- In general sense, all the economic policies which directly or indirectly seem to promote the expansion of the private sector or the market (economy) have been termed as the process of privatization.

DISINVESTMENT

- Privatisation of the public sector undertakings by selling off part of the equity of PSUs to the public is known as disinvestment.
- The purpose of the sale, according to the government, was mainly to improve financial discipline and facilitate modernisation.
- Government envisaged that privatisation could provide strong impetus to the inflow of FDI.
- Every year, the government fixes a target for disinvestment of PSUs. For instance, in 1991-92, it was targeted to mobilise Rs 2,500 crore through disinvestment.
- Critics point out that the assets of PSUs have been undervalued and sold to the private sector. This means that there has been a substantial loss to the government.
- The proceeds from disinvestment were used to offset the shortage of government revenues rather than using it for the development of PSUs and building social infrastructure in the country.

Navaratnas, Maharatnas & Miniratnas

In 1996, in order to improve efficiency, infuse professionalism and enable them to compete more effectively in the liberalised global environment, the government chose nine PSUs and declared them as navaratnas.

They were given greater managerial and operational autonomy, in taking various decisions to run the company efficiently and thus increase their profits

Navratna was the title given originally to 9 Public Sector Enterprises (PSEs) identified by the Government of India in 1997 as "public sector companies that have comparative advantages", giving them greater autonomy to compete in the global market so as to "support them in their goal to become global giants".

PSU companies are divided into three categories:

- **Maharatna**
- **Navratna**
- **Miniratna**

Originally, the term *Navaratna* meant a talisman or ornament composed of nine precious gems. Later, this symbology was adopted in the courts of Emperor Vikramaditya and the Mughal emperor Akbar, where the Navaratnas were a group of nine extraordinary men in their respective courts.

The Maharatna category has been the most recent one since 2009, the other two have been in function since 1997.

As of 2022, there are 11 Maharatnas, 13 Navratnas and 74 Miniratnas

The government grants the **status of Navratna, Miniratna, and Maharatna** to Central Public Sector Enterprises based upon the profit made by these CPSEs.

In 2009, the government established the **Maharatna** status, which raises a company's investment ceiling from Rs. 1,000 crore to Rs. 5,000 crore. The Maharatna firms can now decide on investments of up to 15 per cent of their net worth in a project; the Navaratna companies could invest up to Rs 1,000 crore without explicit government approval.

Types of Miniratnas

The Miniratnas can be divided into two categories I and II.

- For a miniratna belonging to category I financial autonomy of up to Rs. 500 crore or equal to their net worth, whichever is lower is granted.
- A category II miniratna financial autonomy of up to Rs. 300 crore or up to 50% of their net worth, whichever is lower is granted.

Examples of some Maharatna companies-

1. Bharat Heavy Electricals Limited (BHEL)
2. Coal India Limited
3. Gas authority of India limited (GAIL)
4. Indian Oil Corporation Limited (IOCL)
5. National Thermal Power Corporation Limited (NTPC Limited)
6. Oil & Natural Gas Corporation Limited (ONGC)
7. Steel Authority of India Limited (SAIL)
8. Bharat Petroleum Corporation Limited

Examples of some Navratna companies

1. Bharat Electronics Limited (BEL)
2. Container Corporation of India Limited
3. Engineers India Limited
4. Hindustan Aeronautics Limited
5. Hindustan Petroleum Corporation Limited
6. Mahanagar Telephone Nigam Limited
7. National Aluminium Company Limited

GLOBALISATION

- Globalization is termed as '**an increase in economic integration among nations**'.
- For the **WTO**, the official meaning of globalization is movement of the economies of the world towards "**unrestricted cross border movements of goods and services, capital and the labour force**".

Globalization is world economic integration through free movement across national borders of:

- Financial capital represented by investment in capital markets and money markets,
- Physical capital represented by plant and machinery
- Technology

MAINS ELEMENTS OF GLOBALISATION

- To open the domestic markets for inflow of foreign goods, India **reduced customs duties** on imports – to **only 10%**
- The **import licensing** has been almost **abolished**.
- Tariff barriers have also been eliminated significantly to encourage trade volume to rise in keeping with the World trade Organization (WTO)
- The FDI policy of the GoI encouraged the inflow of fresh foreign capital by **allowing 100% foreign equity in certain projects** under the automatic route.

POST-REFORM BENEFITS

- **Rise in growth rate** – economy grew at a faster pace than pre reform era.
- **Rise in exports** – Exports grew considerably. India is global leader of software export.
- Surge in inflows of **foreign investment**
- **Growth of private sector** – The private sector entered into new areas and expanded production and employment
- **Robust performance of the service sector** – with the onset of reforms, the share of services sector went up to 44 percent in total GDP.
- **Built up of foreign exchange reserves** With **\$608.99 billion** in currency reserves as of June 25, 2021, India is the world's fifth-largest Forex reserve holder(as per the Ministry of Finance recent statement)

CHAPTER - 12

This chapter will demystify the following concepts:

- ✓ Poverty
- ✓ Types of Poverty
- ✓ Poverty Line
- ✓ Committees regarding Poverty Evaluation
- ✓ Causes of Poverty
- ✓ Poverty Alleviation Programmes by the government

- Poverty is a condition in which a person lacks the financial resources and essentials things to enjoy minimum standards of life.
- **Relative poverty** and **Absolute poverty** are the two variants of poverty.
- **Relative poverty** refers to poverty of people in comparison to other people in different region or nations.
- **Absolute poverty** refers to total number of people living below the poverty line.
- Poverty line refers to that line which expresses **per capita average monthly expenditure that is essentially required** by the people **to satisfy** their **minimum needs**.
- A person is considered poor if his or her income or consumption level falls below a given **minimum level** **necessary to fulfil basic needs**.
- The accepted **average calorie requirement** in India is 2400 calories per person per day in rural areas and 2100 calories per person per day in urban areas.
- As per **Tendulkar committee**, poverty line is estimated in monthly basis as **Rs. 816 in rural areas and Rs. 1000 in urban areas**. People who are not able to earn even such amount in a month are considered below poverty line.
- A person who is able to earn enough money to cover his basic needs is considered to be above the poverty line (APL), while those who are unable to do so are said to be below it (BPL)



Poverty estimation in pre-independent India

- **Dadabhai Naoroji** was the first to discuss the concept of a Poverty Line.
- Dadabhai Naoroji's efforts and careful research led him to establish a **subsistence-based poverty level (though he never used the term "poverty line")**
- It was calculated using the cost of a subsistence diet of rice or flour, dal, mutton, vegetables, ghee, vegetable oil, and salt."

Poverty estimation in Post-Independent India

- In post-independent India, there have been several attempts to work out a mechanism to identify the number of poor in the country.
- For instance, in 1962, the Planning Commission formed a Study Group.
- In 1979, another body called the 'Task Force on Projections of Minimum Needs and Effective Consumption Demand' was formed. Popularly known as "**Y K Alagh Committee**"

- The **YK Alagh Committee's suggestion** in 1979, which said that persons who consume less than **2100 calories in urban areas or less than 2400 calories in rural regions** are poor, was the first to use this approach.
- The discrimination between rural and urban areas was based on the fact that rural people do more physical labour.
- **As a result, YK Alagh established India's first poverty line.**
- The Planning Commission established the **Suresh Tendulkar committee in 2005.**
- **Tendulkar Committee** used the **cost of living as a method for evaluating poverty.**
- As per Tendulkar committee, poverty line is estimated in monthly basis as **Rs. 816 in rural areas and Rs. 1000 in urban areas.** People who are not able to earn even such amount in a month are considered below poverty line.
- In 2014, the **Rangarajan Committee** was appointed which increased the monthly per capita expenditure to **Rs 972 in rural India and Rs 1,407 in urban India**
- The **decision is yet to be taken on the Rangarajan Committee recommendations.**
- **Therefore, the Tendulkar poverty line remains the official poverty line and is the basis of the current official poverty estimates**

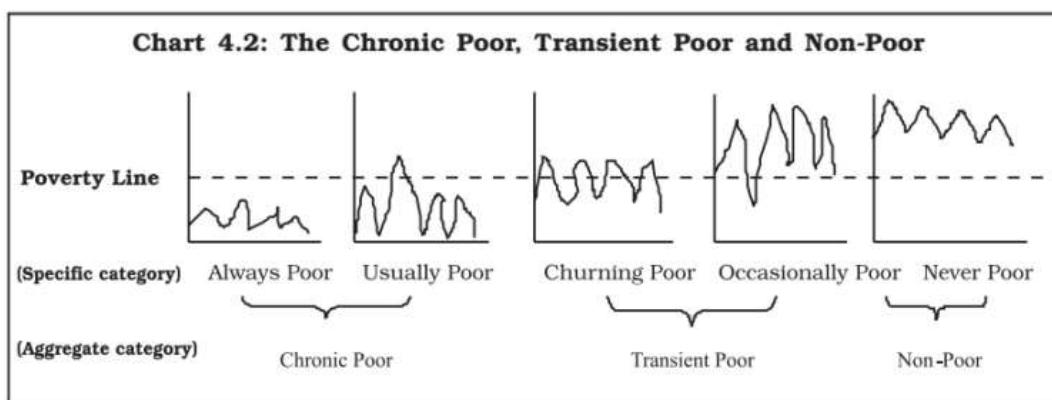
Note: As per the Tendulkar estimation, the percentage of people living below the poverty line in India is 21.9%. However, as per Rangarajan estimation, the percentage of people living below the poverty line in India is 29.5%.



Categorizing Poverty:

Chronic Poor- People who are always poor and those who are usually poor but who may sometimes have a little more money (example: casual workers) are grouped together as the chronic poor.

Transient poor- People who regularly move in and out of poverty (example: small farmers and seasonal workers) and the occasionally poor who are rich most of the time but may sometimes have a patch of bad luck. They are called the transient poor.



Causes of Poverty in India

1. Low level of economic development under the British colonial administration: Policies of the colonial government ruined traditional handicrafts and discouraged development of industries like textiles.

2. Low Rate of Growth until 1980s:

- This resulted in less job opportunities and low growth rate of incomes.
- This was accompanied by a high growth rate of population.
- The two combined to make the growth rate of per capita income very low.
- The failure at both the fronts: promotion of economic growth and population control perpetuated the cycle of poverty

3. Irrigation and Green Revolution:

- With the spread of irrigation and the green revolution, many job opportunities were created in the agriculture sector.
- But the effects were limited to some parts of India

4. Industries:

- The industries, both in the public and the private sector, did provide some jobs. But these were not enough to absorb all the job seekers.
- Unable to find proper jobs in cities, many people started working as rickshaw pullers, vendors, construction workers, domestic servants etc.
- With irregular small incomes, these people could not afford expensive housing.
- They started living in slums on the outskirts of the cities and the problems of poverty, largely a rural phenomenon also became the feature of the urban sector.

5. Income inequalities:

- Another feature of high poverty rates has been the huge income inequalities.
- One of the major reasons for this is the unequal distribution of land and other resources.
- Land reforms have not been properly implemented and lack of adequate land resources is also a reason for many people to be poor.
- Small farmers borrow money for seeds, fertilisers and pesticides, etc. and later on fail to pay landing in debt trap. This high level of indebtedness is both the cause and effect of poverty.
- Since lack of land resources has been one of the major causes of poverty in India, proper implementation of policy could have improved the life of millions of rural poor.

Anti-Poverty Measures

Removal of poverty has been one of the major objectives of Indian developmental strategy. The current anti-poverty strategy of the government is based on the following two objectives –

(iii) Promotion of Economic Growth:

- The government has promoted economic growth during the last few years. Economic growth was low till the 1980s but has increased significantly since then, causing significant poverty reduction.
- The high economic growth helps in a significant reduction of poverty. There is strong linkage between economic growth and poverty reduction.
- Economic growth widens opportunities and provides the resources needed to invest in human development.

- High economic growth encourages people to send their children (including the girl child) to school with hope of better economic returns from investing in education.
- But still, the rural poor may not take direct advantage of economic growth. Due to lack of growth in the agricultural sector, the large number of people remain poor in rural areas

(iv) Targeted Anti-Poverty Programmes-

- **Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA)-**
The Act provides 100 days assured employment every year to every rural household. One-third of the proposed jobs would be reserved for women. The central government will also establish National Employment Guarantee Funds. Similarly, state governments will establish State Employment Guarantee Funds for implementation of the scheme. Under the programme, if an applicant is not provided employment within 15 days s/he will be entitled to a daily unemployment allowance
- **Public Distribution System (PDS)**
(PDS) which evolved as a system of management for food and distribution of food grains plays a major role in poverty alleviation. This programme is operated jointly by the Central Government and the State Government of India. The responsibilities include:
 - Allocations of commodities such as rice, wheat, kerosene, and sugar to the States and Union Territories.
 - Issue of Ration Cards for the people below the poverty line.
 - Identification of families living below the poverty line.
 - Management of food scarcity and distribution of food grains.
- PDS was later launched as Targeted Public Distribution System (TPDS) in June 1997 and is controlled by the Ministry of Consumer Affairs, Government of India. TPDS plays a major role in the implementation and identification of the poor for proper arrangement and delivery of food grains. Therefore, the Targeted Public Distribution System (TPDS) under the Government of India plays the same role as the PDS but adds a special focus on the people below the poverty line.
- **National Rural Livelihood Mission (NRLM)**
 - It was launched in 2011 by the Ministry of Rural Development and aided by the World Bank. NRLM aims to create an efficient and effective system for the rural poor to access financial services.
 - Self Help groups are formed at the village level to help the needy.
 - To that end, the objective is to create sustainable opportunities by empowering and enabling the poor to increase their household income. In addition to income-generated assets to the poor — they would also be facilitated to achieve increased access to rights, entitlements and public services, diversified risk and better social indicators of empowerment.
 - The mission aims at harnessing the innate capabilities of the poor and complements them with providing them the capacity to participate in the growing economy of the country. In 2015, the program was renamed to Deendayal Antyodaya Yojana (DAY-NRLM).

- **National Urban Livelihood Mission**
 - It was launched in 2013 by the Ministry of Housing and Urban Affairs.
 - It focuses on organizing urban poor in Self Help Groups, creating opportunities for skill development leading to market-based employment and helping them to set up self-employment ventures by ensuring easy access to credit
- **Pradhan Mantri Jan Dhan Yojana**
 - It was launched in 2014 by the Ministry of Finance.
 - It aimed at direct benefit transfer of subsidy, pension, insurance etc. and attained the target of opening 1.5 crore bank accounts. The scheme particularly targets the unbanked poor.
- **Pradhan Mantri Awas Yojana**
 - It was launched in 2015 by the Ministry of Housing and Urban Affairs
 - The Housing for All scheme was an initiative of the Indian government to establish housing facilities for slum dwellers. It was introduced by the Indian government's Ministry of Housing and urban poverty Alleviation. This is also known as the Pradhan Mantri Awas Yojana. It is for both people residing in urban and rural areas that fulfil certain criteria.
 - The aim is to provide solid and permanent housing with all the basic amenities including toilet, LPG connection, electricity connection and drinking water.
- **Pradhan Mantri Ujjwala Yojana (PMUY)**
 - It was launched in 2016 by Ministry of Petroleum and Natural Gas.
 - It envisages the distribution of 50 million LPG connections to women below the poverty line
- **National Nutrition Mission (NNM), Poshan Abhiyan**
 - It was launched in 2018 by Ministry of Women and Child Development.
 - To reduce the level of under-nutrition and also enhance the nutritional status of children in the country. Also, to improve the nutritional outcomes of adolescents, children, pregnant women and lactating mothers.
- **Pradhan Mantri Shram Yogi Maan-Dhan (PM-SYM)**
 - It was launched in 2019 by Ministry of Labour and Employment
 - It is a central government scheme that is introduced for old age protection and social security of Unorganised Workers (UW)
- **Prime Minister Street Vendor's AtmaNirbhar Nidhi – PM SVanidhi**
 - It was launched in 2020 by the Ministry of Housing and Urban Affairs.
 - It aims to provide micro-credit facilities to street vendors affected due to COVID-19 pandemic

CHAPTER - 13

This chapter will demystify the following concepts:

- ✓ Human Capital
- ✓ Role of Education, Health & Training
- ✓ How much India spends on Education

Human Capital Formation

- Human capital formation is the process of transforming the people in a country into workers who are capable of producing goods and services.
- During this process, relatively unskilled individuals are given the skills they need to contribute to the economy.
- Human Capital refers to the *stock of 'skill and expertise' of a nation at a point of time*. It is the sum total of skill and expertise.
- Human Capital Formation is the process of adding to the stock of human capital over time.
- Human capital considers education and health as a means to increase labour productivity.
- Human development is based on the idea that education and health are integral to human well-being because only when people have the ability to read & write and the ability to lead a long and healthy life, only then they will be able to contribute to their society and nation.



Sources of Human Capital Formation

- Expenditure on Education
- Expenditure on Health
- On-Job-Training
- Migration
- Expenditure on Information

Expenditure on Education

The education expenditure is an important source of human capital formation as it is the most effective way on enhancing and enlarging a productive workforce in the country. Nations and individuals invest in education with the objective:

- increasing their future income.
- generating technical skills and creating manpower, well suited for improving labour productivity and thus, sustaining rapid economic development.
- to bring down birth rate which in turn, brings decline in population growth rate. It makes more resources available per person.
- education also results in social benefits since, it also spreads to others.

Education plays a very important role in human capital formation for the following reasons:

1. An educated human can be considered an asset for the economy and not a liability.
2. Education can help an individual make better use of economic opportunities. It helps in enhancing the national income, cultural richness and increases the efficiency of the Government.
3. It enhances individual productivity in terms of quality and quantity.
4. Because being educated can help the economic status of an individual, it also develops the consciousness towards society.
5. An educated person is also aware of health and hygiene, and it will ultimately result in better health of the people of a country.

Expenditure on Health

- Health is another important source of human capital formation.
- A sick labourer without access to medical facilities is compelled to abstain from work and there in a loss of productivity.
- If an individual is healthy, he or she may have better immunity to fight illness.
- Being healthy will also increase the overall outcome of an individual. The efficiency of a healthy person is higher than that of an unhealthy person.
- The health of an individual is directly proportional to the work he does. A healthy person can spend more time working in comparison to an unhealthy person.
- Thus, better health will increase efficiency. The above-mentioned points prove that if better health care measures are taken up due to which an individual in a country becomes healthier, the human capital and productivity will also increase.

On-job-Training

- Expenditure regarding on-the-job training is a source of human capital formation as the return of such expenditure in the form of enhanced labour productivity is more than the cost of it.
- Firms spend huge amounts on giving on-the-job training to their workers. It may be in different forms like a worker may be trained in the firm itself or under the supervision of a skilled worker or can be sent for off campus training.
- The firms then insist that workers should work for at least some time in their company so that they can recover the benefits of the enhanced productivity owing to the training.

Expenditure by Government on training

Example: Pradhan Mantri Kaushal Vikas Yojana enables Indian youth population to take up industry related skill training. This training helped them to secure a better livelihood.

Migration

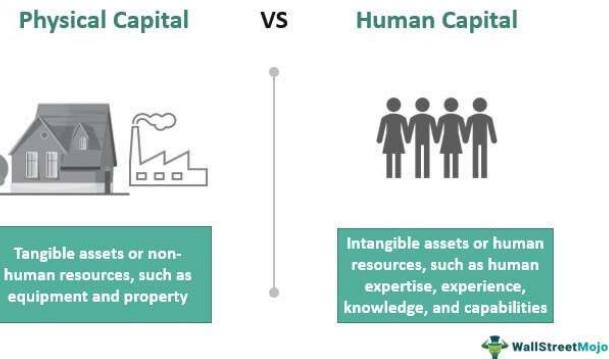
People migrate from one place to another in search of jobs with higher income prospects.

- Unemployed people from rural areas migrate to urban areas in search of jobs.
- Technically qualified persons (like engineers, doctors, etc.) migrate to other countries because of higher salaries that they may get in such countries.
- Migration in both these cases involves two kinds of cost: cost of transportation from one place to another, the higher cost of living in migrated places.

1. Expenditure on migration is a source of human capital formation as enhanced earnings in the migrated place is more than the increase in costs due to migration.
2. This leads to capital formation through proper utilization of skills.

Expenditure on Information

People spent to acquire information relating to the labour market and other markets like education, health, etc. For example, people seek information regarding salaries and other facilities available in different labour markets, so that they can choose the right job. Expenditure incurred for acquiring information regarding labour markets and other markets like education and health have also become an important source of human capital formation.



What are the problems of human capital formation?

The main problems of human capital formation are:

(1) Rising population	<ul style="list-style-type: none"> ▪ The rising population adversely affects the quality of human capital. ▪ It reduces per head availability of existing facilities like sanitation, employment, drainage, water system, housing, hospitals, education, food supply, nutrition, roads, electricity, etc.
(2) High regional and gender inequality	<ul style="list-style-type: none"> ▪ Regional and gender inequality lowers the human development level. ▪ There is inefficient manpower planning in less developed countries where no efforts have been made either to raise the standard of education at different stages to maintain the demand and supply of technical labour force.
(3) Brain Drain	<ul style="list-style-type: none"> ▪ 'Brain Drain' is the migration of highly skilled labour. ▪ It adversely affects economic development.
(4) High poverty level	<ul style="list-style-type: none"> ▪ A large portion of the population lives below the poverty line. ▪ Due to the low level of income, they cannot afford higher and quality education or expensive medical facilities.

Human Capital and Economic Growth

- Human capital formation increases productivity of physical capital, as specialized engineers and skilled workers can certainly handle machines better than the other.
- Human capital facilitates innovation of new methods of production and this increase the rate of economic growth in the form of increase in GDP.
- Similarly, the availability of educated labor force facilitates adaptation to new technologies.
- Human capital formation leads to a higher employment rate. With increase in employment, the productivity rises. Also, increase in employment opportunities increases the level of income and this helps in reducing inequalities of wealth. Both, increase in employment rate and decrease in income inequalities are pointers of economic development.
- The process of human capital formation brings in a positive outlook to the society which is different from orthodox and traditional ways of thinking, and hence increases the rate of participation in the workforce causes increase in level of production

Education Sector in India

Education implies the process of teaching, training and learning especially in schools or colleges, to improve knowledge and develop skills.

Following points explain the important or objective of education-

- It produces good citizens.
- It develops science and technology.
- It facilitates the use of natural and human resources of all regions of the country.
- It expands mental horizon of the people.

Growth in Government Expenditure on Education

Government expenditure on education can be expressed in two ways

- As a percentage of total government expenditure.
- As a percentage of Gross Domestic Product (GDP).

The percentage of education expenditure of total government expenditure indicates the importance of education in the scheme of expenses of the government.

Expenditure on education out of our GDP shows how much we are committed towards the development of education in our country.

How much India spends on Education

NOTE: The National Education Policy, 2020 (NEP) calls for investment on education to 6% of GDP. India's education budget has never touched this number yet. As per the latest Economic Survey (2021) the expenditure on education as a percentage of GDP was:

- **2019-20: 2.8%**
- **2020-21: 3.1%**
- **2021-22: 3.1%**
- The **Union Education Budget 2022** focused mainly on digital education, the creation of a digital university, job creation, agricultural universities, skill development of programmers, etc.
- The education budget 2022 has been allotted Rs 1,04,278 crore -- a rise of Rs 11,054 crore from the previous year. The education budget allocation for 2021-22 was Rs. 93,223 crores.
- **To meet the 6% of GDP criteria, the education budget for 2022-23 should have been almost double that of last year's allocation.**

CHAPTER - 14

This chapter will demystify the following Concepts:

- ✓ **Rural Development**
- ✓ **Rural Credit**
- ✓ **Regional Rural Banks (RRBs)**
- ✓ **Agriculture Marketing**
- ✓ **Mandis (Farmer Markets)**
- ✓ **NABARD**

Rural development means an action-plan for the social and economic upliftment of the rural areas. The key issues of action plan for rural development are

- Development of infrastructure
- Human capital formation
- Development of productive resources
- Poverty alleviation
- Land reforms



Rural development usually refers to the method of enhancing the quality of life and financial well-being of individuals, specifically living in populated and remote areas.

Rural development still remains the core of the overall development of the country. More than two-third of the country's people are dependent on agriculture for their livelihood, and one-third of rural India is still below the poverty line. Therefore, it is important for the government to be productive and provide enough facilities to upgrade their standard of living.

Rural development is a term that concentrates on the actions taken for the development of rural areas to improve the economy.

Importance of Rural Development

Rural development is important not only for the majority of the population residing in rural areas, but also for the overall economic expansion of the nation.

Rural development is considered to be of noticeable importance in the country today. It is a strategy that tries to obtain an improved productivity, higher socio-economic equality and stability among the rural inhabitants.

The primary task is to decrease the hunger issues that existed in roughly 70 percent of the rural population, and to make sufficient and healthy food available.

The secondary task is to ensure the availability of clothing and footwear, a clean environment and house, medical attention, recreational provision, education, transport, and communication.

Objectives of Rural Development

- To improve productivity and wages of rural people
- To guarantee increased and quick employment possibilities
- To demolish unemployment and bring a notable decline in underemployment
- To guarantee an increase in the standard of living of the underprivileged population
- To provide the basic needs: elementary education, healthcare, clean drinking water, rural roads, etc.

Rural Credit

Rural credit means credit for the farming families. **NABARD** (National Bank for Agriculture and Rural Development) is **the apex institution in rural financing**. It was set up in July 1982.

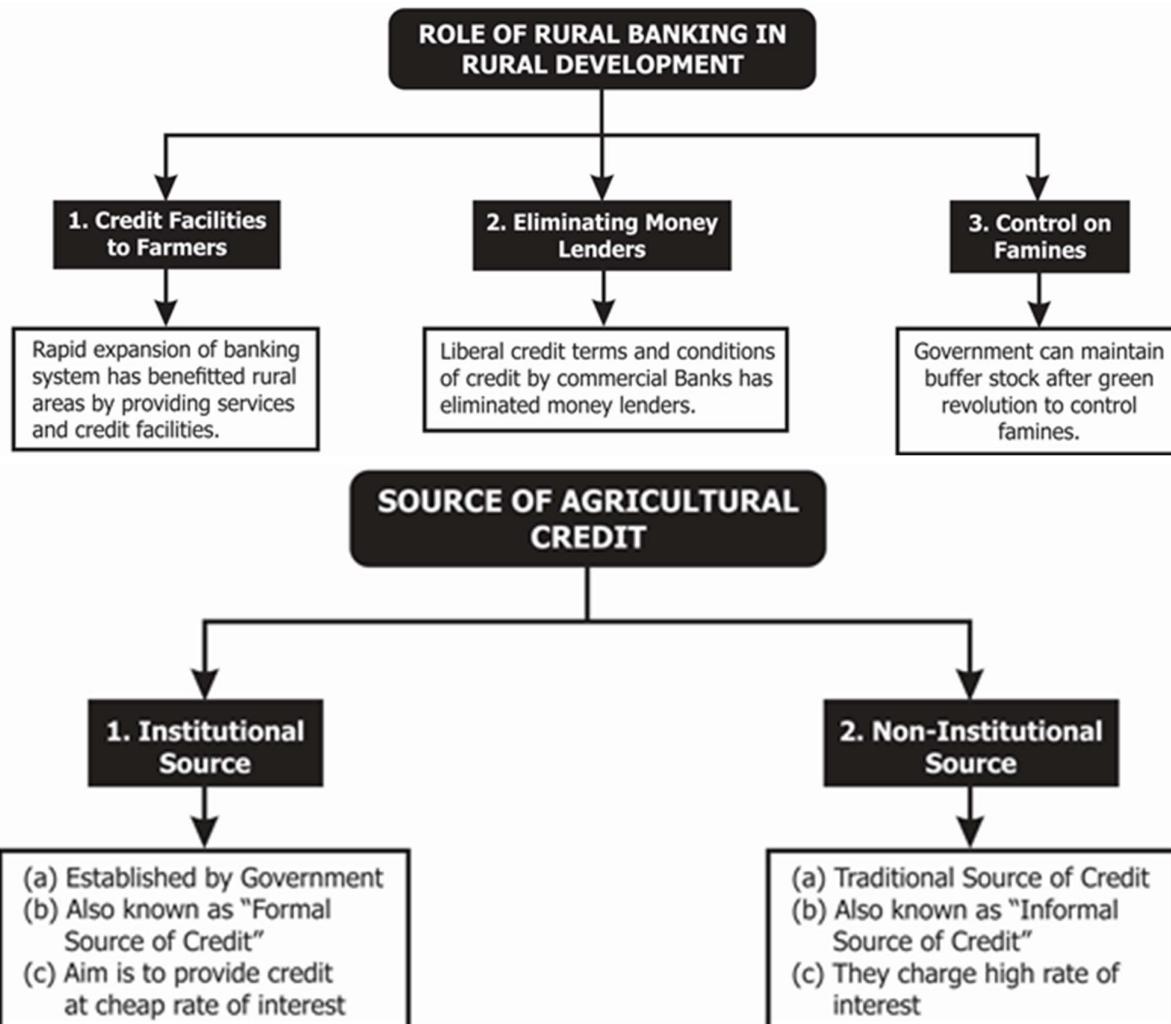
Credit is the life line of farming activity. Credit needs of the typical Indian farmer may broadly be classified as:

1. **Short Term Credit**- relates basically to the purchase of inputs like seeds fertilizers etc. short-term borrowings generally stretches over a period of 6 to 12 months.
2. **Medium Term Credit**- Medium term loans are required for purchasing machinery constructing fences and digging wells. Such loans are generally stretch over a period of 12 months to 5 years.
3. **Long Term Credit**- It is meant for the purchase of additional land. The period of such loan ranges between 5 to 20 years.

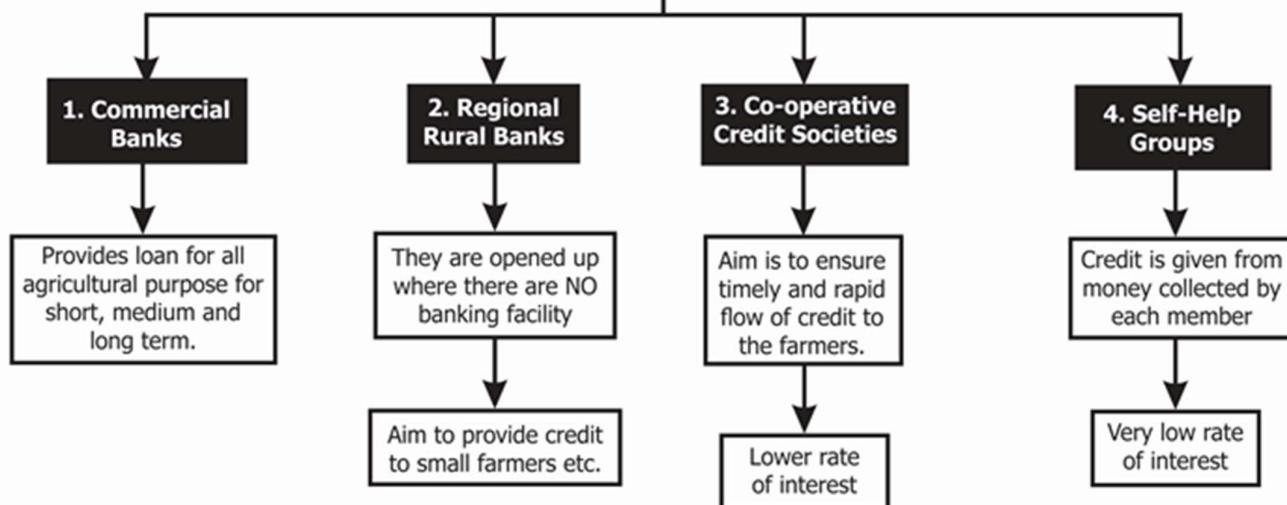
Sources of Rural credit:

The availability of rural credit can be divided into two categories:

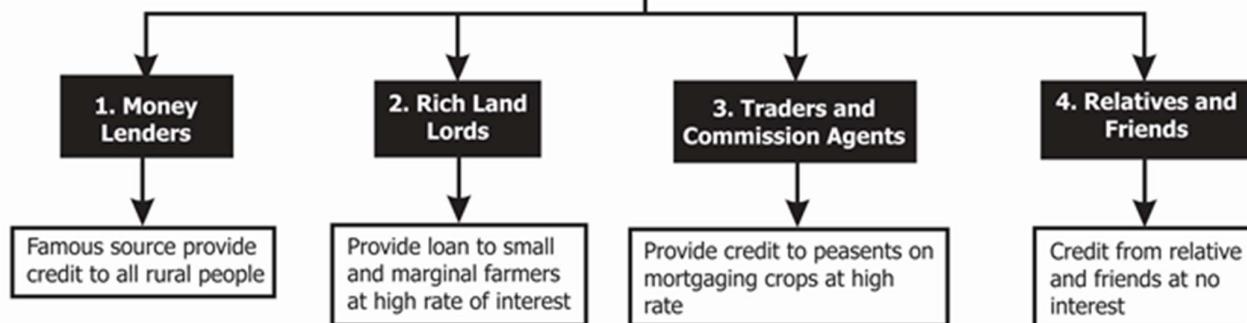
- **Non-institutional Sources:** These are the traditional sources of agricultural credit in India. They include money lenders, relatives, traders, and landlords.
- **Institutional Sources:** Institutional sources include- commercial banks, regional rural banks, cooperative banks, self-help groups (SHGs) etc.



INSTITUTIONAL SOURCE OF CREDIT



NON-INSTITUTIONAL SOURCE OF CREDIT



Cooperative Credit Society

- Cooperative Credit Society is a **group of individuals coming together to promote economic welfare** in the society. Such society can be registered through Cooperative Societies Act. The aim of such societies is to protect the members from the exploitation of lenders who charge high rates of interest on loans. Such societies provide loans to members out of the amounts collected as capital and deposits from the members and charge low rates of interest.
- A credit co-operative society is a credit society that is member-owned financial cooperative and is controlled by its members. Membership for the residents of the locality is open for all.
- They can accept deposit from members and give loans to members. Profit or loss shared among members.
- Credit cooperative society elects their chairman and board of directors.

Regional Rural Banks

- RRBs are financial institutions which ensure adequate **credit for agriculture and other rural sectors**.
- Regional Rural Banks were set up on the basis of the recommendations of the **Narasimham Working Group (1975)**, and after the legislation of the **Regional Rural Banks Act, 1976**.
- The first Regional Rural Bank “Prathama Grameen Bank” was set up on 2nd October, 1975.
- **Stakeholders:** The **equity** of a regional rural bank is held by the **Central Government**, concerned **State Government** and the **Sponsor Bank** in the proportion of **50:15:35**.
- The RRBs combine the **characteristics of a cooperative** in terms of the familiarity of the rural problems **and a commercial bank** in terms of its professionalism and ability to mobilise financial resources.
- Each RRB operates within the local limits as notified by the Government.
- The **main objectives** of RRBs are
 - To provide credit and other facilities to **the small and marginal farmers, agricultural labourers, artisans and small entrepreneurs in rural areas**.
 - To check the outflow of rural deposits to urban areas and **reduce regional imbalances and increase rural employment generation**.
- The RRBs are required to provide 75% of their total credit as **priority sector lending**

Agricultural Marketing

Agricultural marketing is a process that involves the storage, processing, transportation, packaging, grading and distribution of different agricultural commodities across the country. In agriculture marketing, the selling of an agriculture product depends on various components like the demand for the product at that time, availability of storage, etc.

Before Independence, farmers while selling their products to traders experienced massive incorrect weighing and manipulation of accounts. The farmers did not have required information about the prices and were forced to sell at low prices with no proper storage facility.

Sometimes, the product could be sold at a weekly village market in the farmer's village or in a neighbouring village. If these shops are not available, then the product is sold at irregular markets in a nearby village or town, or in the mandi. So, the government took various measures to control the activities of the traders

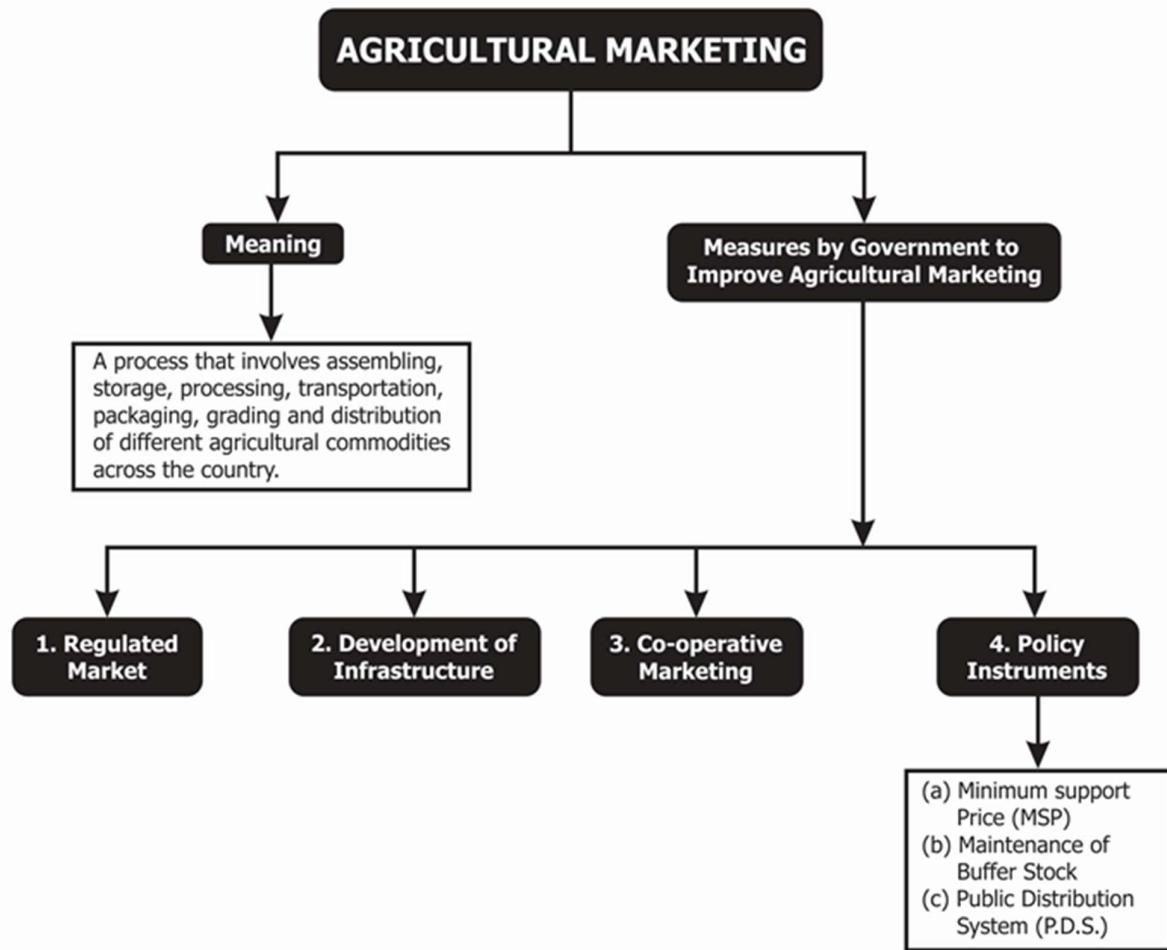
Measures taken by The Government to Improve Agriculture Marketing

- The initial step was to regulate the market and plan a clean, transparent and simple marketing strategy. This regulation helped both the farmers and the consumer.
- The second measure was the procurement process like transportation facilities, warehouse, cold storage, godowns, and the processing unit. However, the current infrastructure is inadequate to adhere to the growing demand and therefore needs to be improved.
- The third aspect is to decide on the fair price for the product. In the past, it has been a setback due to the unequal coverage of farmer members and the absence of a suitable link between marketing, processing cooperatives, and inefficient financial management. Example of a successful cooperative is the Gujarat milk cooperative which transformed the social and economic landscape of Gujarat.

- Policies like-**

1. Guarantee of Minimum Support Prices (MSP) for agricultural products
2. Storage of surplus stocks of wheat and rice by Food Corporation of India (FCI)
3. Distribution of food through PDS

All these measures were penned down to guard the income of the farmers and procuring agriculture products in the subsidized rate to the underprivileged. However, in spite of government interference in agriculture marketing, private traders still dominate the agricultural markets.



Collaboration with national and multinational companies

- Many national and international fast foods chains are rapidly getting into a contract with farmers.
- They encourage the farmers to produce high-quality fruits and vegetables by providing them not only seeds and other materials but also guarantee procurement of the product at pre-decided prices.
- This type of arrangements reduces price risk for farmers and increase farm product in the market.

Farmers market (mandi /bazaars)

It has been realized that if farmers directly sell their produce to consumers, it increases their incomes. Farmers Market was started to give small farmers direct access to the consumers and eliminating the middlemen.

Some examples of farmer markets are:

1. Apni Mandi in Punjab, Haryana and Rajasthan
2. Hadaspar Mandi in Pune
3. Rythu Bazars in Andhra Pradesh
4. Uzhavar Sandies (farmers market) in Tamil Nadu.

Non-Farm Areas of Production Activity/Employment for the Rural Population

Animal Husbandry

Animal husbandry is the science of agriculture where animals are reared, bred and raised for meat, fiber, eggs, milk and other food products. Livestock (farm animals regarded as an asset) production provides increased stability in income, food security, transport, fuel and nutrition for the family without disrupting other food producing activities. Today, livestock sector alone provides alternate livelihood options to over 70 million small and marginal farmers including landless labourers.

Animal husbandry in India

- Livestock sector contributes **4% of GDP and 25% of total Agriculture GDP**.
- According to livestock census 2019, livestock in India witnessed an **increase of 4.6%** as compared to the previous census.
- Livestock productivity has been identified as **one of the seven sources of income growth** by the Inter-Ministerial Committee under the government's target of doubling farmers' income by the year 2022

Importance of livestock farming in India

- **Income:** Unlike crop production, livestock are a secured source of income. Moreover, animals like sheep and goats are used to meet exigencies like marriage, treatment of sick persons, in the times of distress.
- **Employment:** Livestock provides employment to a large section of rural people who remain unemployed due to seasonal nature of crop production. Also, livestock reduces the risk of disguised unemployment in agriculture.
- **Food:** Livestock also provides with the basic nutritious foods like milk, egg, meat, etc thus ensuring healthy diet even in times of economic distress.
- **Social security:** The animals offer social security to the owners in terms of their status in the society. The families, especially the landless which own animals are better placed than those who do not.
- **Gender equality:** Animal husbandry promotes gender equality. More than 3/4th of the labour demand in livestock production is met by women. The share of women employment in the livestock sector is around 90% in Punjab and Haryana.
- **Protection against disasters:** Livestock are the best insurance against the drought, famine and other natural calamities. Majority of the livestock population is concentrated in the marginal and small size of holdings

Fisheries-The fishing community in India depends almost equally on inland sources and marine sources of fishing. Inland sources include rivers, lakes, ponds and streams etc.

Horticulture-Horticultural crops include fruits, vegetables and flowers besides several other. Over time, there has been a substantial increase in area under horticulture.

OUR ACHIEVERS

**SAURABH
TRIVEDI**
0 9 2 6 0 2

**PCS
OFFICER**



**CHANDAN
SHARMA**
3 0 1 3 4 9

**PCS
OFFICER**



**ROSHANI
SINGH**
1 9 8 0 1 1

**PCS
OFFICER**



Due to varying climate and soil conditions, India has adopted growing of diverse horticultural crops such as fruits, vegetables, tuber crops, flowers, medicinal and aromatic plants, spices and plantation crops.

These crops play an important role in providing food, nutrition and employment. The period between 1991-2003 is called '**golden revolution'** because during this period, the planned investment in horticulture became highly productive and the sector emerged as a sustainable livelihood option.

India has emerged as a world leader in producing a variety of fruits, like mangoes, bananas, coconuts, cashew, nuts and a number of species and is the second largest producer of fruits and vegetables.

Economic conditions of many farmers engaged in horticulture have improved and has become a means of improving livelihood for many unprivileged classes

Cottage and Household Industry-This industry has been dominated by such activities as spinning, weaving, dyeing and bleaching.

NABARD (National Bank for Agriculture and Rural Development)

- NABARD is a development bank focusing primarily on the rural sector of the country. It is the apex banking institution to provide finance for Agriculture and rural development.
- Its headquarter is located in Mumbai, the country's financial capital.
- It is responsible for the development of the small industries, cottage industries, and any other such village or rural projects.
- It is a **statutory body** established in 1982 under Parliamentary act-**National Bank for Agriculture and Rural Development Act, 1981**.

Functions of NABARD

- NABARD's initiatives are **aimed at building an empowered and financially inclusive rural India** through specific goal-oriented departments which can be categorized broadly into three heads: **Financial, Developmental and Supervision**.
 - It provides **refinance support** for building rural infrastructure.
 - It prepares **district level credit plans** to guiding and motivating the banking industry in achieving these targets.
- It **supervises Cooperative Banks and Regional Rural Banks (RRBs)**.
- It is involved in designing Union government's development schemes and their implementation.
- It provides **training to handicraft artisans** and helps them in developing a **marketing platform** for selling these articles.
- NABARD has various **international partnerships** including leading global organizations and **World Bank-affiliated institutions** that are breaking new ground in the fields of rural development as well as agriculture.
- These international partners play a **key consultant's role** in providing advisory services as well as **financial assistance** designed to ensure uplifting of rural peoples as well as optimization of various agricultural processes

CHAPTER - 15

This chapter will demystify the following concepts:

- ✓ Unemployment
- ✓ Types of Unemployment
- ✓ Types of Workers
- ✓ Work Force & Labour Force
- ✓ NSSO (National Sample Survey Organization)
- ✓ Causes of Unemployment
- ✓ Tackling Unemployment



Production Activity: It refers to the process of producing goods and services. Employed persons are those who are engaged in some production activity or the other.

Self-employed and Hired Workers: Self-employed workers are those who are engaged in their own business or own profession. Hired workers are those who work for others. They render their services to others, as a reward, get wages/salaries or maybe they are paid in kind.

Casual and Regular Workers: Casual workers are not hired by their employers on regular basis. Regular workers are permanent pay-roll of their employers. A regular worker is usually a skilled worker.

Labour Supply: It refers to supply of labour corresponding to different wage rates. Supply of labour is measured in terms of man-days of work.

Labour Force: It refers to the number of persons actually working or willing to work.

Work Force: It refers to the number of persons actually working and does not account for those who are willing to work.

Informalization of Workforce: It refers to a situation where percentage of work force in the formal sector tends to decline and that in the informal sector tends to rise.

Worker-population ratio:

- Worker-population ratio is an indicator which is used for analyzing the employment situation in the country.
- This ratio is useful in knowing the proportion of population that is actively contributing to the production of goods and services of a country.
- If the ratio is higher, it means that the engagement of people is greater; if the ratio for a country is medium, or low, it means that a very high proportion of its population is not involved directly in economic activities.

Unemployment:

- Unemployment is said to exist when people who are willing to work at the going wages cannot find jobs.
- Unemployment leads to wastage of manpower resource. People who are an asset for the economy turn into a liability.
- When we talk of unemployed people, we refer to those in the age group of 15-59 years. Children below 15 years of age and the old people above 60 are not considered while counting the number of unemployed

- Unemployment tends to increase economic overload. The dependence of the unemployed on the working population increases
- Workforce population includes people from 15 years to 59 years.

The most frequent measure of unemployment is the **unemployment rate**, which is the number of unemployed people divided by the number of people in the labour force.

National Sample Survey Organization (NSSO) defines employment and unemployment on the following activity statuses of an individual:

- Working (engaged in an economic activity) i.e., 'Employed'.
- Seeking or available for work i.e., 'Unemployed'.
- Neither seeking nor available for work.
- The first two constitute the labour force and unemployment rate is the percent of the labour force that is without work.
- **Unemployment rate = (Unemployed Workers / Total labour force) × 100**

The **NSSO** was set up in 1950 to conduct large-scale sample surveys throughout India. The employees of the NSSO are from the Indian Statistical Service (appointed through the UPSC) and the Subordinate Statistical Service (appointed through the Staff Selection Commission).

Types of Unemployment in India:

Disguised Unemployment: It is a phenomenon where more people are employed than actually needed.

- It is primarily traced in the agricultural and the **unorganized sectors of India**.

Seasonal Unemployment: It is an unemployment that occurs during **certain seasons of the year**.

- **Agricultural labourers in India** rarely have work throughout the year.

Structural Unemployment: It is a category of unemployment arising from the **mismatch between the jobs available** in the market and the skills of the available workers in the market.

- Many people in India do not get jobs due to lack of requisite skills and due to poor education level, it becomes difficult to train them.

Cyclical Unemployment: It is a result of the business cycle, where **unemployment rises during recessions and declines with economic growth**.

- Cyclical unemployment figures in India are negligible. It is a phenomenon that is mostly found in capitalist economies.

Technological Unemployment: It is the loss of jobs due to **changes in technology**.

- In 2016, **World Bank** data predicted that the proportion of jobs threatened by automation in India is 69% year-on-year.

Frictional Unemployment: The Frictional Unemployment also called as **Search Unemployment**, refers to the **time lag between the jobs when an individual** is searching for a new job or is switching between the jobs.

- In other words, an employee requires time for searching a new job or shifting from the existing to a new job, this inevitable time delay causes frictional unemployment.
- It is often considered as **voluntary unemployment** because it is not caused due to the shortage of job, but in fact, the workers themselves quit their jobs in search of better opportunities.

Vulnerable Employment: This means, people working informally, without proper job contracts and thus without any legal protection.

- These persons are deemed 'unemployed' since records of their work are never maintained.

- It is one of the main types of unemployment in India.

Causes of Unemployment in India:

Social Factors: In India the caste system is prevalent. The work is **prohibited for specific castes** in some areas.

- In **big joint families** having big business, many such persons will be available who do not do any work and depend on the joint income of the family.

Rapid Growth of Population: Constant increase in population has been a big problem in India.

- It is one of the **main causes of unemployment**.

Dominance of Agriculture: Still in India nearly half of the workforce is dependent on Agriculture.

- However, Agriculture is underdeveloped in India.
- Also, it provides seasonal employment.

Fall of Cottage and Small industries: The industrial development had adverse effects on cottage and small industries.

- The production of cottage industries began to fall and many artisans became unemployed.

Immobility of Labour: Mobility of labour in India is low. Due to attachment to the family, people do not go far off areas for jobs.

- Factors like language, religion, and climate are also responsible for low mobility.

Defects in Education System: Jobs have become highly specialized but India's education system does not provide the right training and specialization needed for these jobs.

- Thus, many people who are willing to work become unemployed due to lack of skills.

Tackling Unemployment

Promoting Labour Intensive Industries: There are a number of labor-intensive manufacturing sectors in India such as **food processing, leather and footwear, wood manufacturers and furniture, textiles and apparel** and garments.

- Special packages, individually designed for each industry are needed to create jobs.

Decentralization of Industries: Decentralization of Industrial activities is necessary so that people of **every region get employment**.

- Development of the **rural areas will help mitigate the migration** of the rural people to the urban areas thus decreasing the pressure on the urban area jobs.

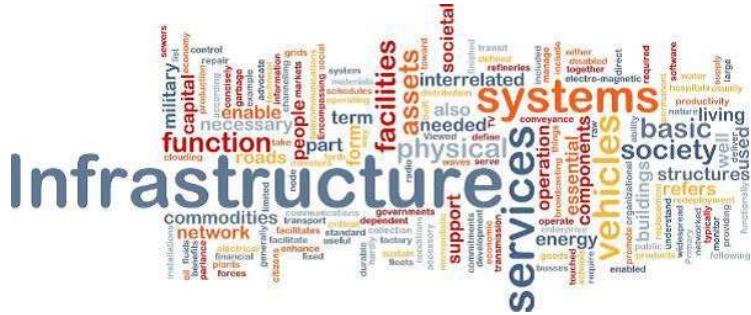
Drafting National Employment Policy: There is a need for a **National Employment Policy (NEP)** that would encompass a set of **multidimensional interventions covering a whole range of social and economic issues** affecting many policy spheres and not just the areas of labour and employment.

- The underlying principles for the National Employment Policy may include:
 - Enhancing **human capital through skill development**.
 - Creating **sufficient number of decent quality jobs for all citizens in the formal and informal sectors** to absorb those who are available and willing to work.
 - Strengthening **social cohesion and equity** in the labour market.
 - Supporting the **private sector to become the major investor** in productive enterprises.
 - Supporting **self-employed persons** by strengthening their capabilities to improve their earnings

CHAPTER - 16

This chapter will demystify the following concepts:

- ✓ **Different Types of Infrastructure**
- ✓ **Importance of Infrastructure**
- ✓ **Public & Private Infrastructure**
- ✓ **Health Infrastructure**
- ✓ **Indian System of Medicine- AYUSH**
- ✓ **Energy Infrastructure**
- ✓ **Challenges in Infrastructure**



Understanding Infrastructure

- It refers to basic facilities which help an economy to run
- It refers to network of physical faculties like roads, bridges, airports, ports etc.
- It also includes social infrastructure like healthcare, Sanitation, Education

Infrastructure provides supporting services in the main areas of industrial and agricultural production, domestic and foreign trade and commerce.

These services include roads, railways, ports, airports, dams, power stations, oil and gas pipelines, telecommunication facilities, the country's educational system including schools and colleges, health system including hospitals, sanitary system including clean drinking water facilities and the monetary system including banks, insurance and other financial institutions.

Concept of Infrastructure- Infrastructure refers to such core elements of economic and social change which serves as a support system to production activity in the economy.

Different Types of infrastructure

Infrastructure can be categorized into 2 types

1. Economic Infrastructure
2. Social infrastructure

Economic Infrastructure- It refers to all such elements of economic change which serve as a support system to the process of economic growth.

Social Infrastructure- It refers to the core elements of social change which serve as a support system for the process of social development of a country.

Infrastructure and Development

Following observations show how exactly infrastructure contributes to the process of growth and development.

- Infrastructure impacts productivity
- Infrastructure induces investment
- Infrastructure generates linkages in production
- Infrastructure enhances size of the market
- Enhance ability to work
- Induces Foreign Direct Investment (FDI)

Different Types Of Infrastructure

Economic Infrastructure

They have Direct Impact on Production

They include
Energy
Transport
Communication

Example

If Electricity Available 24 hours
More Production Possible
If Power cut, less production

Social Infrastructure

They Indirectly support Production

They include
Education
Health
Housing

Example

If Health Facilities are good
Employees will have more Productivity
They will be able to better contribute to production process



School, Colleges, Training Centres



Hospitals, Mohalla Clinics



Internet, Telecommunication
(2G,3G,4G,5G)

Housing

This is Social Infrastructure



Electricity, Hydroelectricity, Wind Energy, Thermal Energy



Roads, Bridges, Rail Transport,



Houses, Apartments, Colonies

Communication

This is Economic Infrastructure

Relevance and Importance of Infrastructure

Helps In Industrial Development

- Infrastructure is support system of Modern Industrial Economy
- Infrastructure provides Roads, Ports, Airports, bridges which help in Industrial Development
- It also provides energy which is required in industrial production



Roads



Railways



Electricity

All this leads to more Production and Industrial Development

Helps in Agriculture

- It helps in transporting seeds, pesticides, fertilizers as well as finished goods
- Agriculture also depends upon insurance and banking facilities
- **Example** - Farmers require crop insurance as well as loans from banks



Transport Facilities
(To transport seeds, fertilizers and crops)



Insurance
(For Crops)



Banking
(For Agricultural Loans)

All this leads to Agricultural Development

Improves Quality of Life

- Good Sanitation and Education helps in improving quality of life of people
- Also, good communication facilities like internet, post and telegraph help people to contact with each other



Education
(Schools, Colleges, Training Centers)



Communication
(Internet, Post, Telephone)



Good Sanitation
(Proper Sewage, Garbage Disposal)

All this Improves Quality of life of People

Reduces Morbidity

- Morbidity means proneness to fall ill.
- Clean Drinking Water and Good medical facilities help in preventing many diseases.

Infrastructure Provides



Clean Drinking Water



Good Medical Facilities

*All this help in preventing
many diseases
(Reduces Morbidity)*

Different States with Best Infrastructure in India

Infrastructure helps in development of country

Different States of India which have best infrastructure in different fields prosper

Different States with Best Infrastructure



Punjab



Haryana

Best Irrigation Facilities

Example-Bakra Nangal Dam, Canals
These States Prosper in Agriculture



Maharashtra

Gujarat

Best Transportation Facilities (Near Ports)

These States do well in Manufacturing Industry
as raw materials required are easily accessible



Bangalore

Best Communication Facilities and IT Infrastructure

It does well in Software and IT Field
Many companies operate from Bangalore

Who is Responsible for Developing Infrastructure in India?

Public Sector

Traditionally Govt was solely responsible for developing infrastructure

Example - It is responsibility of govt to make roads, bridges etc.

Private Sector

Private Sector by itself also sometimes leads to development of infrastructure

Example - Reliance Jio was launched by Reliance, Adani Ports by Adani

Joint Partnership

Many projects are held in partnership with govt and private sector

Example - Many toll roads and toll plaza are made by private sector in partnership with govt



How is Infrastructure Development different for low income and high-income countries?

For low Income Countries

These are mainly dependent on agriculture

Basic Infrastructure Services are more important

Example - Transport, Power, Irrigation

For high Income Countries

For these countries, share of agriculture sector is less

More service-related infrastructure is required

Example - Better Telecommunication Infrastructure (like better internet speed)

Infrastructure in Low Income and High Income Countries

Low Income Countries

They are less Industrialized
More dependent on Agriculture

Basic Infrastructure is required

Example
Transport, Power, Irrigation

High Income Countries

They are more Industrialized
More dependent on Industry and Service Sector

Service Related Infrastructure is Required

Example
Better Telecommunication Infrastructure (like better internet speed)

Is Investment in India sufficient as compared to other countries?

- No
- India spends only 30% of its GDP on Infrastructure
- It is far less than % spending by countries like China and Indonesia
- India is still lacking in basic infrastructure especially in rural areas

Infrastructure Issues in Rural India



Lack of Electricity

Only 56% have Electricity connection
43% still use kerosene



Lack of Cooking Gas

85% still use cow dung as Bio Fuel



Lack of Drinking Water

Tap water available to only 31% of Households
69% Drink water from Open sources



Lack of Proper Sanitation

Improved Sanitation available to only 30% of Population

China

- Investment in Infrastructure
44% of GDP
- Drinking Water Resources
96% of Population
- Sanitation Services
72% of Population
- Consumption of Energy
324 million tones
of Oil Equivalent

India

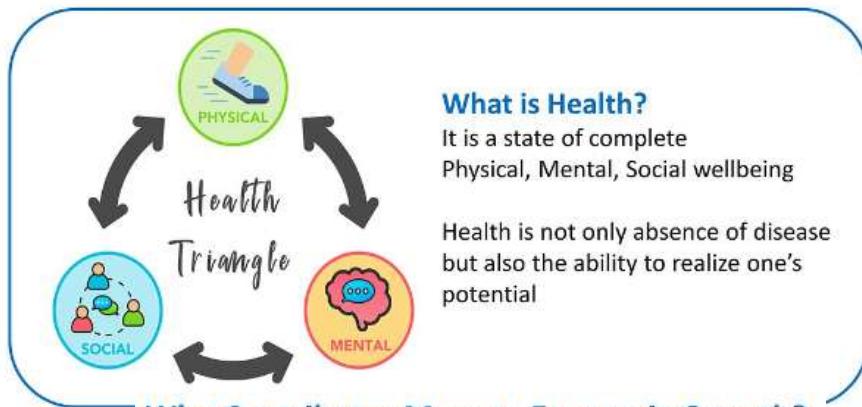
- Investment in Infrastructure
30% of GDP
- Drinking Water Resources
94% of Population
- Sanitation Services
40% of Population
- Consumption of Energy
809 million tones
of Oil Equivalent

*Infrastructure Facility in India is insufficient
Basic Facilities are still not provided to large chunk of Population especially in Rural Areas*

What is Health?

Health Sector Development

- Health is not only the absence of disease but ability to realize one's potential
- It means achieving complete mental, physical and social wellbeing



What is Health?

It is a state of complete Physical, Mental, Social wellbeing

Health is not only absence of disease but also the ability to realize one's potential

Why is Health Important?

- Health is a holistic process important for overall growth and prosperity of a nation
- If population of country is not healthy, it will not contribute to growth and prosperity of a nation

Who Contributes More to Economic Growth?



Healthy Person



Sick person

He is fit and has higher productivity in job
So, contributes more to Economic Growth

He is sick and weak and has lower productivity
Doesn't contribute much to economic Growth

What is Health Infrastructure?

- Health Infrastructure means making available to Public facilities like- Hospitals, Doctors, Nurses, beds, Medicines etc.

HEALTH INFRASTRUCTURE

It is a state of complete Physical, Mental, Social wellbeing

It refers to basic facilities which help an economy to run

Health Infrastructure means providing basic health facilities to public like Hospitals, Doctors, Nurses, Beds, Medicines, Vaccines etc.



Health Infrastructure

Different Types of Health Infrastructure

How to keep person Healthy



Get them Vaccinated to Prevent Disease



Treat their disease



Make them Aware about health issues



Provide Clean Drinking Water

Preventive Medicine Infrastructure

It means providing facilities for preventing diseases like COVID Vaccines

Curative Medicine Infrastructure

(it means providing facilities of doctors, hospitals, beds, surgery, medicine to cure different disease

Social Medicine Infrastructure

(it means providing awareness about different health issues through banners, pamphlets, advertisements

Basic Facilities Infrastructure

(it means providing facilities like clean drinking water, garbage removal to reduce risk of different diseases

Development of Health Services After Independence

There has been a large-scale improvement in health facilities. Following are the highlights:

- Decline in death rate
- Reduction in infant mortality
- Rise in expectancy of life
- Control over deadly diseases
- Reduction in child mortality rate

Three Tier System of health Infrastructure

India's health infrastructure is made up of 3 tiers:

1. Primary Sector
2. Secondary Sector
3. Tertiary Sector

What are Primary Health Centers or Community Health Centers?

- They provide Primary healthcare Services in Rural Areas and Small Towns
- They are run by Single Doctor, a nurse and limited medical supplies
- They provide immunization and vaccination and treat basic health issues like high fever etc.
- When the condition of a patient is serious, they refer them to secondary or tertiary hospitals

Story of Mr Raju

Mr. Raju was feeling chest pain



He approached his local Village Primary Health Center

Doctor gave some medicine and advised ECG

So we went to local district hospital for ECG

Doctor diagnosed tumor in heart and referred him to AIIMS Delhi

Surgery was finally conducted at AIIMS Delhi and he is fine now

Different Sectors in Health Infrastructure



*This is Primary Sector
They treat only basic health issues*



*This is Secondary Sector
They provide primary health care facilities + additional facilities like ECG, X Ray*



*This is Tertiary Sector
They provide specialized health care as well as Quality Medical Knowledge*

Three Tier System of Health Infrastructure

Primary Sector

They provide Primary Healthcare facilities

They are present in villages and small towns

Less Medical Staff

Example
Primary Health Center

Secondary Sector

They provide Primary Healthcare Facilities + Additional Facilities like X Ray, ECG, MRI, Surgery

They are present in district level

More Medical Staff and More Facilities

Example
District Hospital

Tertiary Sector

They provide Advanced Medical Surgery + Quality Medical Education

These are present in major cities of India like Delhi

Very high Medical Staff latest machines and Infrastructure

Example
AIIMS

Primary Health Center



Which Tier?	Primary Sector
Where Found?	Rural Areas Small Towns
Which Services?	Primary health care Services like Vaccination TREATING High Fever, Cold etc.
Type of Infrastructure?	Single Doctor Nurse (AXM) Limited Medical Supplies

Who is AXM?

- AXM means Auxiliary Nursing Midwife
- It is the first person which provides primary healthcare in Rural Areas
- An auxiliary nurse is involved in providing basic services like checking temperature and Blood pressure of patients, vaccination etc.

Who is AXM?



Full Form	Auxiliary Nursing Midwife
Meaning	It is the first person which provides Primary Healthcare in Rural Areas
Functions	Basic services like checking temperature and Blood pressure of patients, vaccination etc.
Where Present	Primary Healthcare Center in Rural Areas

Private Sector Health Infrastructure

VS

Public Sector Health Infrastructure



Private Hospitals



Private Clinics



AIIMS



PHC

They run
Private Run hospitals
clinics, Nursing Homes

Present Mostly in
Cities

They cover
70% of hospitals
2/5 of Hospital beds
80% of OPD
46% of Inpatient

They provide
Medical Tourism

They run
Govt run hospitals
and health Centers

Present in both
Cities and Villages

They cover
30% of hospitals
3/5 of Hospital beds
20% of OPD
54% of Inpatient

They normally treat
Indian Patients

Private Sector Health Infrastructure

Private Sector is also involved in developing health infrastructure in India on a large scale

Example - There are many privately run hospitals, clinics, nursing homes across India

Important Points

- More than 70% of Hospitals run by Private Sector
- 2/5 of Hospital beds are in Private Sector
- 80% of Outpatients (OPD) are managed by Private Sector
- 46% of Inpatients are managed in Private Sector
- Private Sector are actively involved in Education and Training of Medicine Professionals, Medical Research, Sale of Pharmaceuticals etc.
- Many super specialty hospitals have been developed in India after liberalization.
- These provide Medical Tourism to India

What is Medical Tourism?

Many people from outside country are coming into India for their medical treatment

This is called Medical Tourism

Reason:

India has latest medical technologies and trained doctors

Cost is much less as compared to developed countries like USA.

Benefits to India

It leads to increase in foreign exchange for India and enables India to become recognized and trusted medical facility hub.

Foreign Patient

Treatment

Indian Hospital

Benefits

- Savings in Cost
- Qualified Doctors
- Good Health Infrastructure

Benefits

- Increase in Revenue of Hospitals
- Increase in Foreign Exchange to India
- Boost Local Economy (Stay and Travel Cost of Tourism and Attendant)

Ex:



USA Patient to undergo Surgery

Cost in USA

\$ 10000

This is Expensive

Cost in India

Rs 150000
(\$ 2000)

+
\$1000 Travelling Cost

This is Cheaper

Treatment in Afghanistan

Not Available
(Lack of latest equipment)
(Not many Qualified Doctors)

This is not an option

Treatment in India

Available
Reasonable Rates
Good Medical Infrastructure

So Afghan Patient comes to India for treatment

Example 2 -Medical Tourism



Afghanistan Patient to undergo Surgery

What is Indian System of Medicine?

It refers to 6 systems of Medicine which were traditionally used in India. They are together called **AYUSH**:

- A-Ayurveda
- Y-Yoga
- U-Unani
- S-Siddha
- H-Homeopathy and Naturopathy



Allopathy



It is conventional system of medicines followed worldwide

There are Side effects Of using these medicines

Expensive Treatment

Standardized Education

Proper Research and Development

Ayush



It is Indian system of medicines traditionally followed

They are effective and safe (no side effects)

They are relatively inexpensive

No Standardized Education

Lack of Research and Development

Evolving Standards of AYUSH

Ayurveda, Siddha, Unani and Homeopathy drugs consist of various kinds of formulations prepared from plants, minerals, metals, animal and marine products as raw material. These formulations are prepared after various kinds of processing with the specific methods prescribed in these systems. These formulations are grouped in various dosage form according to their method of preparation, acceptability, bioavailability and therapeutic values.

Given the growing consumer acceptance of AYUSH in the domestic and global society as an important component of pluralistic schemes of healthcare, the **Govt. of India (Centre of Excellence, Ministry of AYUSH)** has decided to identify reputed AYUSH knowledge engage in Education / Drug Development & Research / Clinical Research etc. in Government/Non-Government/ Non-profit and to support them to upgrade their functions and facilities to levels of excellence.

National AYUSH Mission: The basic objective of NAM is to promote AYUSH medical systems through cost effective AYUSH services, strengthening of educational systems, facilitate the enforcement of quality control of Ayurveda, Siddha and Unani & Homoeopathy (ASU & H) drugs and sustainable availability of ASU & H raw-materials.

Drug Control Cell (Ministry of AYUSH):

To administer regulatory and quality control provisions for Ayurveda, Siddha, Unani & Homoeopathy (ASU&H) drugs. It also manages the implementation of the Quality Control of ASU&H drugs related part of the National AYUSH Mission (NAM) through which grant in aid is provided for improving infrastructural and functional capacity of Drug Testing Laboratories & Pharmacies.

Urban-rural and Poor-rich Divide

Differences in medical healthcare between urban – rural and poor-rich can be understood from the points given below

- Only one-fifth of total hospitals are located in rural areas. Rural India has about half the number of dispensaries. People in rural areas do not have sufficient medical infrastructure. This led to difference in the health status of people. Out of 7 lakhs beds, roughly 11% are available in rural areas.
- There are only 0.36% hospital for every one lakh people in rural areas while urban areas have 3.6% hospitals for the same number of people.
- The PHCs located in rural areas do not offer even X-ray or blood testing facilities which, for a city dweller, constitutes basic healthcare. Even though 315 recognized medical colleges produce 30,000 medical graduates every year. Still there is

Healthcare For Rich Vs Poor

Rich People



Higher Income



Have proper Diet



Maintain Proper Hygiene



Less Prone to Disease

Poor People



Lower Income



Can't Afford Nutritious Diet



Do not maintain proper hygiene



They fall ill easily

shortage of doctors in rural areas. One-fifth of these doctors migrate from one country to another for better job opportunities.

- The poorest 20% of Indians living in both urban and rural areas spend 12% of their income on healthcare while the rich spend only 2%.

Who Spends Higher on Health?



High Global Burden of Disease(GBD)

- GBD is an indicator which measures number of people dying prematurely due to a particular disease or number of years they spend in state of disability in case of disease
- India bears 20% of Global Burden of Disease (GBD)
- It means large number of death and disabilities of diseases of world is found in India

What steps need to be taken to Improve health infrastructure in India?

1. Public Health Services need to be decentralized

(Instead of having only few good hospitals in main cities, we should have good health infrastructure all over India, especially rural areas)

2. Better health infrastructure required

More hospitals and clinics needed to be opened to serve vast population of India especially in rural areas

3. Primary health Care need to be developed

This will help in treating symptoms in early stage and preventing serious disease

4. Better Health Education

Proper Education needed to be taken in maintaining health and hygiene and preventing various diseases

5. Use of information technology to Improve health

Information Technology (internet) can be used to spread information about various diseases and how to prevent ourselves from it

Energy Sector

In Economics, Energy means power utilized from utilization of physical or chemical resources to run machines and provide heat and light.

Example

- We burn coal to generate heat, so it is a form of energy
- We use petrol to run our cars (which is a machine), so petroleum is a form of energy

Why do we need energy?

- It is used in Industries to Run Machines
- It is used in houses for cooking, heating and lighting
- It is used in Agriculture to transport agriculture goods, fertilizers, seeds as well as irrigation (tube wells use electricity to draw water for irrigation)

In what forms energy available?

Energy is available in various forms like:

- Coal
- Petroleum
- Electricity
- Fuel Wood
- Cow Dung etc.

Some of these are commercial while others are non-commercial:

Different Sources of Energy

Commercial Sources

- There is commercial trading of this source of energy
- It can be easily brought and sold and is available to consumers at a price
- They are produced in power plants

Example

- Coal, Petroleum, Electricity
- It is used in both urban and rural areas
- It is exhaustible source of energy except hydropower energy
- (It is available in limited supply and will be finished in future)
- They can be conventional or Non-Conventional Source of energy

Non-Commercial Sources

- There is no commercial trading of the source of energy
- It is normally available to customers free of cost
- They are naturally found in nature

Example

- Cow Dung, Fire wood
- It is mainly used in urban areas
- It is inexhaustible source of energy
- They are conventional sources of energy

Consumption Pattern of Energy in India

More Commercial Energy Used. Share of Commercial Energy is more than non-commercial energy

- Commercial Energy 74%
- Non-Commercial Energy 26%

Share of Coal is highest followed by oil and natural gas

- Coal 54%
- Oil (Petroleum) 32%
- Natural Gas 10%
- Hydro and Other Renewable 4%

Over 80% of India's energy needs are met by three fuels: coal, oil and solid biomass. Coal has underpinned the expansion of electricity generation and industry, and remains the largest single fuel in the energy mix. Oil consumption and imports have grown rapidly on account of rising vehicle ownership and road transport use. Biomass, primarily fuelwood, makes up a declining share of the energy mix, but is still widely used as a cooking fuel. Despite recent success in expanding coverage of LPG in rural areas, 660 million Indians have not fully switched to modern, clean cooking fuels or technologies.

Natural gas and modern renewable sources of energy have started to gain ground. The rise of solar energy in particular has been spectacular; the resource potential is huge, ambitions are high, and policy support and technology cost reductions have quickly made it the cheapest option for new power generation.

- Coal is mainly used to generate electricity.
- It is a fossil fuel and exhaustible in nature
- Burning of coal lead to pollution
- Share of Atomic Energy is only 2.5% which is much less than global average of 13%
- Share of Renewable Sources of electricity like solar energy and wind energy is very less, it needs to be increased

In India, power is generated from conventional (Thermal, Nuclear & Hydro) and renewable sources (Wind, Solar, Biomass etc.). However, Major production of electricity is achieved through coal a thermal power.

As of September 2021, thermal power— power generated from burning coal, gas and petroleum— comprised 60% of India's installed capacity in power generation. Coal alone accounted for nearly 50%. By comparison, renewable sources such as wind and solar energy and biomass accounted for 26%.

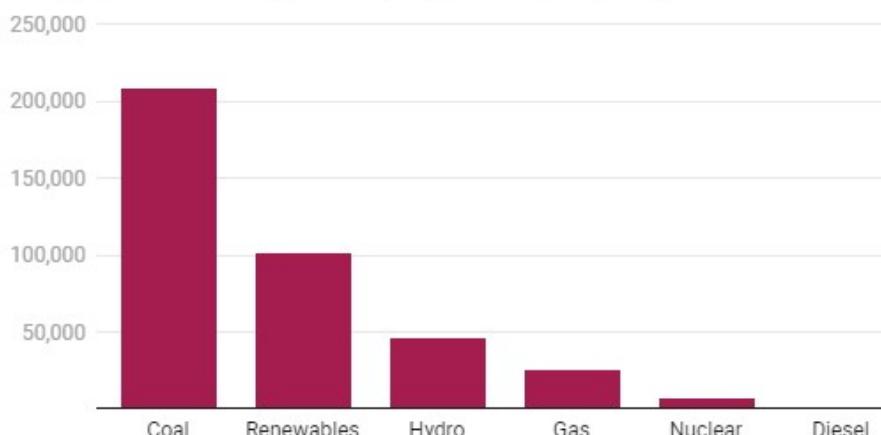
Challenges in Power Sector

1. Insufficient Installed Capacity

Demand for energy in India is rapidly increasing due to Increase in Population as well as Increase in Economic Development. Energy supply needs to be increased accordingly.

Over 50% of India's installed power capacity is in coal-based power plants

Category-wise installed power capacity in India (Megawatt)



2. Underutilized Installed Capacity

Plans which are running are not been functioning properly. Hence, they are not able to generate electricity up to their installed capacity.

3. Transmission Loss

(Electricity which is generated in first transferred to power stations which transfer to our homes and offices. A lot of electricity is lost during this transmission and hence there is lot of difference between electricity generated and electricity used.

4. Wrong Pricing of Electricity

Electricity Rates are heavily subsidized especially to poor and middle-class families. In many states, it is provided free of cost. This leads to loss of State electricity boards (SEB).

5. Distribution of Free Electricity to Farmers

In Many states, farmers get electricity free of cost or at subsidized rates for irrigation. This leads to losses of SEB

6. Theft of Electricity

Many people steal electricity and tamper their Electricity meters. This leads to losses of SEB

7. Shortage of Raw Materials

Thermal Power Plants mainly run-on coal. However, supply of coal is insufficient in many areas.

8. Public Unrest

Common Public has to face lot of problems due to frequent power cuts as well as high electricity bills.

What is the reason for heavy losses to State Electricity Boards?

State Electricity Boards are suffering huge losses due to following reasons:

- Transmission Loss
- Wrong Pricing of Electricity
- Distribution of Free Electricity to Farmers
- Theft of Electricity

Measures to be taken to Revive Electricity Sector:

1. More Public investment

Govt needs to increase its spending in Electricity Sector by opening Power Plants. This will generate additional electricity

2. Better Research and Development Efforts

Research and Development needed to develop alternative sources of energy and reduce the dependence on coal and petroleum (Example-Electric Cars)

3. Use of Renewable Sources of Energy

Currently coal and petroleum are mainly used to generate electricity. These are harmful to environment and generate more carbon footprint. Instead of them, we can use alternative sources of energy like wind energy, solar energy.

4. Use of CFL and LED Bulbs to Save Energy

Traditional bulbs consume lot of electricity. They were replaced by CFL Bulbs which were later replaced by LED Bulbs. LED Bulb consumes half electricity compared to a CFL Bulb and 1/10 energy as compared to traditional bulb. Moreover, this bulb last longer compared to traditional bulb

CHAPTER 17

This chapter will demystify the following concepts:

- ✓ Sustainable Development
- ✓ Strategies for Sustainable Development
- ✓ Global Warming
- ✓ Absorptive Carrying Capacity of Environment
- ✓ Basics of Environment

What is Sustainable Development?

It means Development which meets need of present generation without compromising ability of future generation to meet

their own needs.

It means our economic development should not damage the environment so much that our future generations have to face environmental problems.

For example-

Our factories should not generate so much air pollution that it is difficult to survive for our future generations.

How can we achieve Sustainable Development?

1. Limiting the Human Population



Sustainable Development needed because
Our economic development should not damage the environment so much that our future generations have to face environmental problems



Sustainable → Something Which can be maintained for long period of time (For future generation)
+
Development → Progress or Economic Development (for current generation)
=
Sustainable Development → Development which meet needs of current Generation without compromising ability of future generation to meet their needs



Lesser the population, less will be burden on environment (Example less trees to be cut, less water is polluted, less garbage produced)

2. Technological Progress should be input efficient

(We should develop new technologies which use those inputs which are environment friendly and available in large amount

(Instead of generating electricity from coal, we can use solar power)

3. Rate of extraction of renewable resources should not be more than rate of regeneration (Example - Tree is a renewable resource, if 1000 Trees are cut, more than 10000 should be planted in its place)

4. Controlling Pollution

(Air and water pollution should be controlled so that our future generation have clean air to breathe and clean water to drink)

Problems



More Population → More Garbage

*Population Explosion
(Creating Burden on Resources)*

What To Do



Less Population → Less Waste

*Limiting the Population
to reduce burden*



More Industries → More Coal Required

*Technological Progress
Is Input Consuming*



More Industries → Use Solar Power

*Technological Progress
should be Input Efficient*

What is Brundtland Commission?

It is a suborganization of United Nations. Its aim is to unite countries in pursuit of sustainable development. This commission emphasizes on following points-

- We should protect the interests of future generation
- It is our moral responsibility to hand over planet in good order to future generation
- They should have a quality of life no less than what we inherited

It furnished a report in 1987- '**Our Common Future**'. As per this Report,

Sustainable development means meeting basic needs of all. "Sustainable development is development that meets the needs of the present without compromising the ability of future generations to meet their own needs."

Strategies For Sustainable Development

Strategy-1: Use of Non-Conventional Source of Energy

Conventional Sources

Sources of energy which are *normally used* Since long period of time

Example



Thermal Energy *Hydro Energy*

Non Conventional Sources

New Sources of energy which *have not been much used* due to lack of technology

Example



Solar Energy *Wind Energy*

Problems

- Causes Pollution
- Limited Supply
- Doesn't cause Sustainable Development

Advantages

- More used as technology easily available

Advantages

- Environment Friendly
- Abundant Supply
- Leads to Sustainable Development

Problems

- Less used because of lack of technology

Problems with Conventional Energy

These sources of energy are not Environment Friendly

Example 1

- In Thermal Power Plants, Coal is burnt to generate electricity
- This generates large amount of Carbon dioxide which causes Green House Effect
- It also produces fly ash which also causes water and land pollution



Thermal Power Plant

Coal is burnt to Generate Electricity

Problems

Burning Coal Releases Carbon dioxide
It is a Green House gas

Raises Temperature
Causes Global Warming

Fly ash also produced
Contaminates Land and Water

Coal Reserves available in Limited Supply Will be exhausted in future



Hydel Power Plant

Water is used to Generate Electricity

Problems

Dams are Created to block flow of water
Natural flow of water is disturbed

Forests are flooded
Lead to loss of Habitat for Plants & Animals

Example 2

- Hydroelectric Plants generate electricity with help of water
- This causes flooding in forests.
- Also, it interferes with natural flow of water

Why Non-Conventional Sources of energy should be used?

Cleaner-These do not cause pollution and are environment friendly.

Abundant Supply-They are available in abundant supply and would not be depleted.

Problems/Challenges-They are used less due to lack of technological devices.



Wind Energy

Electricity generated using Power of Wind



Solar Energy

Electricity Generated using Sun's energy

Benefits

- Available in abundant supply
- Will not be exhausted
- Doesn't cause Pollution

Benefits

- Available in abundant supply
- Will not be exhausted
- Doesn't cause Pollution

Strategy 2- Use of LPG and Gobar-Gas in Rural Areas

Traditional Fuels in Rural Areas

In earlier times, Rural Households generally used cow dung cakes or wood as fuel.

This leads to-

Deforestation (Cutting of trees to Obtain wood for burning)

Air Pollution (Burning of wood/cow dung causes air pollution which damages the lungs)



Cow Dung Cake

Problems

Burning of these Causes Pollution

Causes Wastage of Cattle Dung (Which could be used as Manure)



Burning of Wood

Problems

Burning of these Causes Pollution

Leads to Cutting of Trees and Deforestation

New Methods Promoted by Govt

1. Subsidized LPG

- LPG means Liquified Petroleum Gas. These are regular gas cylinders used at home.
- Govt has started giving this at subsidized rates in Rural areas to promote its use.
- Use of LPG leads to reduction in air pollution and preventing trees from being cut.

2. Gobar Gas Plants

- Cattle Dung is collected and fed to gobar gas plants.
- This generates gas from the cattle dung.
- This gas is supplied to homes to be used as fuel.
- The leftover slurry is used as soil conditioner and organic manure.
- Govt has promoted the use of gobar gas plants by providing subsidy and easy loans.



Gobar Gas Plants

Cattle dung is fed to Plant
Gobar Gas and Slurry Produced

Benefits

- Gobar gas used as Fuel
Reduces Household Pollution
- Slurry used as Organic Manure
and Soil conditioner

Govt gives
Subsidy (Discount) & Loans
to make Gobar Gas Plant



LPG Cylinder

Cooking gas provided to
homes by Govt Agencies

Benefits

- LPG Cylinder is cleaner fuel
Reduces Household Pollution
- Prevents trees from being cut

Govt gives
Subsidy (Discount)
on LPG Cylinders

Strategy 3 - Use of CNG in Urban Areas and Odd Even Scheme

CNG means Compact Natural Gas. It is a fuel which can be used as alternative to petrol and diesel.

Benefits of Using CNG

Cleaner Fuel- Smoke from petrol and diesel cars cause lot of pollution. Use of CNG has helped to make air cleaner

Saves Costs- Vehicles running on CNG give better mileage and save costs compared to petrol and diesel cars.

New Alternative Measures to Reduce Pollution



Using CNG

It is a cleaner fuel, doesn't cause pollution,
Saves Cost (Better Mileage)



Using Electric Vehicles/E-Rickshaw

It also doesn't cause pollution
Saves Cost (Better Mileage)



Car Pooling

Two or More People Share one car
Saves Costs, Reduces Pollution and Traffic



Scheme launched by Govt to Reduce Pollution

As per ODD Even Scheme of Delhi Govt
Odd numbered vehicles to operate on odd days
Even numbered vehicles on Even Days

Fuel for Vehicles in Urban Areas



What initiatives have been taken by cities like Delhi to Prevent Pollution?

1. Compulsory CNG for Public Transport

Use of CNG made compulsory for Public Vehicles like Buses and Auto rickshaw

2. Odd Even Scheme

Delhi govt also launched Odd Even Schemes to reduce air pollution.

On Odd Days, odd numbered vehicles run and on even dates even numbered vehicles run.

Strategy 4-Wind Power

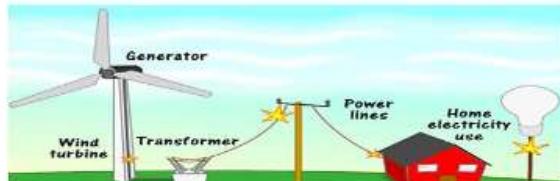
What is Wind Power?

Power obtained by harnessing energy of wind is called Wind Power.

Power of wind makes the turbines move and generate electricity.

Where is Wind Power Used?

It is used in those Places where wind speed is higher.



Meaning	→ Power obtained by harnessing energy of wind is called Wind Power
How it Functions	→ Power of wind makes the turbines move and generate electricity
Where Used	→ In Windy Areas (Open Spaces not surrounded by buildings)
Benefits	→ Saves Costs Pollution Free

Example

Open spaces not surrounded by buildings.

What is the benefit of Using Wind Energy?

1. Free from Pollution

Coal is not burnt to generate electricity, hence it does not cause air pollution

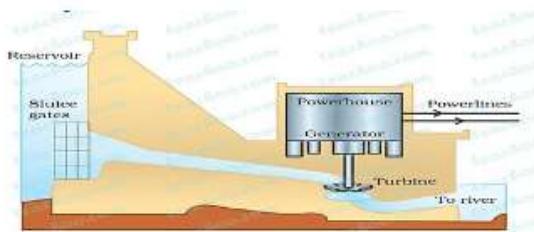
2. Saves Cost

Wind Energy can be used locally and there is no need for expensive grid lines and cables to transmit electricity over large areas

Strategy 5-Mini Hydel Plants

What are Hydroelectric Power Plants?

- These are power plants which generate electricity with the help of water
- Water is allowed to fall on turbines which move generating electricity



What are Mini Hydel Plants?

- These also generate electricity from flow of water on a small scale
- These are developed in mountainous areas where there are lot of streams
- Energy from streams is used to turn small turbines
- These generate small amount of electricity.

Meaning	→ <i>These are power plants which generate electricity with the help of water</i>
How it Functions	→ <i>Energy from streams is used to turn small turbines</i> <i>These generate small amt of electricity which can be used electricity</i>
Where Used	→ <i>In mountainous areas (where there are lot of streams)</i>
Benefits	→ <i>Environment Friendly (No Pollution)</i> <i>No Need for Large Investments</i> <i>Less Transmission Loss</i>

Benefits of Mini Hydel Plants

1. They are environment friendly

They do not burn coal to generate electricity and hence do not cause pollution.

2. No Need for Large Investments

They do not need large transmission towers and cables. Hence, they are budget friendly

3. Less Transmission Loss

Since electricity is to be used locally, there is less transmission loss from transmitting from power stations to homes.

Strategy 6 - Using Traditional Knowledge and Practices

We should use traditional Indian Practices in health care, agriculture, housing, transport etc.

Example

Ayurveda, Yoga, Unani, siddha, Tibetan

Benefits

1. These practices are environment friendly
2. No Harmful chemical used
3. No Side effects
4. Does not involve large scale industrial or chemical processes
5. Do not cause Pollution



Modern System

Use Chemicals
(Harmful to Body)

Developed in Large Scale Industries
(Cause Pollution)

Traditional Systems

Use Natural Products
(No Side Effects)

No Large Scale Industrial Processing Required
(Pollution Free)

Doesn't Damage Environment
Leads to Sustainable Development

Strategy 7 – Using Bio-Compost

What is Bio Compost?

- It is decayed organic matter which is used as manure
- This manure is used to make soil fertile for agriculture

How is Bio Compost Made



Dead Plants and leaves are stored in Compost Bin



These are mixed with cow dung which is used as soil conditioner



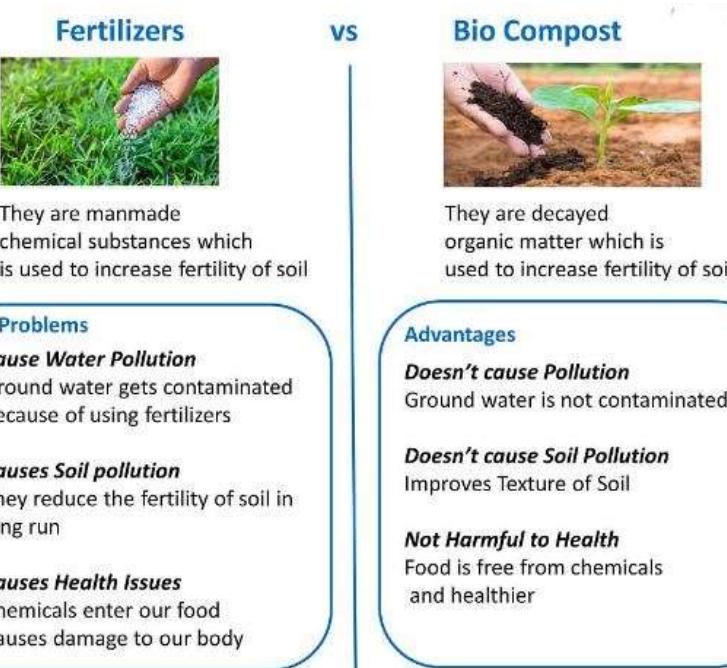
Earthworms are used as they make the composting process faster

How is Compost Made?

- Dead Plants and leaves are stored in Compost Bin
- These are mixed with cow dung which is used as soil conditioner
- Earthworms are used as they make the composting process faster

Why should Bio Compost be used instead of fertilizers?

- Fertilizers cause soil pollution and water pollution
- Ground water gets contaminated because of using fertilizers
- They also reduce the fertility of soil in long run
- Crops grown by using organic manure and biocomposting are free from chemicals and healthier as compared to fertilizers



Strategy 8 Bio-Pest Control

What are Pests?

Animals and insects which attack crops and food are called Pests.

Example - Rats, Ants, Cockroaches etc.

What are Pesticides?

It is a chemical substance which is used to kill pests.

These Pesticides are sprayed to prevent the crop from damage and increase yield.

What are harmful effects of using Pesticides?

- They contaminate the soil
- That mix with water to cause water pollution
- They even contaminate the crop and food

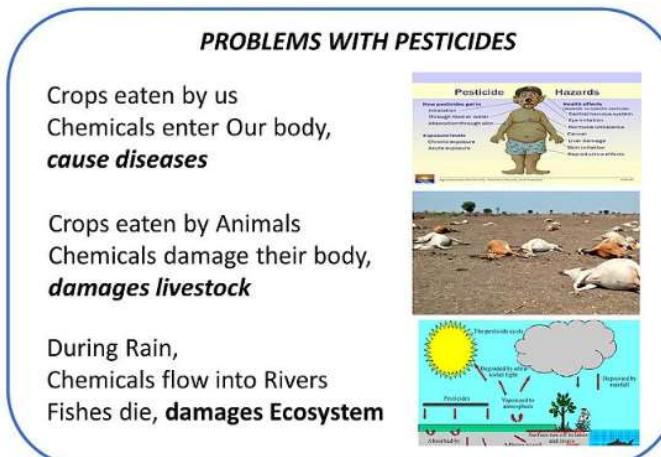
What is Bio-pest Control?

It is a process of controlling the growth of pests using Natural Methods.

Different Methods of Bio-Pest Control

Using Neem Made Pesticides

- Instead of using harmful chemicals, pesticides made from neem tree are used
- They do not cause any harm to human body



Mixed Cropping

- Mixed Cropping means growing more than one crop on same piece of land
- Pests are mainly attracted to crops due to their odour (smell)
- Growing 2 or more crops confuse the pests and they attack the crop less
- Many farmers also use trap crops (at boundary) - crops which pests do not like and main crop in the inside area to control pests

Using Animals and Birds to Control Pests

Various animals and birds feed on pests

Example - Snakes kill Rats, Lizard eats insects

These animals and birds can help to naturally kill pests

Different Types of Biopests Controls



Using Neem Based Biopests

↓
Neem Doesn't Contaminate Food or Cause Pollution

Mixed Cropping System

↓
Two or More Crops on Same Land (Confuses the Pests)

Using Animals/Birds to Control Pests

↓
Snakes Kills Rats
Bird kills insects

Solar Power



Strategy 9-Solar Power

What is Solar Power or energy?

- Energy Derived from the heat of the Sun is called Solar Energy
- Power derived from harnessing sun's rays is called solar power

How can Solar Energy be converted into electricity?

- Solar energy can be converted into Electricity with the help of photovoltaic cells
- Solar Photovoltaic (PV) cells generate electricity by absorbing sunlight and using that light energy to create an electrical current.

Meaning	→ Power obtained by harnessing energy of sun's rays is called Solar Power
How it Functions	→ By using Solar PV Cells (Photovoltaic Cells) They absorb sunlight and convert it into electric current
Where Used	→ Area closer to equator where plenty of sunlight is received
Benefits	→ Saves Costs Pollution Free Suitable for Remote Areas

Why is Solar Power suitable for India?

- India is closer to equator and have large open fields which receive plenty of sunlight throughout the year
- India also has shortage of electricity especially in rural areas
- Hence, solar energy can be used to provide electricity in remote areas where grid or power lines are either not possible or are very costly

What steps India have taken to increase Power Generation in Rural Areas?

- India is leading an international body in Solar energy called **International Solar Alliance**

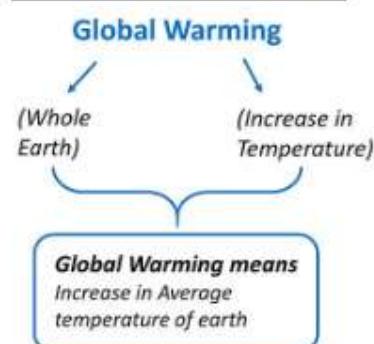
- India has encouraged use of Solar energy in villages by providing Solar Lights and **Solar Water Pumps** in Rural Areas
- **Solar Water Pumping** decreases impact on the environment by utilizing Solar Power in water irrigation, making the process sustainable and profitable in the long term.
- Hence the decrease in impact on Environment happens by shifting the source of energy by taking it directly from the sun. It also reduces the need for petrol/diesel and electricity.



Global Warming

What is Global Warming?

- It is the gradual increase in Average temperature of earth
- It is caused due to increase in Greenhouse gasses like Carbon dioxide (CO₂), Methane (CH₄), Nitrous Oxide, CFCs, Ozone, Sulphur hexafluoride (SF₆) etc.



What are Causes and Effects of Global Warming?

- Due to industrialization and urbanization, there is increased burning of fossil fuels and deforestation
- This has led to increase in greenhouse gases like carbon dioxide and methane in the atmosphere
- Also, there is increase in cattle production which release high amount of methane in environment

CAUSES OF GLOBAL WARMING



Industrialisation

More fossil fuel burnt like Coal, Petroleum

Increase in Carbon dioxide and Methane



Deforestation

Cutting of trees

Less trees in Environment
Less Carbon dioxide converted into Oxygen



Increase in Cattle Production

Higher Animal Waste Created

Increase in Methane

Example

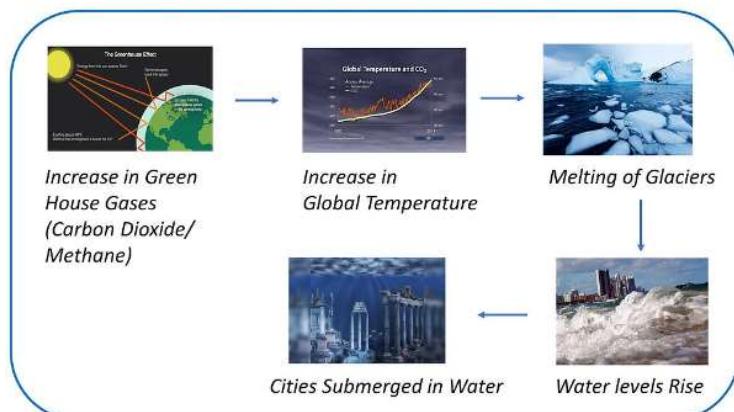
Average temperature of earth increased by 1 Degree in last century

Increase in Gases like Carbon dioxide and Methane
These gas trap heat of sun (causes Green house Effect)

Effects

- These gases have greenhouse effect (trap heat of the sun)
- It has led to increase in global temperature
- This has led to our glaciers getting melted and water level increasing
- In future, many cities may get submerged in water due to this.

What is Effect of Global Warming?



Absorptive Carrying Capacity of Environment

What happens when we use resource?

- When we use the resource, it gets depleted
- However, it is soon regenerated by environment
- Also waste products get absorbed in environment

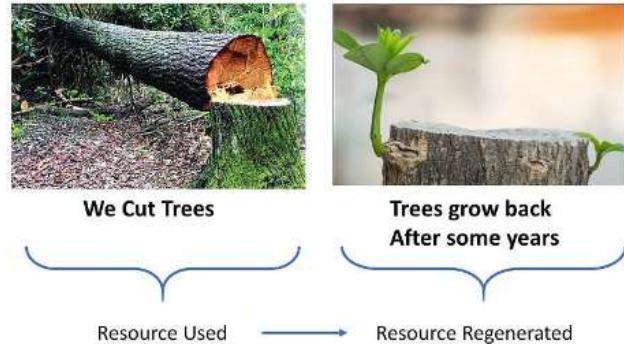
Example

- When we cut trees, they grow back after some time
- Also, decomposition of dead plants and trees mix nutrients into soil and make it fertile.

Is Rate of Regeneration Same for all Resources?

- No
- Some resources get regenerated in few months, Example - Plants

What Happens when we use a Resource ?



Example 1

Suppose in a Country	
Petroleum Available	2000 million tonnes
Petroleum Used every year	500 million tonnes
Time taken for Petroleum to Regenerate	10 million years

Year	Resource Available	Resource Extracted	Resource Regenerated	Closing Resource
1	2000	500	0	1500
2	1500	500	0	1000
3	1000	500	0	500
4	500	500	0	0

→ Resource Getting Depleted
→ Resource Getting Depleted
→ Resource Getting Exhausted

Rate of Extraction is more Rate of Regeneration is 0

Due to this Resource gets exhausted in Year 4

- Some take many years, **Example** - Trees
- Some take millions of years. **Example** - Coal, Petroleum

Why do Resources get exhausted?

It is because we are using the resources more than it is regenerated

Example - We are using huge quantity of petroleum but it will take millions of years to regenerate. Hence, petrol will get exhausted in near future

Example 2

Suppose in an Area

No of Trees Available	100
No of Trees Cut	60
No of Trees Grown	20

Year	Resource Available	Resource Extracted	Resource Regenerated	Closing Resource
1	100	60	20	60
2	60	60	20	20
3	20	60	20	-20

↓ ↓

Rate of Extraction is more Rate of Regeneration is less

Due to this Resource gets extracted in Year 3

} Resource Getting Depleted
} Resource Getting Exhausted

What is Absorptive or Carrying Capacity of environment?

- It means ability of environment to absorb degradation
- If the extraction of resource is not above rate of regeneration of resource, it is said that resource is used within carrying capacity
- If we over use the resource, it leads to exhaustion of resource and damages the environment

Example 3

Suppose in an Area

No of Trees Available	100
No of Trees Cut	20
No of Trees Grown	20

Year	Resource Available	Resource Extracted	Resource Regenerated	Closing Resource
1	100	20	20	100
2	100	20	20	100
3	100	20	20	100

} What is Carrying Capacity or Absorptive Capacity?
It is 20 trees

*Rate of Extraction=Rate of Regeneration
So Resource will never get exhausted*

Carrying capacity means

*Capacity of environment to absorb degradation
If the extraction of resource is not above rate of regeneration of resource, it is said that resource is used within carrying capacity*

What happens if we overuse resources more than its Carrying capacity?

- In this case, Resources get depleted fast
- However, they are not replenished fast

Effects Of Overuse Of Resources In Environment



Resource become Exhausted



Waste gets Accumulated



Pollution



Not able to Sustain Life



Global Warming



Ozone Layer Depletion

- Hence, some resources cease to exist (get exhausted) or remain in short supply

Example - Many wild animals have become extinct or are on verge of extinction

- Waste gets accumulated
- More we use the resources, more waste we generate
- This excess waste is not absorbed by environment
- Environment is not able to full fill function of Sustaining life
- Humans have cut trees in forests to make roads and cities
- This has led to loss of habitat to many plants and animals

Causes pollution

- Waste generated by factories and cities are thrown in rivers which cause water borne diseases
- Smoke from factories and vehicles damage our lungs and cause air pollution

Global Warming

- Burning of fossil fuels and deforestation has led to increase in greenhouse gases like carbon-dioxide
- This has led to increase in global temperature
- This has led to our glaciers getting melted and water level increasing
- This has led to increase in water level which may lead to many cities getting submerged in water

Ozone Depletion

- It refers to Reduction in amount of ozone gas in environment
- This ozone gas is useful for preventing harmful gas to enter earth
- Depletion of Ozone layer has led to conditions like skin cancer.
- It also damages the growth of phytoplankton and effects aquatic plants also
- This ozone depletion is caused by use of Chlorofluorocarbons (CFC) in refrigerators and AC

What is Environment?

The place, people, things and nature that surround any living organism is called the environment. It is a combination of natural and human-made phenomena.

What are Components of Environment

It has 2 components or elements:

1. Biotic Elements

It refers to all the living elements like animals, plants, human beings etc

**2. Abiotic Elements**

It refers to all non-living elements like rocks, sunlight

Supplies Resources
(Both Renewable/Non Renewable)

What are Functions of Environment?**1. It Supplies Resources**

We get both Renewable and non-renewable resources from environment

**2. It assimilates waste**

- Waste generated by humans get thrown in environment
- Example - Industrial waste gets thrown in rivers and seas

Assimilates Waste
(Waste gets thrown into environment)

3. It sustains life

- Different Animals and Plants are able to exist because of environment
- One organism serves as food for other and we together form the food chain

4. It provides aesthetic Services (Scenery)

- Aesthetic means the pleasant, positive or artful appearance
- Various components of environment together form a beautiful scene

Aesthetic Service
(Scenery/Beauty)

Vast Natural Resources of India**1. Rich Quality of Soil**

India has large variety of soil which is used to grow different crops

Example - Black soil in Deccan areas is suitable for growing cotton

2. Number of Rivers and Distributaries

India has large amt of rivers and distributaries which provide water for agriculture as well as provide source of fishing and transportation

3. Lush Green Forests

- India has large number of forests scattered all around India.
- They are habitat of many plants and animals

4. Range of Mountains

India is blessed with Himalayas in North India which is not only known for tourist place but also provide many medicinal plants

5. Indian Ocean

India is blessed with vast area near Oceans. A large variety of fishes are found.

6. Fertile Indo-Gangetic Plains

- The Indo-Gangetic Plains stretch from Arabian Sea to Bay of Bengal
- These are highly fertile areas and hence highly populated

7. Large Amt of Minerals

- Large amt of minerals like iron ore, bauxite, copper, gold etc. are found in India
- 8% of total iron ore reserves are found in India

Due to all this, India is able to support 17% of world's human population and 20% of world's livestock population in mere 2.5% of geographical area of world

What is effect of economic development on India's Natural resources?

Land Degradation

- Land degradation means lack of productivity of soil
- India's fertile soil is facing damage due to overuse of fertilizers, deforestation, soil erosion etc.

Biodiversity Loss

- Cutting of trees in forests for economic development has led to loss of habitat for wild animals and plants
- Many of them have become extinct or on verge of extinction

Air Pollution

- Main cause of air pollution is vehicles like two wheelers and cars which run on petrol and diesel
- Air pollution is also caused by smoke from factories.

Fresh Water Management

- India's fresh water comes from river and lakes
- However, these are contaminated because of sewage being sometimes carelessly discharged into it without any processing
- Hence, India is facing shortage of drinking water

Solid Waste Management

- Large amount of waste is produced by growing population as well as industries
- However, they are not disposed-off properly
- Hence garbage gets piled up in many places causing many diseases

What we did for Economic Development



Green Revolution (Increase use of Fertilizers, Pesticides)



Urbanization (Cutting of trees to make way for cities)



Improvement in Modes of Transport



Industrialisation of India Population Explosion

What was the Effect?



Land Degradation



Biodiversity Loss (Loss of habitat of Plants and Animals)

What was the Effect?



Air Pollution Causing Health Problems



Waste Management Problems Drinking Water Shortage

CHAPTER 18

This chapter will demystify the following concepts:

- ✓ Comparison of India's Development with its neighbours (China & Pakistan)
- ✓ Human Development & its Indicators



Why it is important for Countries like India to Understand Development Process of Neighbours?

Due to Increased Globalization, there is lot of competition from developed countries like USA as well as developing countries like China.

Hence, it is important to understand the development process in these countries so that

1. We are able to compete with them better (as we share common economic activities with them)
2. We are able to learn from good economic policies adopted from them and implement them in our country
We are also able to understand mistakes committed by them and not repeat them in our own country
3. It is better to comprehend own strengths and weakness on comparing with neighbours

Why to Learn Development Process of Neighbours?



Development Path - India Pakistan and China Snapshot

PARTICULARS	India	Pakistan	China
When was Independence gained?	(India got independence from Britishers in 1947)	(Pakistan got independent from Britishers in 1947)	(People's Republic of China was established in 1949)
When were 5 Years Plans Introduced?	1951	1956	1953
Economic policy Adopted After Independence	<p>Creating Huge Public Sector</p> <p>(Govt Set up Huge Large Capital-intensive Industries while Private Sector developed small Industries and factories)</p> <p>Increased Public expenditure on Social Development like New Schools, Colleges, Hospitals</p>	<p>Creating Huge Public Sector</p> <p>(Govt Set up Huge Large Capital-intensive Industries while Private Sector developed small Industries and factories)</p> <p>Increased Public expenditure on Social Development like New Schools, Colleges, Hospitals</p>	<p>All critical Sectors of Economy came under Govt Control</p> <p>Govt owned all the land and all the factories and land</p> <p>GLF Campaign (Great Leap Forward Campaign) was launched in 1958 whose aim was to industrialize the economy on a large scale</p>
Agriculture	<p>Agriculture was with Private Sector</p> <p>Small Farms Owned by Individual Farmers</p>	<p>Agriculture was with Private Sector</p> <p>Small Farms Owned by Individual Farmers</p>	<p>Govt Owned the land, communes were set up in villages where all the people collectively cultivated land</p>



All 3 got Independence around same time

India
1947
(From Britishers)

Pakistan
1947
(From Britishers)

China
1949
(People's Republic of China was formed)

5 Years Plans announced around the same time

India
1951

Pakistan
1956

China
1953

Strategies Adopted in 5 Year Plans



India
Mixed Economy

(Govt run large industries while Private Sector owned run small industries)

Pakistan
Mixed Economy

(Govt run large industries while Private Sector owned run small industries)

China
Socialist Economy

(All Major Sectors under Government Control)

Who Owned Land?

India
Private Sector

Small Farms Owned by Individual Farmers

Pakistan
Private Sector

Small Farms Owned by Individual Farmers

China
Government

Govt Owned the land. Communes were set up in villages where all the people collectively cultivated land

Important Years of China's Development

1949 People's Republic of China was formed in 1949

All Critical Sectors of Govt, Land and Enterprises were brought under Govt Control

1958 Great Leap Forward (GLF) Campaign was Launched

Industrialization of the country was started on large scale

People were asked to set up factories in their backyards

In Rural Areas, Commune System was launched where people collectively cultivated lands

GLF Campaign faced a lot of problems due to drought which killed 39 million people
There was conflict with Russia.

During these conflicts, Russia withdrew its professionals which were sent to China to help in industrialization process

1966-76 "Great Proletarian Cultural Revolution"

During this period, Students and professionals were sent to countryside(villages) to learn and work

1978 Economic Reforms were Launched

In initial stages, Reforms were in Agriculture, Foreign Trade and Investment Sectors

Major Reforms undertaken in 1978

1- Reforms in Agriculture

Commune lands were divided and allocated to individual households for use

However, ownership remain with government

These farm owners were allowed to keep all profit after paying taxes to govt.

2- Reforms in Private Sector

Private Sector was allowed to produce goods and compete with Public Sector Enterprises (called SOE-State Owned Enterprises)

3- Dual Pricing

- Agriculture and private Sector had to buy and sell goods at 2 Prices
- A certain fixed Quantity at Govt determined Prices
- Balance Quantity at Market Prices

Note

In earlier years, production was more at Govt prices

In later years, as production increased, goods at market determined prices increased

4- Reforms in Investment Sector

- Govt Promoted foreign investment by allowing Special Economic Zones (SEZ) to be set up
- Govt gave tax concessions to foreign companies who established their units in these SEZ

5- Investment in Infrastructure

- Massive Investment in Infrastructure was undertaken like Building of roads, bridges, electricity supply, new cities, extension of basic health services
- These not only provided jobs but also boosted the industrial sector



Great Leap Forward Reforms of 1958

Commune System was Launched

People collectively Cultivated Lands
Income from Farming went to Govt)

All Major Sectors with Government

State Owned Enterprises did not face
any completion from private sectors)



1978 Reforms of China

Commune land divided into Small Plots

(These were allocated for use to
individual households)
Income from Farming went to Individual
households after paying applicable taxes

Private Sector firms allowed

State Owned Enterprises
faced competition

Great Leap Forward Reforms of 1958

Foreign Investment Not allowed

China was a closed economy and
there was very little foreign
investment

Less focus on Infrastructure

Not much development in
Roads, Electricity supply et)

1978 Reforms of China

Foreign Investment Encouraged

Govt set up SEZ (Special Economics
Zone) where tax concessions were
given to foreign investors

Large Scale Infrastructure Development

Massive Investment in Infrastructure
was undertaken like Building of
roads,bridges,electricity supply, new
cities ,extension of basic health services

Comparison-India vs China Development Policies



	India	China
Independence	1947	1949
5 Year Plans	Started 1951	Started 1953
Who Owned Land	Private Sector	Government
Agriculture	Small Farmers owned small pieces of land	Commune System and collective Farming
Reforms in Agriculture	Green Revolution (1960'S)	1978 Reforms, Commune land divided and allocated to Small Households)
Industry	Public Sector Undertakings run large Industries Private Sector operated small business	Earlier, Only Govt Sector run major sectors Later in 1978, Private Sector also allowed
Reforms in Industry	1991 Reforms (Policy of Liberalization, Globalization, Privatization)	1978 Reforms (Dual Pricing, Foreign Investment allowed, Infrastructure Improvement

Important Stages of Pakistan's Economic Development

1947

- Pakistan got independence from British Rule on 14 Aug 1947
- Pakistan during that time was largely dependent on imports just like India

1950-60

- Pakistan introduced following Reforms for import Substitution Based Industrialization
- Tariff Protection for Manufacturing of Consumer Goods
- Increase in Public investment on Infrastructure
- Green revolution was launched to increase Agriculture Output by mechanization

1970's

Nationalization of Capital goods Industries took place

Late 1970-1980

- Denationalization took Place and private Sector was encouraged
- Pakistan received financial support from Western Nations like USA
- It also received foreign remittance from a number of Pakistani nationals to Middle East (Saudi Arab, UAE)

1988

- Major Reforms were undertaken in
- Trade Liberalization, Export Promotion, Financial Sector Reforms

Comparison-India vs Pakistan Development Policies

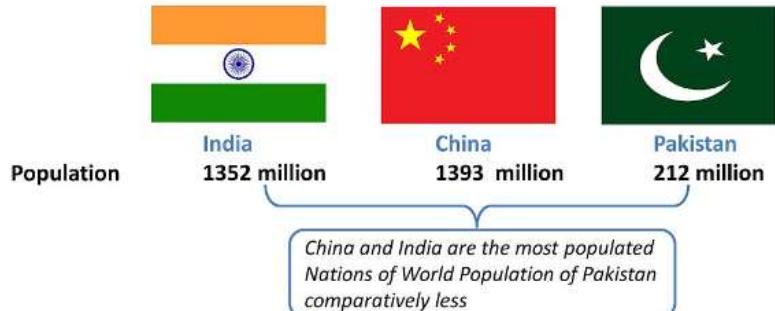


	India	Pakistan
Independence	14-Aug-47	14-Aug-47
5 Year Plans	Started 1951	Started 1956
Policy followed 1950-60	Import Substitution Protection of Domestic Industries Public Investment in Infrastructure Green Revolution	Import Substitution Protection of Domestic Industries Public Investment in Infrastructure Green Revolution
Nationalization of Capital Goods Industries	Already under Govt (PSU)	1970'S
Denationalization	1991	Late 1970-80
Major Reforms	Started 1991 (Liberalization, Globalization, Privatization)	Started in 1988 Trade Liberalization, Export Promotion, Financial Sector Reforms

Comparison of Development Indicators - India vs Pakistan vs China

Population

- China is most populated country in the world closely followed by India
- Population of Pakistan is very less (around 1/10 of India or China)



Population Growth

- Population is Growing very fast in Pakistan and less fast in India
- In China, there was One child Policy due to which Population Growth was low

Population Density

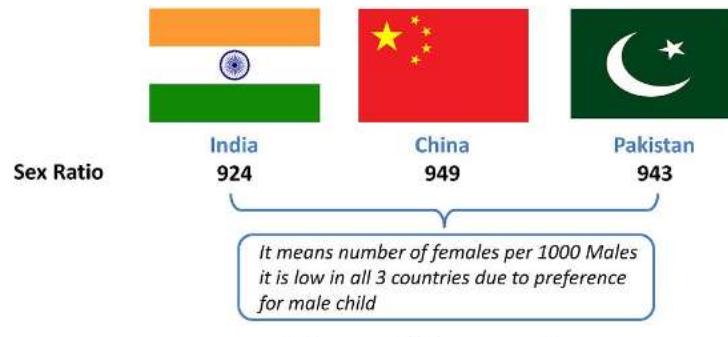
- It means number of people living per unit of area
- Population Density is lowest in China (because of its higher area)
- Population Density is highest in India followed by Pakistan

Population Density per sq km	India	China	Pakistan
	455	148	275

*It means number of people living per unit of area
 Population Density is lowest in China (because of its higher area)
 Population Density is highest in India followed by Pakistan*

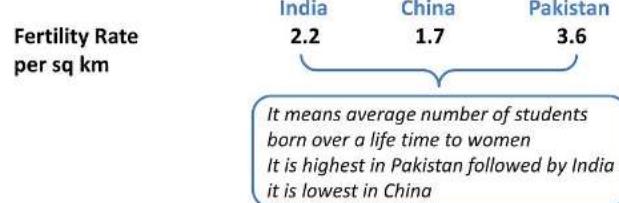
Sex Ratio

- It means number of females per 1000 Males
- Ideally, it should be 1000 females per 1000 Males
- But it is less in all 3 Countries - India, China and Pakistan because of patriarchal society (male dominated society) and female infanticide (girl child is killed before birth)

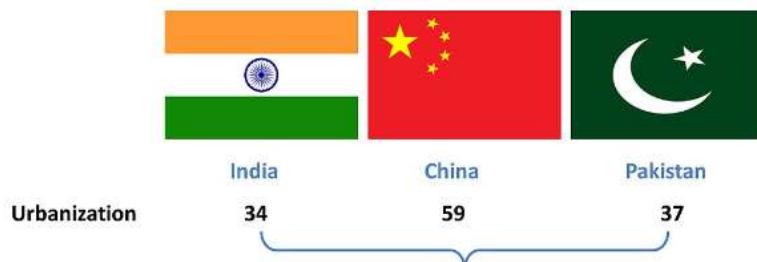


Fertility Rate

- It means average number of children born over a lifetime to women
- It is highest in Pakistan followed by India
- It is lowest in China



Which Country is More Urbanized?



*It means percentage of population living in urban areas
 It is highest in China followed by Pakistan, then India
 It means there is still large no of people living in rural areas in India as well as Pakistan*

Comparison of GDP - India, Pakistan and China

GDP

It means gross value of Goods and Service produced in country

GDP Growth

Increase in GDP Compared to previous year in %

Population	➤	China and India very high, Pakistan low
Population Growth	➤	Highest in Pakistan, then India, then China
Area	➤	China much higher, India smaller, Pakistan smallest
Population Density	➤	Very high in India and Pakistan, less in China
Sex Ratio	➤	Poor in All 3 countries
Fertility Rate	➤	Highest in Pakistan, then India, then China
Urbanization	➤	China much more urbanized, India and Pakistan rural

What is GDP and GDP Growth Rate?

Example

Suppose in a country,
Gross Value of Goods and Services produced in Country =

In Year 2021 1000 Crores
In Year 2022 1040 Crores



What is Increase in GDP?

	2021	2022
GDP	= 1000	1030

What is GDP?

Value of Goods and Service Produced

Increase in GDP 30

What is GDP Growth Rate?

increase in GDP Compared to previous year in %

$30/1000 * 100 = 3\%$

In Industrialized Nations, more industry and Service Sector contribute to growth of the nations. In less industrialized nation, share of Agriculture Sector is more.

Share of Agriculture Sector to GDP

It is lowest in China (7%) followed by India (16%) and Pakistan (24%)

It means China is much less dependent on Agriculture while India and Pakistan are more dependent

Share of Service Sector

It is high in all 3 Countries -India: 54%, China: 52%, Pakistan: 57%

Share of Industrial Sector

Contribution of Industrial Sector is Highest in China at 41%

Share of India is only 30%

Pakistan is least industrialized of 3 nations at 19%



Distribution of Workforce in Different Sectors

	India	China	Pakistan
Agriculture	43%	26%	41%
Industry	25%	28%	24%
Services	32%	46%	35%

Large Share of Population still dependent on Agriculture in India and Pakistan
China more industrialized so more people working in Manufacturing Sector
Service Sector also providing jobs in all 3 countries

Distribution of Workforce

High Dependence on Agriculture

In India and Pakistan, still a large amt of people are dependent on Agriculture

In China, it is much less

(43% in India, 41% in Pakistan compared to 26% in China)

What is Human Development Index?

It is an index which measures achievement in different areas of human development like

- Long and Healthy life
- Knowledge
- Decent Standard of living

What are Different Human Development Indicators?

In this case, we measure following:

Indicators	Meaning
Life Expectancy	No of Years Person is expected to live
Mean Years of Schooling	No of years a person has attended school
Gross National income per Capita	Income per Person
People below Poverty Line	No of Persons earning below Poverty line
Infant Mortality Rate	No of children who die at birth
Maternal Mortality Rate	No of women who die at child birth
Population with at least Basic Sanitation	Availability of Sanitation Facilities like Toilet
Population with at least Basic Drinking Water	Availability of clean drinking water
Percentage of undernourished Children	No of Children who do not get sufficient nutrients required for growth



Long and Healthy Life

Life Expectancy

No of Years Person is expected to live

Infant Mortality Rate

No of children who die at birth

Maternal Mortality Rate

No of women who die during child birth

Percentage of Undernourished Children

No of Children who do not get sufficient nutrients

Knowledge

Mean Years of Schooling

No of years a person has attended school

Decent Standard of living

Gross National income per Capita

Income per Person

Population with at least Basic Sanitation facilities

Availability of Sanitation Facilities like Toilet

Population with at least Basic Drinking after

Availability of clean drinking water

How do India, Pakistan and China Rank on Various Human Development Indicators?

China Perform better than India and Pakistan on almost all Human Development Indicators

Example

- China has higher Human Development Index Rank and Value
- It also has higher Per capital income, higher life expectancy and higher mean years of schooling
- It also has lower Infant and Maternal Mortality Rate and Percentage of undernourished Children
- It is also better than India and Pakistan in Basic Sanitation and Clean Drinking Water

Long and Healthy Life Comparison – India, China and Pakistan in HDI

	India	China	Pakistan
Life Expectancy	69.4	76.7	67.1 → Higher the better
Infant Mortality Rate	29.9	8.5	57.2 → Lower the better
Maternal Mortality Rate	174	27	178 → Lower the better
Percentage of Undernourished Children	37.9	8.1	37.6 → Lower the better

China has better health facilities so has better life expectancy and lower mortality Rate compared to India and Pakistan

Knowledge and Education Comparison – India, China and Pakistan in HDI

	India	China	Pakistan
Knowledge			
Mean Years of Schooling	6.5	7.9	5.2 → Higher the better

China has better education facilities compared to India and Pakistan

How do China India Pakistan perform on Liberty Indicators?

India is much higher than both Pakistan and China on liberty indicators

In India,

- There is freedom to protest, freedom to practice one's religion and independent judiciary
- India also has solid democracy where elections are held regularly and government of different political parties is formed.

In China

- there is one Party Rule
- Hence, people do not have fundamental rights like electing their own governments

In Pakistan

- There is democracy and government are elected regularly
- But there have been military coups in Pakistan where military have forcefully taken over the governments

Summary

- China is better in Human Development Indicators but lacks in Liberty Indicators
- India performs much better in Liberty indicators but have work to do in Human Development Indicators
- Pakistan has performed better than India in reducing no of people below poverty line but lacks on other fronts

Which Country is better to Live?



China

Advantage

Higher Income
Better Living Standards



India

Disadvantage

Lower Income
Lower living Standards

These are Human Development Indicators

Disadvantage

No Democracy, One Party One Rule
No Right to protest of Citizens
No Independent Judiciary

Advantage

Democratic Country - Different Political Parties and Elections
Constitutional Protection of Fundamental Rights of Citizens
Independent Judiciary to protect people's Right

These are Liberty Indicators

China is better in Human Development Indicators but lacks in Liberty Indicators

India performs much better in Liberty indicators but have work to do in Human Development Indicators

Reform Process in Pakistan

How did Pakistan perform Pre and Post Reforms

Pakistan actually performed worse after Reforms.

Before Reforms

In 1970-80

Pakistan's GDP Growth Rate was better than India (6.3% of Pakistan compared to 5.7% of India)

After Reforms

Pakistan growth rate declined to 5.3%



Pakistan's Performance

Before Reforms (1970-80)

GDP Growth Rate
6.3%

After Reforms (in 1988)

GDP Growth Rate
5.3%

After Reforms

GDP Growth Actually Declined due to

- Volatile Performance of Agricultural Sector → (Too much dependent on Monsoon)
- Lack of Industrial and Service Sector Growth → (Products not Internationally competitive)
- Growing Dependence on Foreign Loans → (Low foreign exchange on Export)
- Lack of Political Stability → (Too many military coups, Govt change)

Main Reason for Slow Growth of Pakistan's Economy

1. Volatile Performance of Agricultural Sector

- Pakistan is an agrarian economy which is highly dependent on monsoon
- During the years of good harvest, Pakistan's economy performed well
- However, during bad season, Pakistan economy suffered stagnation or negative trend

2. Lack of Industrial and Service Sector Growth

- Pakistan has not been able to improve its industrial sector and make it internationally competitive
- Hence, there is very less export of manufactured goods from Pakistan (like in case of China)
- Also, it has not developed its IT Sectors (there is very little export of IT Services like in case of India)

3. Growing Dependence on Foreign Loans

- Main Source of foreign exchange in Pakistan is not exports
- It is from Pakistani workers sending remittance from Middle East (Saudi Arabia, UAE)
- Also, Pakistan had to frequently borrow large sum of money from China and USA
- Due to high interest burden, it has not been able to prosper

4. Lack of Political Stability

- There are frequent military's coups in Pakistan
- Due to this, it has not been able to receive foreign investment which was necessary for its growth

CHAPTER 19

This chapter will demystify the following concepts:

- ✓ Different type of Sectors
- ✓ Different type of Goods
- ✓ Microeconomics
Macroeconomics

vs

Economy is a system by which Goods and services are produced, sold and bought in an area.

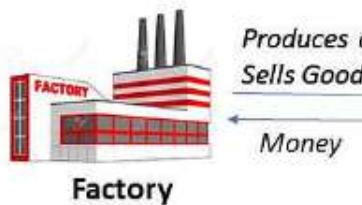


Example

Suppose there are only 2 people in an area -Factory and Mr. A

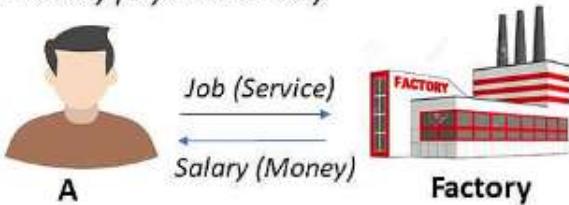
Factory Sells goods to Customer A

A pays them money



Factory is Producing and Selling Goods to A

A also works in same factory as Employee
Factory pays him Salary



A selling its services to Factory

What is an Economy
It is a system by which Goods and services are produced ,sold and bought

Types of Sectors & Types of Goods in an Economy

Four Sectors of Economy

From the economic point of view, a mixed economy is divided into four sectors.

1. Private Sector:

All the enterprises owned by the private individuals or group of individuals belong to the private sector. The private sector consists of companies/firms/enterprises in India which are not owned by the government.

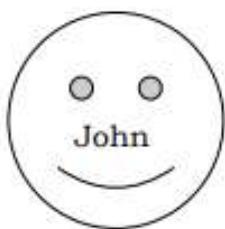
2. Government Sector:

This sector includes public administration, police, defence, framing of laws and enforcing them. Apart from imposing taxes and spending money on various infrastructure and healthcare services and education etc., government also undertakes production activity through its companies like Coal India Ltd. (CIL), National Thermal Power Corporation (NTPC) etc. So, all the companies owned by the Central or State Governments i.e. Public Sector Undertakings (PSUs) also belong to the government sector.

3. Household Sector:

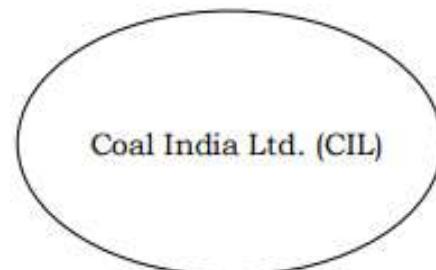
A group of persons who normally live together and take food from a common kitchen constitutes a household. The size of a household is the total number of persons in the household. We should always remember that households consist of people. These people work in firms as workers and earn wages. They are the ones who work in the government departments and earn salaries and they are the owners of firms and earn profits. So, all the human beings (population) belong to household sector.

Suppose a person named "John" works in "Coal India Ltd. (CIL)" which is a government company then John belongs to the household sector and the company CIL belongs to the government sector.



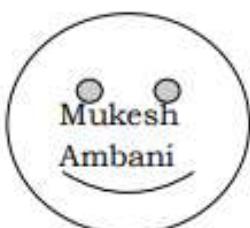
Household Sector

John works in CIL



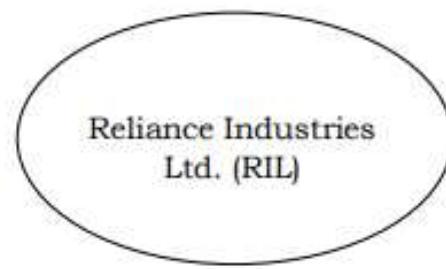
Government Sector

Reliance Industries Ltd. (RIL) is owned by Mukesh Ambani, but Mukesh Ambani belongs to the household sector and "RIL" (which is a passive object and on whose name all the business is being carried out) belongs to the private sector.



Household Sector

Mukesh Ambani owns RIL



Private Sector

4. External Sector: This sector consists of the exports and imports of goods and services flowing into the country or out of the country. It also includes the financial flows from and into the domestic country.

OUR ACHIEVERS

MOHD.
HABEEB
4 3 2 1 8 7

PCS
OFFICER



AFTAB
ALAM
3 3 7 4 4 5

PCS
OFFICER



KUMARI
NEHA
4 4 5 3 6 1

PCS
OFFICER



SATYA
PRAKASH
0 3 7 0 7 6

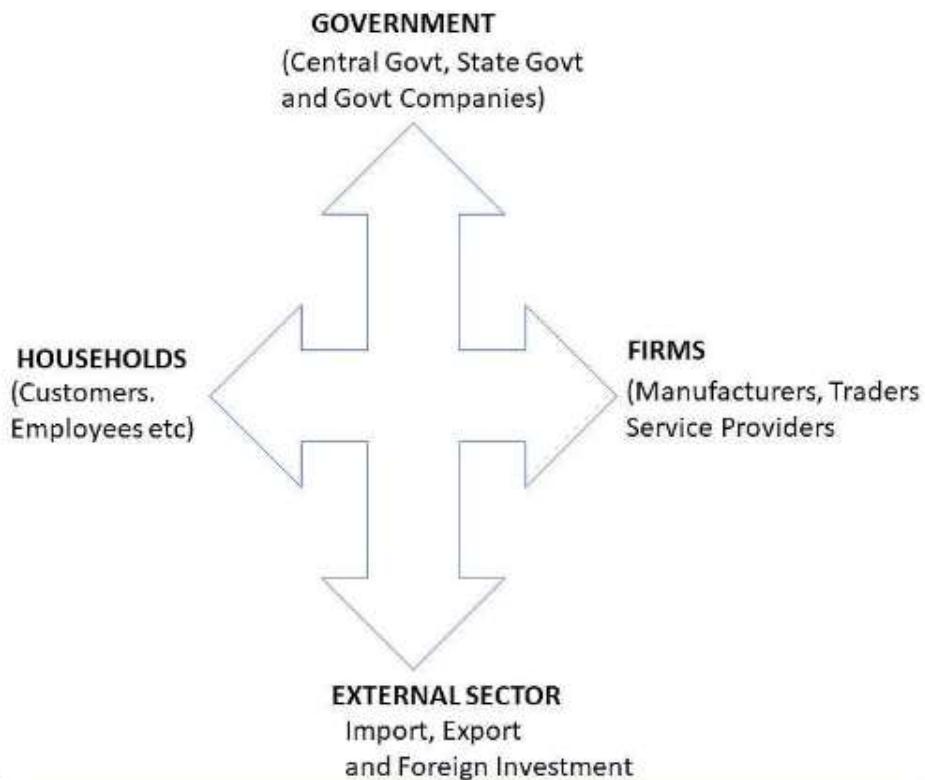
PCS
OFFICER

Production Activities of Government

Sale of Goods and Service from Firm to Household



Factor Service From Household To Firm





HEALTH



EDUCATION



POLICE



ROADS

In this case, Government purchases different goods and services from Firms to provide to public



Many Employees also work in Govt Departments



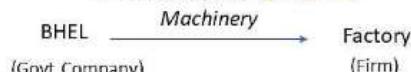
Let us understand in detail the private sector first.

In this case, Government Companies produces different goods and services and sells to Firms and households

Example 1
Service Provided by Govt to Households →



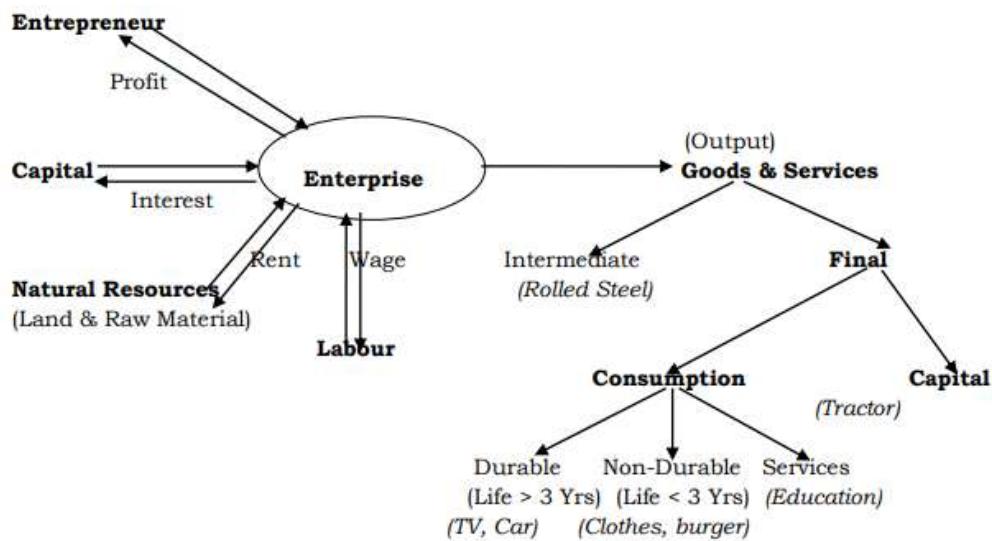
Example 2
Goods sold by Govt to Firms →



Private Sector

All the firms or enterprises owned by private individuals or entrepreneurs belong to private sector and their basic function is production of output i.e. goods and services. To produce output, any enterprise will require certain inputs. An enterprise may require one input or it may require hundreds of inputs to produce the desired output. All the inputs that an enterprise may require are broadly divided into four categories i.e. entrepreneur, capital, natural resources and labour.

The four inputs that an enterprise requires to produce output (goods and services) are called the four "factors of production" or the "inputs of production". These four factors of production are the following (as shown in the figure):



1. Entrepreneur: The person who takes the risk and starts a new business. This person takes the risk to bring in capital, labour and natural resources together in the form of an enterprise and in return expects "Profit". The entrepreneur is a human being and he belongs to the household sector.

2. Capital: In today's world, capital can be physical, financial or intellectual. But from an economic point of view, only the physical capital goods are considered as capital. So, capital includes the building, machinery, equipment etc. The return for the capital is called "Interest".

3. Natural Resources: Natural resources include land and raw materials which are naturally available and are not produced through manmade processes. The return for the natural resources is called "Rent".

4. Labour: It is the human labour which may be physical or mental i.e. it can be unskilled, semi-skilled or skilled. When a human being provides his labour to the enterprise, in return he/she expects "wages". The labour (who is providing the labour services) is a human being and belongs to the household sector.

TYPES OF GOODS

Intermediate goods

These are semi-finished goods which have been produced by a process but cannot be used as it is and need to go through further production process to be converted into a final good. For example, steel sheets. The steel sheets cannot be used as it is and needs to be transformed into final products like automobiles, appliances etc.

Final goods

These goods do not undergo any further transformation in the production process. Final goods can be of two types -**consumption goods and capital goods**.

1. Consumption Goods: Goods which are consumed by the ultimate consumers or meet the immediate need of the consumer are called consumption goods. They can be of three categories-

(i) Durable Consumption Goods: Consumption goods which do not get exhausted immediately but last over a period of time are called consumer durables. Life of consumer durables is generally more than 3 years. For examples home appliances, consumer electronics, furniture etc.

(ii) Non-Durable Consumption Goods: Consumption goods which get consumed immediately and whose life is generally less than 3 years. For example, cosmetics, food, fuel, paper, clothing etc.

(iii) Services: Services are intangibles and are a kind of consumption goods only, as, it is consumed immediately. For example, education, banking, telecom, healthcare etc.

2. Capital Goods: A particular good will be capital in nature only if it possesses the following three characteristics:

- (i) It is a produced durable output of a man-made process
- (ii) It again acts as an input for further production process (to be sold in the market)
- (iii) While acting as an input, it does not get transformed or consumed

For example, Tractor. Tractor must have been produced in a factory so it is a produced durable output. Tractor again acts as an input in the production of agricultural products like wheat and rice. And while acting as an input it does not get transformed and remains as it is. (Wear and tear of tractor happens over a long period of time but we cannot say that the tractor is getting transformed or consumed).

In strict sense the economists consider only the physical capital as the capital but in today's world intangible capital is increasingly becoming important. So, ***capital can be divided into three categories-***

- (i) Physical Capital (capital goods)
- (ii) Financial Capital (money)
- (iii) Intellectual Capital (patents, copyrights etc.)

Note:

Consumption and Capital goods: A particular good can be consumption as well as capital good. For example washing machine. When a person is using washing machine at his home for washing of his own clothes then it will act as consumption good.

But, if the same washing machine is purchased by a businessman for providing laundry services then it is acting as a capital good. Because in the latter case, washing machine is being used to produce washed clothes for the market and not for own consumption.

So whether a good is consumption or capital also depends on the purpose for which it is being used. If a good is being used to produce some other goods/services to be sold in the market then it will be a capital good. For example, when we purchase a car for our home then it is consumption good but when "Ola Cabs" purchase a car to provide transportation services for the market then the car becomes a capital good.

Note:

Intermediate and Final good: A particular good can be final as well as intermediate. For example, "tea leaves". When a person is purchasing the "tea leaves" for his home consumption purpose then the "tea leaves" will be a final good.

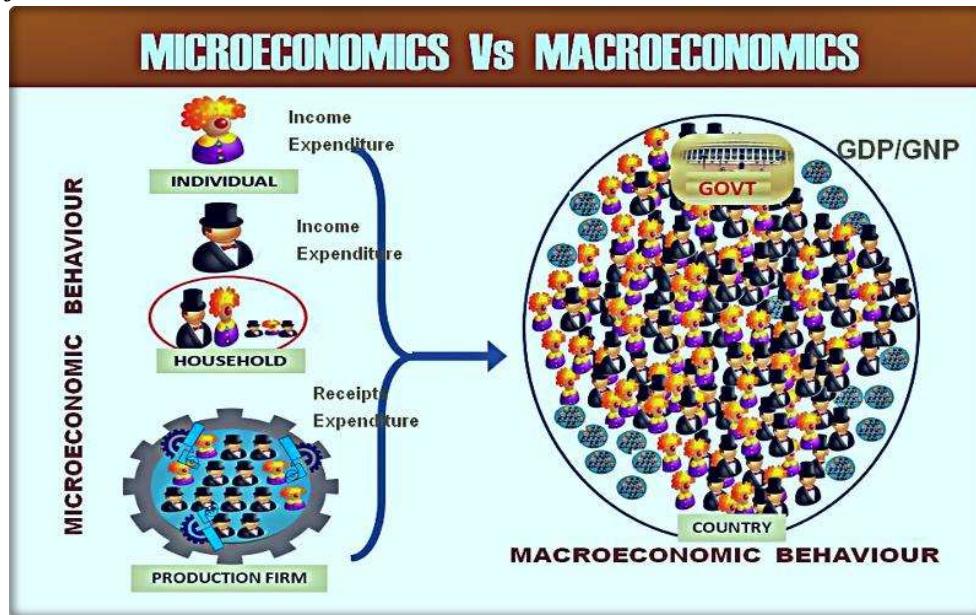
But when a tea seller is purchasing the "tea leaves" to prepare "tea" and sell it in the market then "tea leaves" is intermediate good and the "tea" is the final good. The distinguishing characteristic whether a good is final or intermediate is "the last transaction in the market".

In case of tea seller, the last transaction in the market is of tea, so "tea" is final good. But in case of the person purchasing tea leaves for home purpose, "tea leaves" is the last transacted good in the market, so "tea leaves" will be final good

Microeconomics and Macroeconomics

Economics is divided into two important sections: Macroeconomics & Microeconomics.

Macroeconomics deals with the behaviour of the aggregate economy and **Microeconomics** focuses on individual consumers and businesses.



Microeconomics

Microeconomics focuses on the choices made by individual consumers as well as businesses concerning the fluctuating cost of goods and services in an economy. Microeconomics covers several aspects, such as –

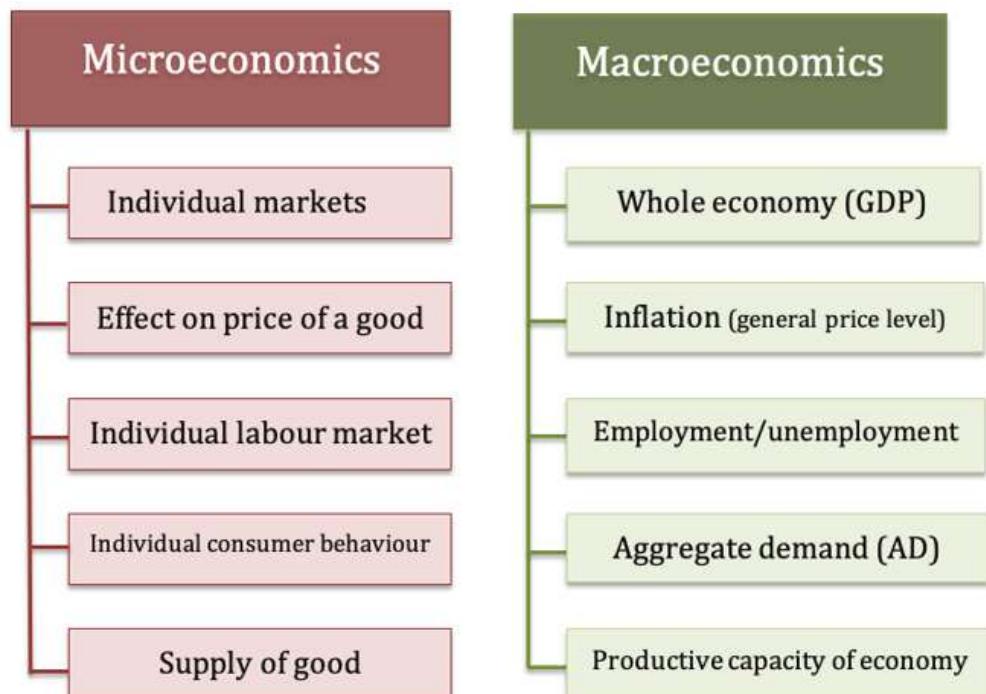
- Supply and demand for goods in different marketplaces.
- Decisions made by people and businesses regarding the allocation of resources and prices of goods and services.
- Consumer behaviour, as an individual or as a group.
- Demand for service and labour, including individual labour markets, demand, and determinants like the wage of an employee.
- It takes a bottom-up approach to analyse the economy.
- It does not decide what are the changes taking place in the market, instead, it explains why there are changes happening in the market.

Examples: Individual demand, price of a product, Individual income etc.

Macroeconomics

- **Macroeconomics** is a branch of economics that deals with ***how an economy functions on a large scale***. It differs from microeconomics, which deals with how individual economic players, such as consumers and firms, make decisions.
- It deals with the issues of an economy as a whole, rather than those of individual agents or specific markets.

- Macroeconomics is concerned with the understanding of aggregate phenomena such as economic growth, unemployment, inflation, fiscal policies of the govt, monetary policies of the central bank, globalisation and international trade.



Differences between Microeconomics & Macroeconomics

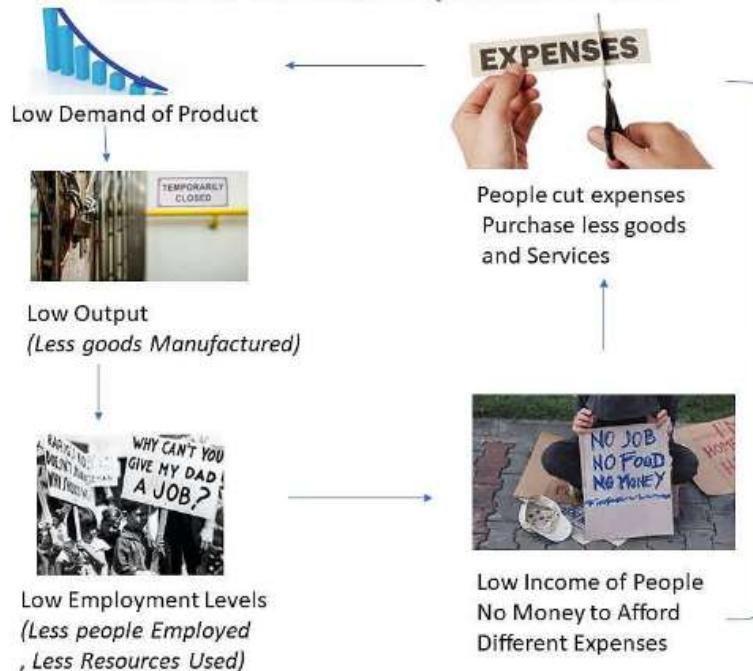
MICRO-ECONOMICS	MACRO-ECONOMICS
Microeconomics primarily deals with individual income, output, price of goods, etc.	Macroeconomics is the study of aggregates such as national output, income, as well as general price levels.
It is related to the study of individual, household and firm's behaviour in decision making and allocation of the resources.	It deals with the study of the behaviour and performance of the economy in total. The most important factors studied in macroeconomics involve gross domestic product (GDP), unemployment, inflation and growth rate etc.
Microeconomics studies the particular market segment of the economy	Macroeconomics studies the whole economy, that covers several market segments
Microeconomics focuses on overcoming issues like- allocation of resources, demand, supply, factor pricing, product pricing, economic welfare, production, consumption etc.	Macroeconomics deals with various issues like national income, distribution, employment, general price level, money
Microeconomics accounts for factors like demand and supply of a particular commodity.	Macroeconomics account for the aggregated demand and supply of a nation's economy.
It is useful in regulating the prices of a product alongside the prices of factors of production (labour, land, entrepreneur, capital, and more) within the economy.	It solves the major issues of the economy like deflation, inflation, unemployment, and poverty as a whole.

The Great Depression of 1929

Great Depression occurred in economies of North America and Europe. It occurred during period from 1929 to 1939. During this period, there was Low demand of Product. Because of low demand, there was low output and employment levels. There was very high unemployment rate. Stock market crashed. Many people went bankrupt

Positive Effect

It led to the study of Macroeconomics as a separate branch of economics. Main contribution in this regard was by John Maynard Keynes (British Economist). He published his book on Macroeconomics called 'The General Theory of Employment, Interest and Money in 1936' during this period.



When Occurred
Between 1929 to 1939

Where Occurred
North America & Europe

Any Positive Effect?
Led to Study of Macroeconomics
By John Maynard Keynes

CHAPTER -20

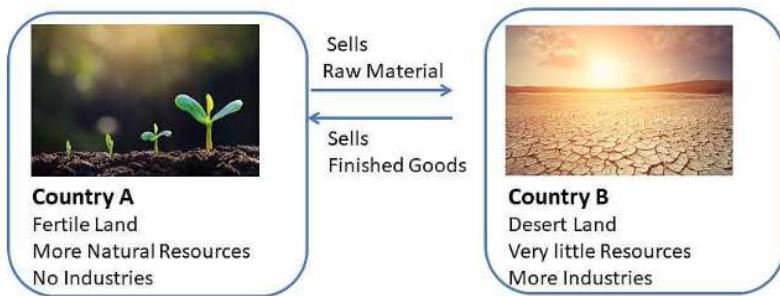
This Chapter will demystify the following concepts:

- ✓ Wealth of a Nation
- ✓ Flow of Production
- ✓ Intermediate & Final Goods
- ✓ Stock & Flow
- ✓ GDP, GNP, NNP
- ✓ Market Price & Factor Cost
- ✓ Normal Residents & Non-Residents
- ✓ Net Factor Income from Abroad (NFIA)
- ✓ National Income
- ✓ Domestic Territory



What generates Economic wealth of Nation?

- Suppose there are 2 countries A and B
- A has more natural resources and fertile land
- B is a Desert. But B has more industries and factories
- B purchases raw material from A and manufactures them



Which Country will be More Rich?

Country B
Possessing of Natural Resources doesn't make a country rich
It needs to be transformed by a production process

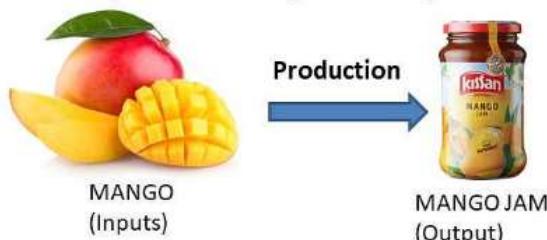
Which Country will be more rich-

- B will be more rich country
- It is because mere possession of natural resources does not make a country rich
- The Resources have to be transformed by a production process

INPUT $\xrightarrow{\text{PRODUCTION}}$ OUTPUT

Example 1

A Factory converts Mango into Mango Jam



Note

Mango is different from Jam
During a production process, a product loses its specific characteristics and gets transformed into a completely new product

This is flow of production of goods

What generates Economic wealth of Nation

- Economic Wealth of a country does not depend upon possession of resources.

- It depends upon how these resources are used to generate flow of production.
- This Production leads to income and wealth.

What is flow of Production?

It means producing different goods and services using various inputs.

Production may be of goods or services.

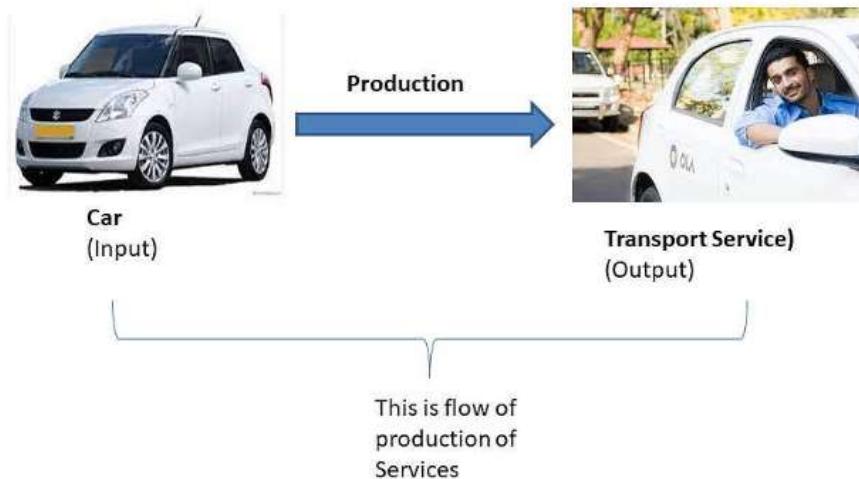
Output of One production process may become Input of Other Production Process

Example

- Suppose a Farmer produces Raw Cotton
- He sells it to spinning mill
- Spinning mill produces yarn which it sells to Textile Mill
- Textile Mill produces cloth which it sells to a tailor
- This Tailor produces a shirt from this cloth and sells it to a Consumer

Example 2

A taxi Operator buys a Car to Provide Transport Service



Note

During a production

process, a product loses its specific characteristics and get transformed into a completely new product

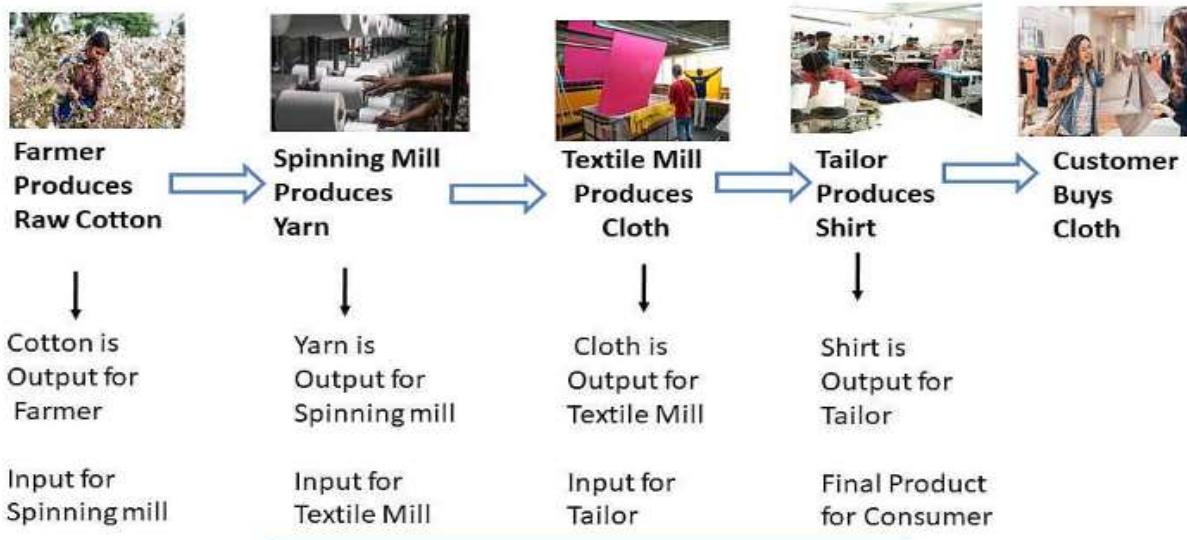
Example

Yarn is completely different from cotton; cloth is different from yarn and shirt is completely different from cloth

Farmer -----> Spinning Mill -----> Textile Mill -----> Tailor -----> Consumer

I	I	I	I
Produces	Produces	Produces	Produces
Raw Cotton	Yarn	Cloth	Shirt

Output of One production process may become Input of Other Production Process



Intermediate and Final Goods

Example

Suppose a Farmer grows Sugarcane

A sugar factory uses this sugarcane to make Sugar

A sweetshop uses this sugar to make Sweets

which is purchased by consumer



Different types of intermediate goods

Used for production

Goods
Purchased by Factory

Example

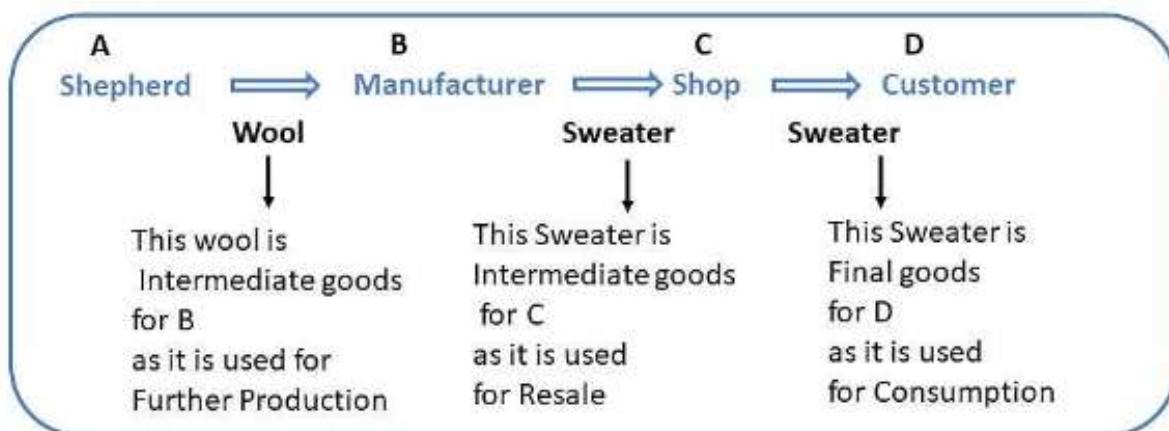
Purchase of Wool by
Factory to make Sweater

Used for resale

Goods
Purchased by Shopkeeper

Example

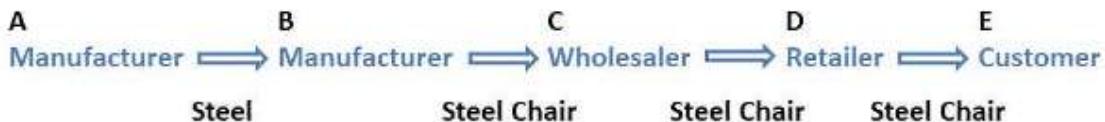
Purchase of Sweater by Shop
to be sold to Customer



Same good may be Intermediate for One & Final for Other

Example 2

Suppose a company A manufactures steel
It is used by company B to make Steel Chair
This Steel Chair is sold to Wholesaler C
who sells it to Retailer D
D sells it to Customer E



In this case

Steel is a Intermediate goods as it is used for Further production
Steel chair is also intermediate goods for C and D as it is used for Resale
Steel Chair is Final goods for E as it is used for Consumption

VALUE ADDITION

A B C D E
Manufacturer \rightarrow Manufacturer \rightarrow Wholesaler \rightarrow Retailer \rightarrow Customer

Steel
Rs 400

Steel Chair
Rs 1000

Steel Chair
Rs 1100

Steel Chair
Rs 1200

Value Addition in all these Stages

No Value Addition

There is
Value Addition
in case of
Intermediate goods

There is
no Value Addition
In case of
Final Goods

Different types of final goods

Used For Final Consumption

Purchase of Goods by
Customer for Use

Example



Computer Purchased by
Customer to be used at home

These are also called
Consumption Goods

Used For Investment

Purchase of Goods by Business
to be used as Fixed Assets

Example



Computer Purchased by Office
to be used by Employees

These are also called
Capital Goods

What is Production Boundary?

It is the imaginary line around the production process
It includes all the producers and activities which causes value addition

Example 1



In above case,

Production Boundary covers Farmers, Spinning mill, Textile Mill and Tailor
It is because all these are involved in production process
Consumer is not part of production process as they do not create any value addition

Why concept of Production Boundary is Important?

All goods purchased within the production boundary are Intermediate goods
All goods falling outside the production boundary are Final Goods

Example



Note

Raw Cotton, Yarn and Cloth are Intermediate goods as they fall within the production boundary

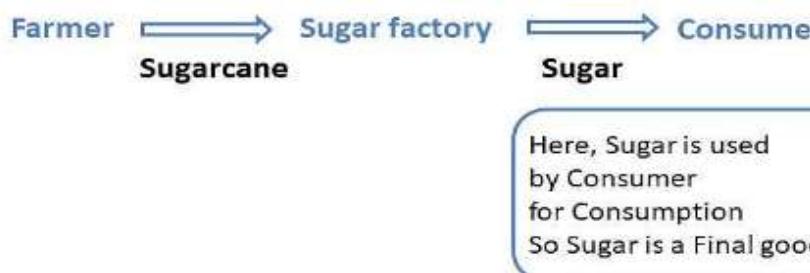
Shirt is a final goods as it lies outside the production boundary

Same Goods may be Intermediate or Final Depending Upon Use

Example 1



Example 2



Stock and Flow Concept in Economics

Stock is a variable which is Measured at a Particular Point of Time

Flow is a variable which is Measured over a period of Point

Example 1

Suppose I have Rs 50000 in my bank account as on 1 Jan

I spent Rs 10,000 during the month of January

Now I am left with Rs 40,000 as on 31 jan

Note:

In this case,

Bank Balance is Stock

(It is measured at particular point of Time (as on 1 Jan or 31 Jan)

Amount spent is Flow

It is measured over a period of time (During Jan)

Example 2

Suppose water is flowing into a tank from a tap

There is 20 litres water in tank as on 9 am

There is 30 litres in tank as on 9.01 AM

It means water is flowing from tap @rate of 10 litres per minute

What is Stock and Flow?

Amt of Water flowing into tank per minute is example of flow

Amt of Water in Tank at a particular time is an example of Stock.

Amt of Water flowing from tap per minute is example of flow

Economic concept of stock and flow

National wealth

It means total assets of a Nation at particular point of time



This is Stock
(Measured at a particular point of time)

Example

National Wealth
as on 31 March 2020

National income

It means value of goods and services produced by nation over a period of time



This is Flow
(Measured over a period of time)

Example

National Income for the year
2021-22

Which has Time Dimension-Stock or Flow?

- Time Dimension means
- Measuring something from one point of time to another
- Stock is measured at a particular point of time
- (There is only one point OF TIME)
- Flow is measured over a period of time (from one point to another)
- (There are two points of time - Starting and ending)
- Hence Flow has Time Dimension (And not STOCK)

Which is Static and Which is Dynamic Concept?

- Static means- Something which is fixed.
- Dynamic means- Something which is continuously moving.
- Let's, take an example of Water flowing in Tank
- Amount of Water flowing into tank per minute is example of flow
- Amount of Water in Tank is an example of Stock
- Amount of water in a tank at a particular point of time is static (fixed)
- Hence, we can say Stock is Static Concept
- Amount of water flowing in a tank is dynamic (moving).
- Hence, we can say Flow is Dynamic Concept.

Difference between Stock and Flow:

Stock	Flow
It is a variable which is measured over a particular point of time.	It is a variable which is measured over a period of time.
It does not have time dimension	It has time dimension
It is Static Concept	It is dynamic concept

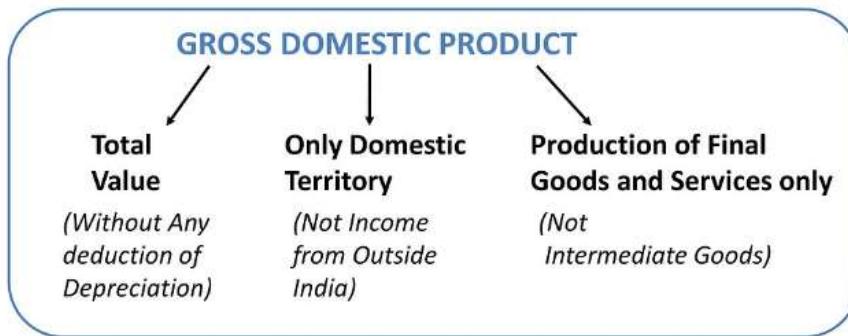
Example:	Example:
National Wealth as on 31 March 2021	National Income for period 2020-21
Covid Cases as on 1st Apr 2020	Covid Cases Increased during April 2020
Total Money in Circulation as on 31st Mar 2021	New Money printed during 2020-21

Understanding GDP and related Terms Through Diagrams

What is GDP?

It means Gross Domestic Product

It is the total value of all goods and services produced within the Domestic Territory



Concept of Domestic Territory

GDP includes Total Production within Domestic Territory

So it does not include income earned by Indian citizen working abroad

It may include income of Foreigners working in India

Example 1

Suppose in a country, there are only 3 persons A, B and C

A and B are working in the country while C is working Outside the Country

Aggregate Value of Final Goods Produced of

A, B and C is 1000, 2000, 2500 respectively

What is GDP of Country?

Answer

GDP of Country = 1000 + 2000 = 3000

Note

(We will not take income earned by C as he earns this income working outside the country)

Example 2

Suppose in a country, there are only 3 persons A, B and C
A and B are working in the country while C is working Outside the Country
Also D is a foreign Citizen working in the country
Aggregate Value of Final Goods Produced of
A, B, C and D is 1000, 2000, 2500, 4000 respectively
What is GDP of Country?

Answer

GDP of Country = $1000 + 2000 + 4000 = 7000$

Note

(We will take into account income earned by
D also as he is working in the country also)

Note

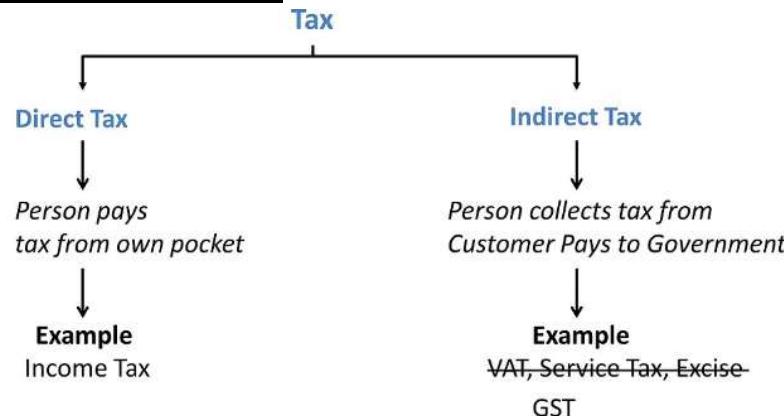
GDP is of 2 types

- **GDP at Market Price**
- **GDP at Factor Cost**

Different Types of GDP

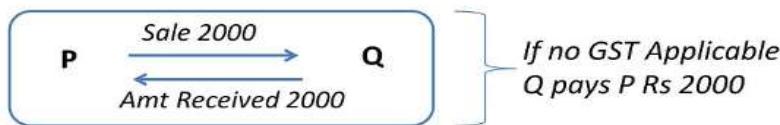


Direct & Indirect Taxes

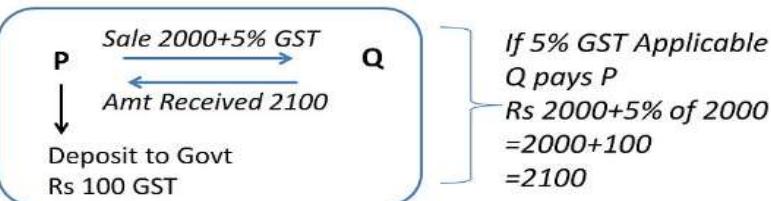


Example of Indirect Tax-GST

Suppose P Sells goods to Q for Rs 2000

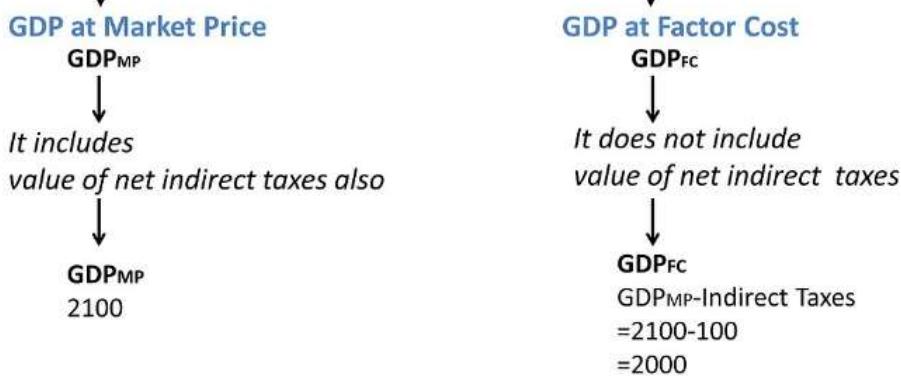


Suppose P Sells goods to Q for Rs 2000 +5% GST



If GST Applicable, Seller charges GST on Invoice from Buyer
 He collects GST from buyer and deposits to Government

Different Types of GDP



Example 2-Calculation of GDP_{MP} and GDP_{FC}

Suppose in an economy, there are only 3 persons - A, B and C



What is GDP in this case?

GDP at Market Price

GDP_{MP}

It is **Gross Market value of all final goods and services produced within Domestic Territory**

It includes
 Net Indirect Taxes

$\text{GDP}_{\text{MP}} = 105$

GDP at Factor Cost

GDP_{FC}

It is **Gross Money value of all final goods and services produced within Domestic Territory**

It does not include
 Net Indirect Taxes

$\text{GDP}_{\text{FC}} = 105 - 5 = 100$

Market Price vs Factor Cost

Market Price (MP)

We write Definition

'Market Value of goods and services'

Example

GDP_{MP} = Gross Market value of all final goods and services produced within Domestic Territory of a Country.

GNP_{MP} = Gross Market value of all final goods and services produced by Normal Residents of a Country.

Factor Cost (FC)

We write Definition

'Money Value of goods and services'

Example

GDP_{FC} = Gross Money value of all final goods and services produced within Domestic territory of a Country.

GNP_{FC} = Gross Money value of all final goods and services produced by Normal Residents of a Country.

What is Subsidy?

Subsidy is Discount or Economic Assistance provided by Govt

It leads to reduction in price paid by consumer

Example

Price of Cooking Gas	1000
Less Subsidy provided by Govt	300
Net Amount paid by Consumer	700

Less amount paid by consumer due to Subsidy

Why govt provides Subsidy?

To Make Product cheaper
so that poor people can afford it

Example -

Subsidy on Cooking Gas

To promote Use
of product

Example

Subsidy on Electric Cars

Difference between GDP_{MP} and GDP_{FC}

GDP at Market Price	GDP at Factor Cost
GDP_{MP}	GDP_{FC}
It is Gross Market value of all final goods and services produced within Domestic Territory	It is Gross Money value of all final goods and services produced within Domestic Territory
It includes Net Indirect Taxes	It does not Include net Indirect Taxes $GDP_{FC} = GDP_{MP} - \text{Net Indirect Taxes}$ $GDP_{FC} = GDP_{MP} - (\text{Net Indirect Taxes} - \text{Subsidy})$ $GDP_{FC} = GDP_{MP} - \text{Net Indirect Taxes} + \text{Subsidy}$
It is not considered for calculating Domestic and National Income	It is considered for calculating Domestic and National Income

Note

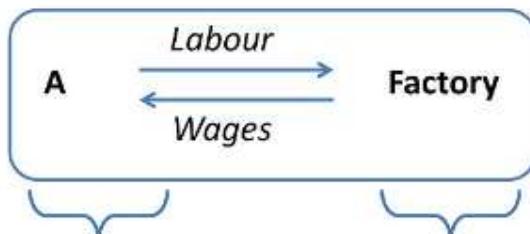
National income and Domestic Income is always calculated at Factor Cost, Not Market Price

Net Factor Income from Abroad

- Factors of Production are Land, Labour, Capital and Entrepreneurship
- Factor Payment is Remuneration paid to Factors of Production.
- like Wages, Interest, Rent, Profit.
- These factor Payments are Factor Income of Receiving Parties.

Suppose A works in Factory as a labour

Factory pays him wages



In this Case

A is Factor of Production

Wages earned is
Factor Income of A

In this Case

Factory is using this Factor of Production

Wages paid is
Factor Payment of Factory

What is Factor Income?

It is the income derived by owners from Factors of Production

Example of Factor Income

Different Factor of Production	Different Factor Income (or Factor Payment)
Labour	Wages
Land	Rent
Capital	Interest/Dividend
Entrepreneurship	Profit

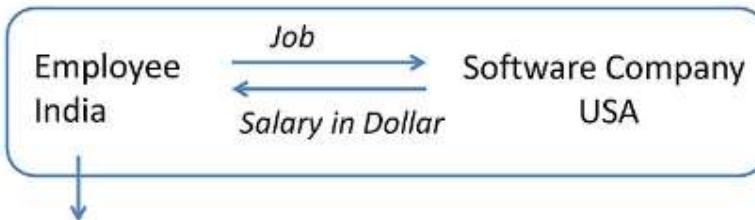
What is Factor Income Received from Abroad?

It is income Received by Domestic Factors of Production from outside country.

Example

- An Indian Employee is working from home for his software company based in USA
- In this case, Indian Employee will receive salary(factor income) from USA
- So we say, this is Factor Income Received from Abroad

What is Factor Income Received from Abroad?



In this Case

Employee is Factor of Production

He Receives Salary from USA

This is Factor income from Abroad

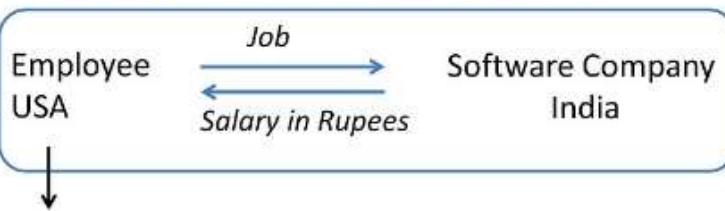
What is Factor Income Paid Abroad?

It is income by Foreign Factors of Production from domestic territory (India)

Example

- A US Employee is working from home for his software company based in India
- In this case, US Employee will receive salary(factor income) from India
- So we say, this is Factor Income Paid Abroad

What is Factor Income Paid Abroad



In this Case

*Employee is Factor of Production of USA
He Receives Salary from India*

This is Factor Income to Abroad

What is Net Factor Income from Abroad (NFIA)?

- It is Difference between Factor Income Earned from Abroad and Factor Income Paid to Abroad.
- It can be Positive or Negative
- It is used to calculate **GNP (Gross National Product)**

What is Net Factor Income from Abroad?

	<i>Case 1</i>	<i>Case 2</i>
Factor Income Received from Abroad	400	400
<i>Less</i>		
Factor Income Paid to Abroad	300	600
Net Factor Income from Abroad (NFIA)	100	-200
	<i>NFIA Positive</i>	<i>NFIA Negative</i>
	<i>Good for Economy</i>	<i>Bad for Economy</i>

GROSS NATIONAL PRODUCT

- It is total value of Goods and Services Produced by Country Residents
- Hence, it includes factor income earned by Citizens from outside the country.
- Also, it reduces factor income earned by foreign citizens in India
- GNP is that income or product which accrues to the economic agents who are residents of the country. (i.e. **income earned by the Non-Resident Indians (NRIs) will not be part of India's GNP**).
- To calculate GNP, we add the factor income of Indians from abroad in GDP and subtract the contribution of foreigners in India's GDP.
- Gross National Product (GNP) = GDP + Factor income earned by the domestic factors of production employed in the rest of the world – Factor income earned by the factors of production of the rest of the world employed in the domestic economy

i.e. $GNP = GDP + \text{Factor Income of Citizens working Outside Country} - \text{Factor Income of Foreign Citizens working in country}$

- $GNP = GDP + \text{Net factor income from abroad (NFIA)}$.
- Factor income is basically the income earned by the four factors of production i.e. profit, rent, interest and wages but it does not include the transfer incomes/payments.
- Hence GNP is the sum of GDP and factor income and it does not include transfer payments from the rest of the world (for example remittances).
- Gross National Product (GNP) is also called Gross National Income.

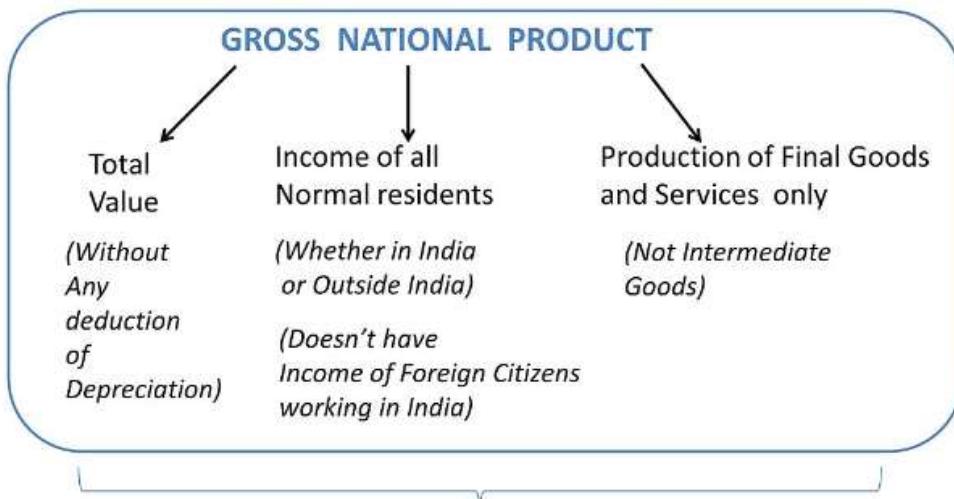
Different Types of incomes	GDP	GNP
<i>Income earned by Indian Citizen in India</i>	<i>Included (Domestic Territory)</i>	<i>Included (Normal Residents)</i>
<i>Income earned by Foreign nationals in India</i>	<i>Included (Foreign Territory)</i>	<i>Not Included (Foreign Residents)</i>
<i>Income earned by Indian Nationals Outside India</i>	<i>Not Included (Domestic Territory)</i>	<i>Included (Normal Residents)</i>

Example of GDP and GNP

Income earned by Indian Citizen in India	1000
Income earned by Foreign nationals in India	600
Income earned by Indian Nationals Outside India	200

What Is GDP And GNP?

GDP	GNP
Total value of Goods and Services Produced in Domestic Territory	Total value of Goods and Services Produced by Normal Residents
$= 1000 + 600$	$= 1000 + 200$
$= 1600$	$= 1200$
	<i>Second Method</i>
	$GDP = 1600$
	$NFIA = 200 - 600 = -400$
	$GNP = GDP + NFIA$
	$= 1600 + (-400)$
	$= 1600 - 400 = 1200$



GNP is Total value of Goods and Services Produced by Normal Residents

Suppose in a country, there are only 3 persons A, B and C
 A and B are working in the country while C is Outside Country
 Also D is a foreign Citizen working in the country
 Aggregate Value of Final Goods Produced of A, B, C and D is 1000, 2000, 2500, 4000 respectively
 What is GDP and GNP of Country?

GDP

Total value of Goods and Services Produced in Domestic Territory
 $= A + B + D$
 $= 1000 + 2000 + 4000$
 $= 7000$

GNP

Total value of Goods and Services Produced by Normal Residents
 $= A + B + C$
 $= 1000 + 2000 + 2500$
 $= 5500$

Second Method

NFIA = Income of C - Income of D
 $= 2500 - 4000$
 $= -1500$
 GNP = GDP + NFIA
 $= 7000 - 1500$
 $= 5500$

Domestic Income

- It is net money value of Goods and Services Produced in domestic territory after Depreciation
- It is also called Net Domestic Product at Factor Price (NDP_{FC})

Formula

$$NDP_{FC} = GDP_{FC} - \text{Depreciation}$$

What is Domestic Income?

It is net money value of Goods and Services Produced in domestic territory after Depreciation

It is also called Net Domestic Product at Factor Price (NDP_{FC})

Formula

$$NDP_{FC} = GDP_{FC} - \text{Depreciation}$$

GDP_{FC}

It is gross money value of Goods and Services Produced in domestic territory

Formula

$$GDP_{FC} = GDP_{MP} - \text{Net Indirect Taxes}$$

It is not Domestic Income

NDP_{FC}

It is net money value of Goods and Services Produced in domestic territory

Formula

$$GDP_{FC} = GDP_{MP} - \text{Net Indirect Taxes}$$

$$NDP_{FC} = GDP_{FC} - \text{Depreciation}$$

It is called Domestic Income

Example

Suppose total value of goods and services produced in DOMESTIC TERRITORY is 100

Depreciation on Maintaining Fixed assets is 20

What is Domestic Income?

GDP _{FC}	100
Less: Dep	20
NDP _{FC} (Domestic Income)	80

Why is this Depreciation Reduced?

It is reduced to account for wear and tear of capital goods

A part of Income which a country earned is consumed in maintaining existing capital goods (fixed assets)

So we reduce it to get correct Net Domestic Product

In above case

Country earned income of Rs 100 but out of this, Rs 20 was spent towards Depreciation

Hence, country actually earned Domestic Income of Rs 80

Concept of Normal Resident

Normal resident of a country refers to an individual or an institution who ordinarily resides in the country and whose Centre of economic interest also lies in that country.

Normal residents include both, individuals and institutions.

'Centre of Economic Interest' implies two things:

1. The resident lives or is located within the Domestic Territory; and
2. The resident carries out basic economic activities of earnings, spending and accumulation from that location.

Following are not included under the category of Normal residents:

1. Foreign tourists and visitors who visit a country for recreation, holidays, medical treatment, study, sports, conferences, etc.
2. Foreign staff of Embassies, officials, diplomats and members of the armed forces of a foreign country, located in the given country;
3. International organizations like UNO, WHO, etc. are not considered as normal residents of the country in which they operate. They are treated as the normal residents of international area.
4. Employees of international organizations are considered as residents of the countries to which they belong and not of the international area. For example, an American working in UNO office located in India will be treated as normal resident of America. However, if the employees are working for more than one year in such International Institutions, then they become the normal resident a country in which such institutions are located. It means, in the given example, if the American is working in UNO office in India for more than one year, then he will be treated as normal resident of India.
5. Crew members of foreign vessels, commercial travellers and seasonal workers, provided their stay is less than one year.
6. Border workers who live near the international border and cross the border on a regular basis to work in the other country. They are treated as normal residents of the country where they live, and not where they work.

GNP refers to all the economic output produced by a nation's normal residents, whether they are located within the national boundary or abroad.

What is National Income?

- It is gross money value of Goods and Services Produced by normal residents of a country after Depreciation
- It is also called Net National Product at Factor Price (NNPFC)

Formula

$$NNP_{FC} = GNP_{FC} - \text{Depreciation}$$

GDP_{FC}

It is gross money value of Goods and Services Produced by Normal Residents of a country

Formula

$$GNP_{FC} = GNP_{MP} - \text{Net Indirect Taxes}$$

It is not National Income

NDP_{FC}

It is net money value of Goods and Services Produced by Normal Residents of a country

Formula

$$GNP_{FC} = GNP_{MP} - \text{Net Indirect Taxes}$$

$$NNP_{FC} = GNP_{FC} - \text{Depreciation}$$

It is called National Income

Example

Suppose total value of goods and services produced by Normal Residents of a country is 140
Depreciation on Maintaining Fixed assets is 20

What is National Income?

GNP _{FC}	140
Depreciation	20
NNP _{FC} (National Income)	120

Why is this depreciation Reduced?

It is reduced to account for wear and tear of capital goods

A part of Income which a country earned is consumed in maintaining existing capital goods (fixed assets)

So, we reduce it to get correct Net National Product

In above case

Country earned income of Rs 140 but out of this, Rs 20 was spent towards Depreciation

Hence, country actually earned Domestic Income of Rs 120

Domestic Income

NDP_{FC}

It is net money value of Goods and Services Produced in Domestic Territory after Depreciation

Formula

$$\text{NDP}_{\text{FC}} = \text{GDP}_{\text{FC}} - \text{Depreciation}$$

It includes

- Income earned by Indian Citizen in India
- Income earned by Foreign nationals in India

It does not include

- Income earned by Indian Nationals Outside India

National Income

NNP_{FC}

It is net money value of Goods and Services Produced by Normal Residents of a country after Depreciation

Formula

$$\text{NNP}_{\text{FC}} = \text{GNP}_{\text{FC}} - \text{Depreciation}$$

It includes

- Income earned by Indian Citizen in India
- Income earned by Indian Nationals Outside India

It does not include

- Income earned by Foreign nationals in India

How to get National Income from Domestic Income?

National Income = Domestic Income + Net Factor income from Abroad

$$NNP_{FC} = NDP_{FC} + NFIA$$

Example

Domestic Income	5000
Income earned by Foreign nationals in India	100
Income earned by Indian Nationals Outside India	200

In this case

$$\begin{aligned} NFIA &= 200 - 100 \\ &= 100 \end{aligned}$$

$$\begin{aligned} NNP_{FC} &= NDP_{FC} + NFIA \\ &= 5000 + 100 \\ &= 5100 \end{aligned}$$

Example-How to Calculate Domestic & National Income

Income earned by Indian Citizen in India	1000
Depreciation	100
Income earned by Foreign nationals in India	600
Income earned by Indian Nationals Outside India	200
Indirect Taxes	200

What Is Domestic Income and National Income?

Calculation of Domestic Income

Step 1 $GDPM_P$

Gross market value of Goods and Services produced in domestic territory.
= Income earned by Indian Citizens in India + Foreign Citizens in India
= $1000 + 600 = 1600$

Step 2 NDP_{MP}

= $GDPM_P - \text{Depreciation}$
= $1600 - 100 = 1500$

Step 3 NDP_{FC} (Domestic Income)

= $NDP_{MP} - \text{Net Indirect Tax}$
= $1500 - 200 = 1300$

Calculation of Domestic Income

Step 4 Calculate NFIA

= Factor income from abroad - Factor income to abroad
= $200 - 600 = -400$

Step 5 NNP_{FC} (National Income)

= $NDP_{MP} + NFIA$
= $1300 - 400 = 900$

Concept of Domestic and National

For all Domestic Concepts.

We mention

Goods and Services Produced in Domestic Territory

(This may be earned by Indian Citizens in India or Foreign Citizens in India)

It does not include Income of Indian Citizens working abroad)

Examples

NDP_{FC} = Net Money Value of all final goods and services produced within Domestic territory of a country.

GDP_{FC} = Gross Money value of all final goods and services produced within Domestic territory of a Country.

GDP_{MP} = Gross Market value of all final goods and services produced within Domestic Territory of a Country.

NDP_{MP} = Net market Value of all final goods and services produced within Domestic territory of a country.

For all National Concepts.

We mention

Goods and Services Produced by Normal Residents of a Country. (This may be earned by Indian Citizens In India or Indian Citizens work-in abroad (it does not include Income of Foreign Citizens in India)

Examples

GNP_{MP} = Gross Market value of all final goods and services produced by Normal Residents of a Country.

NNP_{FC} = Net Money value of all final goods and services produced by Normal Residents of a country.

GNP_{FC} = Gross Money value of all final goods and services produced by Normal Residents of a Country.

NNP_{MP} = Net Market value of all final goods and services produced by Normal Residents of a country.

For all Domestic Concepts.

We mention

Goods and Services Produced in Domestic Territory

(This may be earned by Indian Citizens In India or Foreign Citizens in India)

(It does not include Income of Indian Citizens working abroad)

Examples

Domestic Income

= GDP_{FC}

= Gross Money value of all final goods and services produced within Domestic territory of a Country.

For all National Concepts.

We mention

Goods and Services Produced by Normal Residents of a Country

(This may be earned by Indian Citizens In India or Indian Citizens work in abroad)

(It does not include Income of Foreign Citizens in India)

Examples

National Income

= NNP_{FC}

= Net Money value of all final goods and services produced by Normal Residents of a country.

How to Get from Domestic to National?

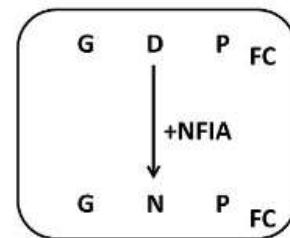
- We add Net Factor Income from Abroad (NFIA)
- Domestic + NFIA =National
- Domestic + (Factor Income earned from Abroad - Factor income Paid Abroad) = National

We add Net Factor Income from Abroad (NFIA)

$$\text{Domestic} + \text{NFIA} = \text{National}$$

Here NFIA =

*Factor Income earned from Abroad
less Factor income Paid Abroad*



Example 1

$$GDP_{FC} = 100$$

$$\text{Factor income from abroad} = 35$$

$$\text{Factor income to abroad} = 20$$

Calculate GNP_{FC}

$$NFIA = 35 - 20 = 15$$

$$NNP_{FC}$$

$$= GDP_{FC} + NFIA$$

$$= 100 + 15$$

$$= 115$$

Example 2

$$GDP_{FC} = 100$$

$$\text{Factor income from abroad} = 35$$

$$\text{Factor income to abroad} = 40$$

Calculate GNP_{FC}

$$NFIA = 35 - 40 = -5$$

$$NNP_{FC}$$

$$= GDP_{FC} + NFIA$$

$$= 100 + -5$$

$$= 85$$

Concept of Domestic Territory

It refers to the geographical territory administered by a government within which persons, goods and capital circulate freely.

It includes:

1. Political frontiers of the country.
2. Ships and Aircrafts owned and operated by the normal residents between 2 or more countries. Eg- Plane operated by Air India between US and Italy will be a part of the domestic territory of India.
3. Fishing vessels, oil and natural gas rigs and floating platforms operated by the residents of a country in the international water, where they have exclusive rights. Eg- Fishing boats operated by Indian fishermen in international waters over Indian Ocean will be a part of domestic territory of India.
4. Embassies, consulates and military establishments of a country located abroad.

It does not include:

1. Embassies, consulates and military establishments of a foreign country. Eg- Chinese Embassy in India will not be a part of domestic territory of India.
2. International Organizations like UN, WHO etc. located in the geographical borders.

Why is Concept of Domestic Territory Important?

- It is important to calculate GDP
- We have already studied that
- GDP includes Total Production within Domestic Territory
- So, it does not include income earned by Indian citizen working abroad

Miscellaneous Details

Normal Resident

- A Normal resident, whether a person or an institution, is one whose centre of economic interest lies in the economic territory of the country in which he lives.
- The centre of economic interest implies in two things:
 - The resident lives or is located within the economic territory for more than one year and
 - The resident carries out the basic economic activities of earnings, spending and accumulation from that location.
- There is a difference between the terms normal resident (resident) and citizen (or national). A person becomes a national of a country because he was born in the country or on the basis of some other legal criterion.
- A person is treated resident of a country on the basis of economic criterion.
- It is not necessary that a resident must also be the national of that country. Even foreigners can be the residents if they pass the above stated economic criterion.
- For example, a large number of Indian nationals have settled in U.S.A., England, Australia, etc. as residents (and not as nationals) of these countries. For India, they are Non-resident Indians (NRI) but continue to remain Indian nationals.

Following are not included under the category of Normal residents:

- (i) Foreign visitors in the country for such purposes as recreation, holidays, medical treatment, study tours, conferences, sports events, business etc. (they are supposed to stay in the host country for less than one year. In case they continue to stay for one year or more in the host country, they will be treated as normal residents of the host country).
- (ii) Crew members of foreign vessels, commercial travelers and seasonal workers in , the country (Foreign workers who work part of the year in the country in response to the varying seasonal demand for labour and return to their households and border workers who regularly cross the frontier each day or somewhat less regularly, (i.e. each week) to work in the neighbouring country are the normal residents of their own countries. Example: Nepal.
- (iii) Officials, diplomats and members of the armed forces of a foreign country.
- (iv) International bodies like World Bank, World Health Organization or International Monetary Fund are not considered residents of the country in which these organizations operate but are treated as residents of international territory. However, the staffs of these bodies are treated as normal residents of the country in which the international body operates. For example, international body like World Health Organization located in India is not normal resident of India but Americans working in its office for more than a year will be treated as normal residents of India.
- (v) Foreigners who are the employees of non-resident enterprises and who have come to the country for purposes of installing machinery or equipment purchased from their employers. (They are supposed to stay for less than one year. In case they continue to stay for one year or more, they will be treated as normal residents of the host country).

Economic territory or Domestic Territory:

- According to the United Nations, economic territory is the geographical territory administered by a government within which persons, goods and capital circulate freely.

- The above definition is based on the criterion “freedom of circulation of persons, goods and capital”. Clearly, those parts of the political frontiers (or boundaries) of a country where the government of that country does not enjoy the above “freedom” are not to be included in economic territory of that country.
- One example is embassies. Government of India does not enjoy the above freedom in the foreign embassies located within India. So, these are not treated as a part of economic territory of India. They are treated as part of the economic territories of their respective countries. For example the U.S. embassy in India is a part of economic territory of the U.S.A. Similarly, the Indian embassy in Washington is a part of economic territory of India.
- International organizations like UNO, WHO, etc. located within the geographical boundaries of a country.
- In layman terms, the domestic territory of a nation is understood to be the territory lying within the political frontiers (or boundaries) of a country. But in national income accounting, the term domestic territory is used in a wider sense. Based on ‘freedom’ criterion, the scope of economic territory is defined to cover:
 - Ships and aircrafts owned and operated by normal residents between two or more countries. For example, Indian Ships moving between China and India regularly are part of domestic territory of India.
 - Similarly, planes operated by Air India between Russia and Japan are part of the domestic territory of India. Similarly, planes operated by Malaysian Airlines between India and Japan are a part of the domestic territory of Malaysia.
 - Fishing vessels, oil and natural gas rigs and floating platforms operated by the residents of a country in the international waters where they have exclusive rights of operation. For example, Fishing boats operated by Indian fishermen in international waters of Indian Ocean will be considered a part of domestic territory of India.
 - Embassies, consulates and military establishments of a country located abroad. For example, Indian Embassy in Russia is a part of the domestic territory of India. ‘Consulate’ is an office or building used by consul (an officer commissioned by the government to reside in a foreign country to promote the interest of the country to which he belongs).

GNP at current MP:

When final goods and services included in GNP are valued at current MP, i.e., prices prevailing in the year for which GNP is being measured, it is called GNP at current MP or Nominal GNP.

GNP at constant MP:

When final goods and services included in GNP are valued at constant prices, i.e. prices of the base year, it is called GNP at constant MP or Real GNP.

GNP Deflator:

It is measured as the ratio of nominal GNP to real GNP, multiplied by 100.

$$\text{GNP deflator} = \frac{\text{Nominal GNP}}{\text{Real GNP}} \times 100$$

Green GNP:

Green GNP refers to GNP adjusted for loss of value due to, (a) Environmental degradation; and (b) Depletion of natural resources on account of overall production activity in the economy

Activities excluded from GDP or GNP:

The activities are as follows:

(a) Purely financial transactions: It may be of three types:

- (i) Buying and selling of securities
- (ii) Government Transfer payments
- (iii) Private Transfer Payments

(b) Transfer of used goods.

(c) Non-market goods and services

(d) leisure activities.

Buying and selling of securities:

- In financial markets potential savers and investors buy and sell financial assets such as shares and bonds.
- While someone buys a share, there is only a transfer of ownership right. It is a claim to ownership of assets.
- Trading in financial instruments does not imply production of final goods and services. As such these are not included in the GNP.

Government Transfer Payments:

Transfer Payments are payments for which no goods and services are provided in exchange. Pension payments employee's social security measures, etc. are examples for Government Transfer Payment as there is no production of final goods and services in response to transfer Payment, transfer payments are not included in GNP.

Private Transfer Payments:

Items such as pocket money given by parents to their children, elders gifting money to the young ones are private transfer payments. This is merely a transfer of money from one individual to another. Hence, this is not included in GNP.

Transfer of used goods:

- GNP refers to the value of the final goods and services produced in a given year. Hence, goods produced in the previous time period cannot be included in the GNP.
- For example, Mr A sells his old bike to Mr B for rs. 30,000 on 25th April 2011 which was purchased by Mr A on 1st March 2010 for Rs. 45,000.
- This transaction should not be included as it has already been included in the 2010 GNP and if we again include it, then it will create the problem of double counting

Non-market goods and services:

- Many final goods and services are not acquired through regular market transaction. Vegetables can be grown in the backyard instead of buying them from the super market or an electrical fault can be repaired by the house owner himself instead of hiring an electrician.
- These are examples of non-marketed goods and services that have been consumed with using organized markets as GNP includes only those transactions that occur through market activities.

(d) Leisure Time Activities:

Activities like painting, growing of flowers in kitchen garden, etc. is not included as their aim is not to earn money but to pass away free time in one's hobby or entertainment.

CHAPTER 21

This Chapter will demystify the following concepts:

- ✓ Barter System and associated problems
- ✓ Purchasing Power of Money
- ✓ Legal Tender
- ✓ Intrinsic Value & Fiat Money
- ✓ Money Supply
- ✓ Different Types of Money
- ✓ Different types of Banks

- ✓ Types of Deposits and Accounts
- ✓ Understanding Balance Sheet
- ✓ Procedure followed to Issue Currency
- ✓ Money Circulation
- ✓ Currency Deposit Ratio (CDR)
- ✓ Reserve Deposit Ratio (RDR)
- ✓ Money Multiplier
- ✓ Inflation: Types & Causes
- ✓ Effects of Inflation
- ✓ Methods for measuring Inflation
- ✓ Monetary Policy Committee
- ✓ Quantitative & Qualitative Tools
- ✓ Reserve Ratios
- ✓ Open Market Operations
- ✓ Securities: Equity & Debt
- ✓ Government Securities (G-Sec)
- ✓ Financial Markets



What is Money?

It is a medium of exchange in form of coins and banknotes. When we sell goods, we exchange goods for money. When we buy goods, we exchange money for goods. So, it is a medium of exchange.

Suppose you go to a Shop to buy a 5 Star Chocolate



What Transaction Occurred in this case?



What is Money ?

It is a Medium of Exchange in form of coins & bank notes

When we buy goods, we exchange money for goods
When we sell goods, we exchange goods for money

What happened during the time when there was no money?

In this case, we had Barter System

Example

Suppose a Mango Farmer wanted to purchase Jewelry for his wife
He gave 1000 mangoes to Jeweller and in return purchased one necklace



Farmer
Grew Mangoes

1000 Mangoes
↔
1 Necklace



Jeweller
Sold Jewellery

What is Barter System?
Exchanging one commodity with other without mediation of money

What are limitations of Barter System?

Barter system of exchange is a system in which goods are exchanged for goods. 2. For example, wheat may be exchanged for cloth; house for horses, etc., or a teacher may be paid wheat or rice as a payment for his/her services.

Such exchange exists in the C-C Economy (commodity to commodity exchange economy).

Problem 1 -Barter System

Problem of Double Coincidence of Wants

Suppose in the below example



Farmer
Grew Mangoes

1000 Mangoes
↔
1 Necklace



Jeweller sold
Jewellery

What if Farmer doesn't need Necklace?
What if Jeweler doesn't need so many Mangoes?
Is Barter System Possible?

Barter System Possible
Only if by chance
Farmer Wants Necklace
and
Jeweler Wants mangoes

This is called
Double Coincidence of Wants
it means
Both person should need each
other's goods for Barter
System to happen

goods produced by two persons are needed by each other. It is double coincidence of wants.

- Double coincidence of wants means that goods in possession of two different persons must be useful and needed by each other. It is the main basis of barter system of exchange. But it is rare.

Problem 2 -Barter System

High Storage Costs

Suppose in the below example



Farmer
Grew Mangoes

1000 Mangoes
↔
1 Necklace



Jeweller
Sold Jewellery

Now Jeweller is owner of 1000 Mangoes
He takes a room on rent and Stores these 1000
Mangoes

There is Storage cost of storing these mangoes
In a room
(if he had received money instead of mangoes,
there would not be any storage cost)

Note: In C-C Economy C stands for commodity.

C-C economy is the one in which commodities are exchanged for commodities. C-C exchange refers to barter system of exchange. Hence, C-C Economy is an economy dominated by barter system of exchange.

Difficulties of barter system are:-

Barter system as a system of exchange is faced with the following difficulties:

Lack of double coincidence of wants:

- Barter is possible only if

- Double coincidence of wants means that goods in possession of two different persons must be useful and needed by each other. It is the main basis of barter system of exchange. But it is rare.

- It is difficult to find such a person every time. In barter system, exchange becomes quite limited.

Lack of divisibility:

In commodity exchange, difficulty of dividing the commodity arises. (ii) For example, animals cannot be divided into smaller units.

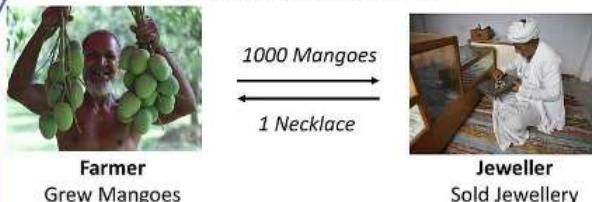
Difficulty in storing wealth:

- It is very difficult to store wealth for future use. Most of the goods like wheat, rice, cattle etc. are likely to deteriorate with the passage of time or involve heavy cost of storage.
- Further, the transfer of goods from one place to another place involves huge transport cost. Transfer of immovable commodities (such as house, farm, land, etc.) becomes almost impossible.

Problem 3 -Barter System

Difficult to Carry forward one's wealth in Barter System

Suppose in the below example



Now Jeweller is owner of 1000 Mangoes
He saves it in his home for future generations
After 1 Year, he dies
His son becomes owner of wealth of Mangoes
Now, Son tries to sell these Mangoes
But Mango Stock get Spoiled, can't be sold

*Difficult to Carry forward one's wealth in Barter System
(not possible to transfer wealth to future generation)
as goods are perishable*

Ac

Absence of common measure of value:

Different commodities are of different values. The value of a good or service means the amount of other goods and services it can be exchanged for in the market. There is no common measure of value under barter system.

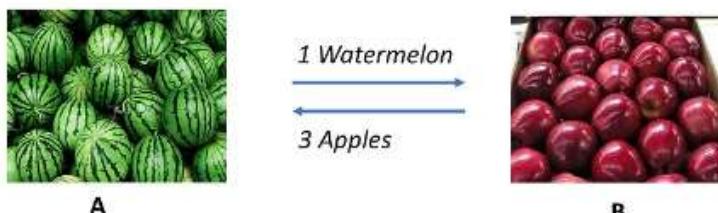
In this situation, it is difficult to decide in what proportions are the two goods to be exchanged.

Problem 4 -Barter System

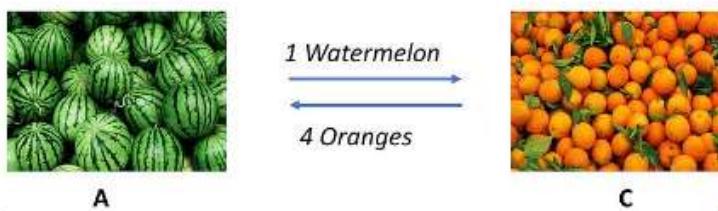
No Proper Unit of Account

Suppose there are 3 persons A, B and C
Who sell Watermelons, Apples and Oranges respectively

Farmer A agrees to give his 1 Watermelon to get 3 Apples from B



But Farmer A agrees to give his 1 Watermelon to get 4 Oranges



What is Price of Watermelon?

It is 3 Apple per watermelon
Or
4 oranges per watermelon

There is no proper unit of account

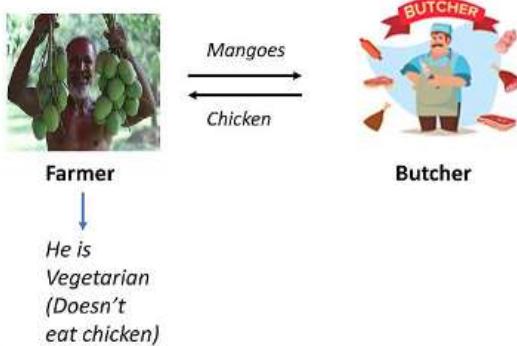
It is Difficult to measure how much quantity in exchange of another commodity

Problem 5-Barter System

Goods not acceptable to Other Person

Example

Suppose a Farmer sells Mangoes
Customer is a Butcher who is willing to purchase Mangoes in exchange of chicken
But Farmer is Vegetarian and doesn't eat chicken?



Lack of standard of deferred payment:

In a barter economy future payment would have to be stated in terms of specific goods or services. This leads to following problems:

Barter System Not Possible
If Goods of one person is not acceptable To other person

- There could be disagreement regarding the quality of the goods or services to be repaid.
- There would be disagreement regarding which specific commodities would be used for repayment.

Problem 6 -Barter System

No Standard of Deferred Payment

Example

Suppose there are 2 Farmers
Farmer 1 Grows Mango
Farmer 2 Grows Wheat
Both agree to exchange their crop with each other
Crop of Mango is Ready
But Crop of Wheat will take 3 months to be ready



Problems in this Barter Transaction

In this case Farmer 2 will make payment at later date
(It is Deferred Payment)

How much wheat will grow in farm?

(No Standard quantity of Deferred Payment)

What if Wheat crop gets damaged due to flood, drought etc?

(No Standard quality of deferred payment)

Problem 7 -Barter System

Lack of Divisibility

Example

Suppose a Farmer has 100 Mangoes

He wants to buy a horse

But horse owner is willing to sell it only for 200 mangoes

Can Farmer buy half horse with his 100 mangoes?



Farmer

1000 Mangoes
↔
1/2 Horse



Horse

Barter System Not Possible

As Horse is not Divisible

(Certain goods cannot be divided, hence barter system not possible)

Why was Money Introduced?

It was introduced to overcome shortcomings of Barter System.

PROBLEMS IN BARTER SYSTEM	BENEFITS OF MONEY SYSTEM
Double Coincidence of Wants	Want Can be of One person also (and not both)
No Proper Unit of Account	Proper Unit of Account
Difficult to Carry forward one's wealth	Easier to carry forward money to future
High Storage Cost	Money Can be easily stored
Not Acceptable to Everyone	Universally accepted
Lack of Divisibility	Easily Divisible

How does Money overcome shortcoming of Barter System

BARTER SYSTEM PROBLEMS

Double Coincidence of Wants

(Both person should need each other goods or service)

High Storage Cost

(Product purchased or sold has to be stored in warehouse/godown)

Difficult to Carry forward wealth

(Some items are perishable, cannot be transferred to future generation)

No Proper Unit of Account

(No fixed price of a product, price varies with product exchanged)

MONEY SYSTEM BENEFITS

Want Can be of One person also

(Only one person may need the good And not both person)

Money Can be easily stored

(It is easier to save notes than goods No need of godown/warehouse)

Easier to carry forward money to future

(Father can save his wealth in form of bank notes and give to his future generation)

Proper Unit of Account

(Price of All goods is measured in terms of Rupees)

Definition of Money

Functions of Money

Money is

Medium of Exchange

Money Act as Medium of Exchange

Goods and Services can be exchanged for money

Measure of Value

Money Act as Measure of Value

We decide Price of different goods and services in terms of money

Store of Value

Money Act as Store of Value

Money can be saved and Stored for use by future generation

And

Means for Standard
Deferred Payment

Money Act as Means for Standard of Deferred Payment

If Payment to be made in future , we know amount to be paid

Does Money only act as Store of Value?

No. Other assets also act as store of value, like Property, Gold, stocks etc.

Why are these assets not used in place of money?

Because these are not easily convertible. Also, they do not have universal acceptability

What is purchasing Power of Money?

Purchasing power of money refers to the quantity of goods and services that can be purchased with it.

Eg: If a person has Rs 60 and want to buy biscuits. Now, the cost of 1 packet of biscuit is Rs10. Here the money can buy 6 packets of biscuit. $(60/10=6)$

What causes Deterioration in Purchasing Power of Money?

Inflation in price levels of goods and services cause deterioration in purchasing power of money.

Inflation refers to the increase in general price levels of goods and services.

Now, in 2021

The person has Rs100 to spend on biscuits. The cost of 1 packet of biscuit has increase to Rs 12 because of inflation. As a result, the money in 2021 can only buy 5 packets of biscuit $(60/12=5)$. So, we can see that the purchasing power of money has decreased due to inflation.

What is Opportunity Cost of Money?

If instead of holding Money in cash form, we deposit it in bank. We get interest.

This is Opportunity cost of Money

Why do People hold money?

They have liquidity preference. It arises because of-

1. Transaction motive of Money

It means the desire to hold money for cash-based transactions

Eg: A person has Rs100 with him. He has 2 options either to spend them or deposit in bank. If the person has the desire to use money for some transaction/ purchase then he will not deposit this in bank and hold it.

2. Speculative Motive of Money

It refers to the desire of a trader/ investor to hold money so as to make use of it when a good investment opportunity arises later.

3. Precautionary Motive of Money

It is a desire to hold money to be able effectively with unexpected events that require cash outlay.

Eg: A person can have the desire to hold money as a precautionary measure to deal with future uncertainties.

Supply of Money

What types of Assets are Money

Suppose a Person is very Rich. He has the following assets

Money in his Pocket



Notes



Coins

These are Money

Money in Banks



Bank Accounts



Fixed Deposit

These are Money

Property



Luxury House



Luxury Car

These are not Money

Money consists of Currency Notes and Coins-

It Also includes Demand Deposits + Term Deposits

Currency Notes

They are issued by Monetary authority of the country

In India, it is Reserve Bank of India

Coins

They are issued by Govt of India

Demand Deposits

Balance in Savings and Current Accounts of Banks is called Demand Deposits

It is called Demand Deposit because it can be withdrawn anytime on demand (by issuing cheques etc)

Term Deposit

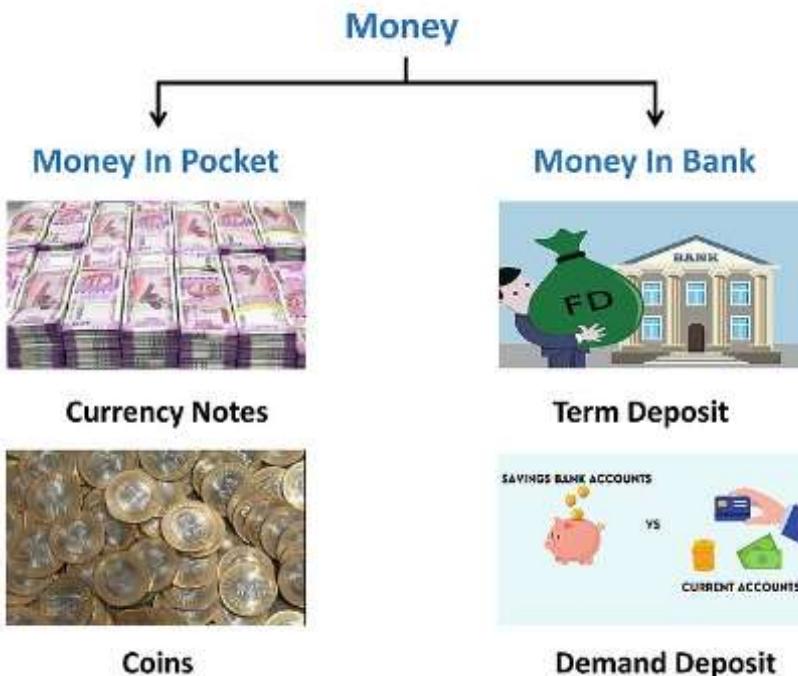
They are deposits for a fixed period of time

Example - Fixed Deposits have a fixed maturity date

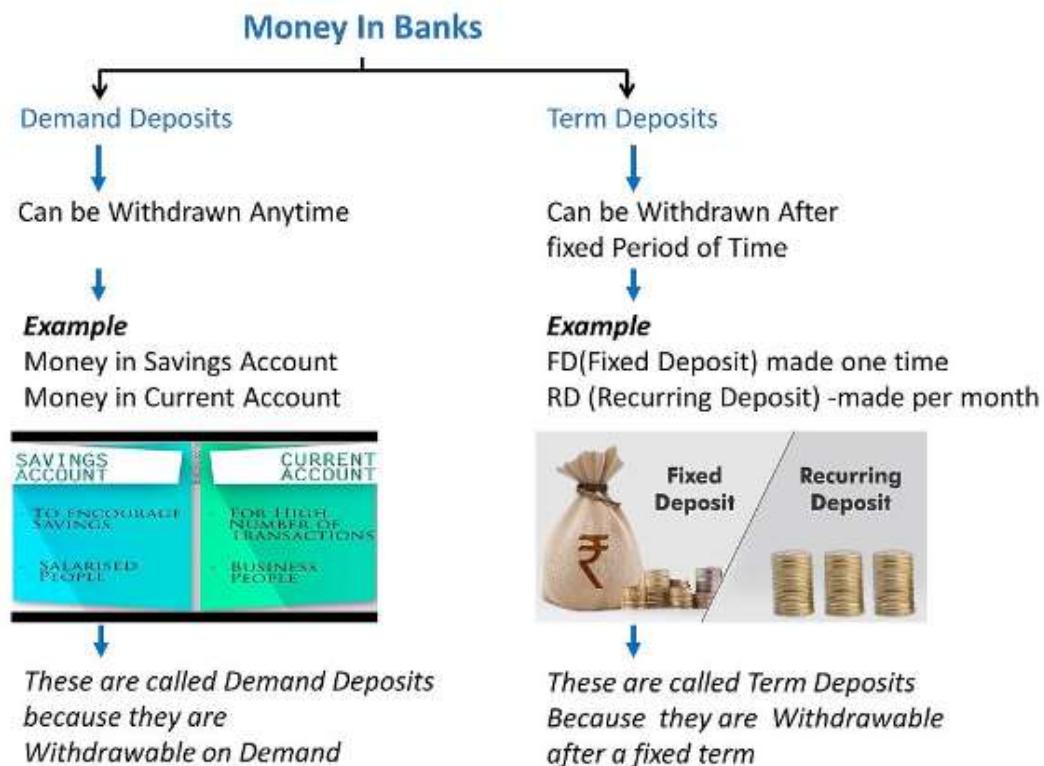
What is Money in Modern Economy

Money consists of Currency Notes and Coins

It also includes Demand Deposits + Term Deposits



Difference between Demand Deposits and Term Deposits



What is Legal Tender?

Example

Suppose you go to Mc Donald's to purchase a Mc Veggie Burger for Rs 70



Can you make payment by 7 Bank Notes of Rs 10? → Yes, shopkeeper has to accept Bank Notes

Can you make payment by 70 Coins of Rs 1 each → Yes, shopkeeper has to accept coins

Can you make payment by Cheque of Rs 70 ? → No, shopkeeper may refuse to take cheque

Can you make payment by FD of Rs 70? → No, shopkeeper may refuse to take FD

What is Legal Tender?

It is a form of money which cannot be refused by any citizen for settlement of any kind of transaction

It is a form of money which cannot be refused by any citizen for settlement of any kind of transaction

Example-

If I have to pay a shopkeeper Rs 500, I can give him any currency note or coin as payment

The person cannot refuse to take any type of currency note

Hence, coins and currency notes are legal tenders.

Exception

However, that person can refuse to take cheque of 500 or Fixed deposit of 500, as these are not legal tenders.

Legal definition of money:

- Legally, money is anything proclaimed by law as a medium of exchange.
- Paper notes and coins (together called currency) is money as a matter of law.
- Nobody can refuse its acceptance as medium of exchange.
- In other words, it is legal tender. It means people have to accept it legally for different payments.

Currency is also called FIAT money because it commands 'FIAT' (order/authority) of the government.

Different Types of Money

Legal Tender

Can be Refused by Any citizen in settlement of any transaction

Example



Currency Notes



Coins

Not Legal Tender

Can be Refused by Any citizen in settlement of any transaction

Example



Fixed Deposit



Demand Deposit

Note

Legal Tender is also of 2 Types

- *Limited legal Tender*
- *Unlimited Legal Tender*

Suppose I want to Purchase a Car for Rs 10 lacs
Can I make Payment of Rs 10 lacs by Coins



Legal Tender

Limited Legal Tender

Payment upto a Certain Amount is allowed

Example

Coins

can be used to make Payment only upto Rs 1000 in India

Unlimited Legal Tender

Payment upto any amount is allowed

Example

Currency Notes

can be used to make Payment up to any amount in India

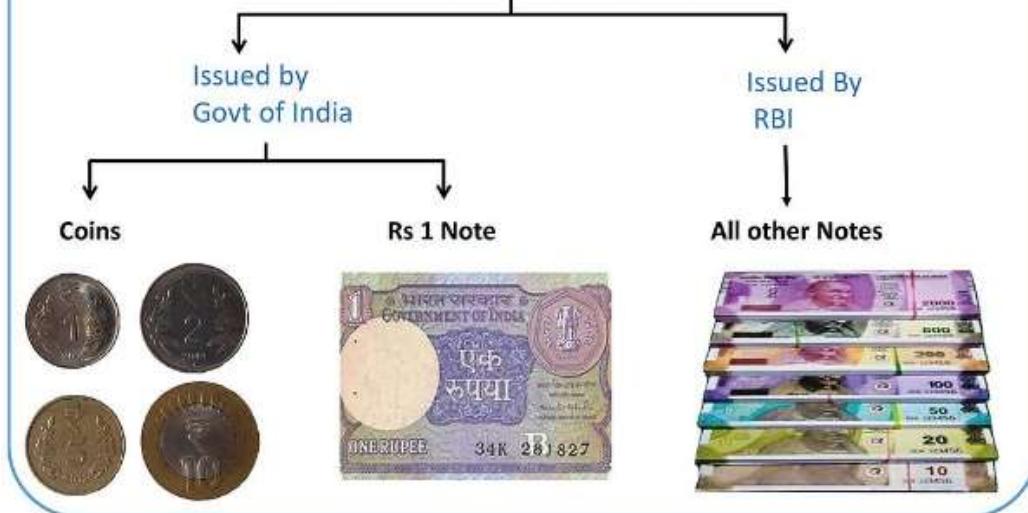
Who Issues Currency Notes and Coins in India?

Normally Coins are issued by Govt of India and Currency Notes are issued by RBI.

Exception

Rs 1 Currency note is issued by Govt of India (and not RBI)

Who Issues Currency Notes and Coins In India?



Concept of Fiat Money

Intrinsic Value and Fiat money

What is Fiat Money?

It is a currency note or a coin which does not have intrinsic value. They are used as legal tender only because of government regulation.

Example- Currency Notes and Coins which are used now a days.

Why are currency notes and coins called Fiat money

In earlier times,

Gold and Silver coins were issued. Gold



No

Value of Paper may be of only Rs 1
but it has legal value of Rs 2000

}
 Intrinsic Value = Rs 1
 Legal Value = Rs 1000
 Both are not same
 So it is called Fiat Money

Are Coins Fiat Money?

Earlier

Gold Coins Used



Intrinsic Value = Rs 10
Legal Value = Rs 10

Both Intrinsic and
Legal value same
It is not Fiat Money

Now

Cheap Metal Coins Used



Intrinsic Value = Rs 1
Legal Value = Rs 10

Both Intrinsic and Legal value
are different
It is called Fiat Money

What is Fiat Money

It is a currency note or a coin which does not have intrinsic value. They are used as legal tender only because of government regulation. Example-Currency Notes and Coins used now a days

and silver were precious metals which had intrinsic value. So, a silver coin worth 100 Rs had an actual value of 500 rupees

Now,

Coins of cheaper metals like copper, nickel, aluminium are used. Also, currency notes are used which are made of paper. A coin of Rs 10 may not have metal worth Rs10. A currency note of Rs500 do not have paper worth Rs 500. Hence, these coins and notes are called Fiat money as they do not have intrinsic value like gold and silver coin.

However, they are legally accepted as legal tender because of govt regulation (govt rules).

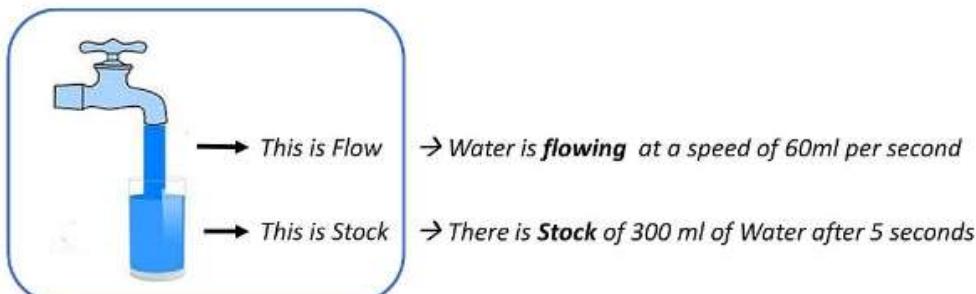
Is Money Supply Stock or Flow?

Example

Suppose a Glass is of 300 ml

It is filled up by tap water in 5 seconds

It means water is flowing from Tap into glass at speed of $300/5 = 60$ ml per second



What is Stock

It is a variable which is measured at a Particular Point of Time

Example

Amount of Water in a Glass

What is Flow

It is a variable which is measured over a period of time

Example

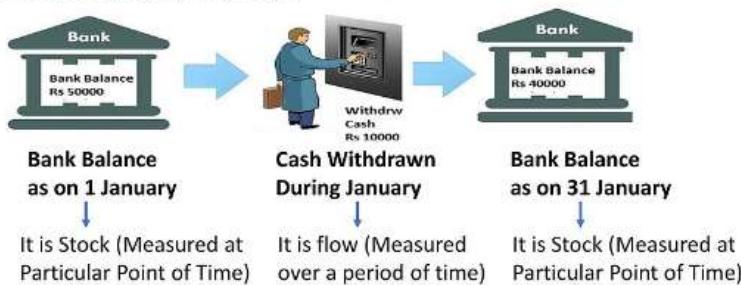
Amount of Water flowing from tap into glass per second

Suppose I have Rs 50000 in my bank account as on 1 Jan

I spent 10000 during the month of January

Now I am left with 40000 as on 31 Jan

What is Stock and Flow in above case?



Difference Between Stock and Flow

Stock

It is variable measured at a Particular Point of time

Example –

Bank balance as on 31st Jan

Flow

It is variable measured over a period of time

Period-

Cash withdrawn during January

What is Money Supply?

It is total stock of Money in Circulation with public at a particular point of time.

What is Money Supply in an Economy

Is Money Supply a Stock Variable or Flow Variable?

Money Supply is a stock variable

It is because it is measured at a particular point of time

Ex - RBI Publishes figures for Money Supply as on 31 Mar 2021 which means total money in circulation among public as on 31 Mar 2021



What is Money Supply?

It is total stock of Money in circulation with public at a particular point of time

Example

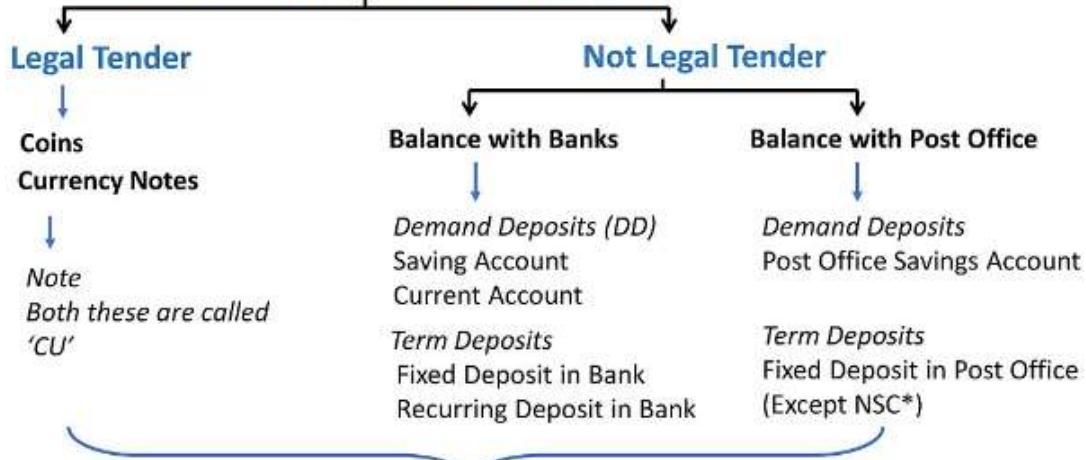
As per RBI Press Release, total money supply as on 31 March 2021 was Rs 188 Lakhs Crores

Is Money Supply Stock or Flow?

Money Supply is Measured at a Particular Date
So it is a Stock

What are Different types of Money Supply ?

Different Types of Money Supply



All these are Categorized into 4 legal Definitions of Money-M1,M2,M3,M4

*What is NSC?

It means National Savings Certificate

It is a scheme of Post office where public invest their money for fixed period of time and get higher amount on maturity.

This is not counted in definition of money supply

Figures Published by RBI for Money Supply

RBI publishes 4 types of figures in case of Money Supply

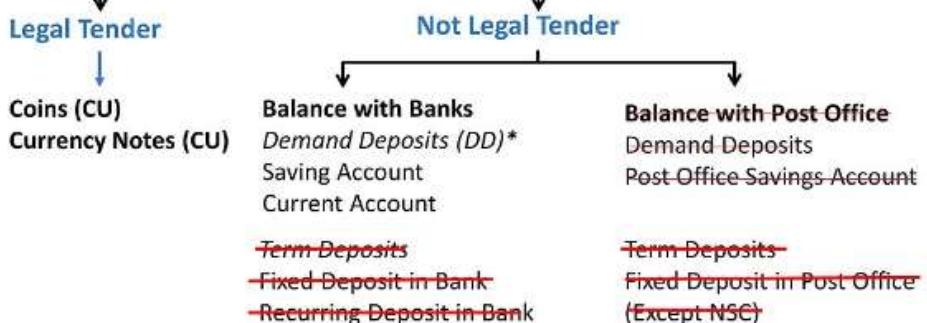
M1,M2,M3,M4

let's learn about it one by one

What is M1

M1 is total of currency notes and coins (CU)
+
Net demand deposits issued of Bank(DD)
 $M1 = CU + DD$

What is Covered in M1



Note

Only Net Demand Deposits covered in M1,
Not term Deposits and that too of bank (Not Post office)
Net demand Deposits means Demand Deposits of public
and not demand deposit of one bank with other bank

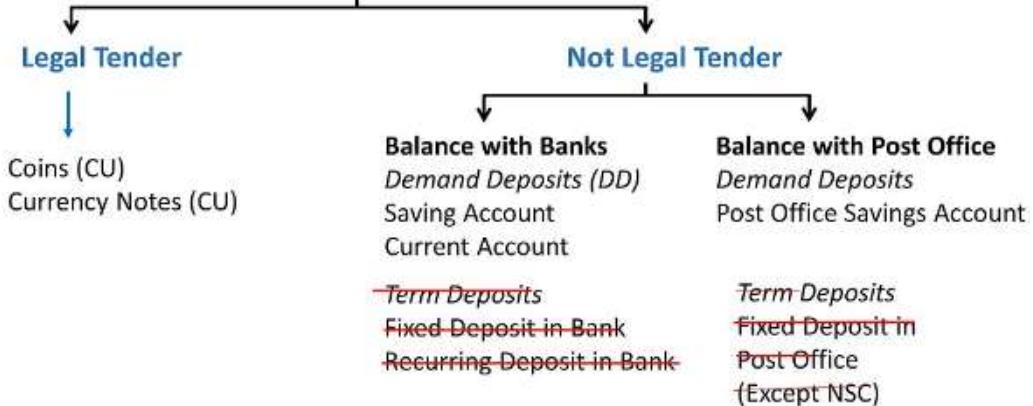
What is M2

In M2, We include savings deposits with Post office savings banks also with M1

$M2 = M1 + \text{Post office savings banks}$

$M2 = CU + DD + \text{Post office savings banks}$

What is Covered in M2



OUR ACHIEVERS

PANKAJ
KUMAR
1 5 8 4 6 3

SELECTED
IN UPSC



PCS
OFFICER | SANDEEP
KUMAR
4 5 7 5 0 1



ABHISHEK
MISHRA
3 3 0 8 5 7

PCS
OFFICER



PCS
OFFICER | MANISH
KUMAR
2 2 1 4 0 5

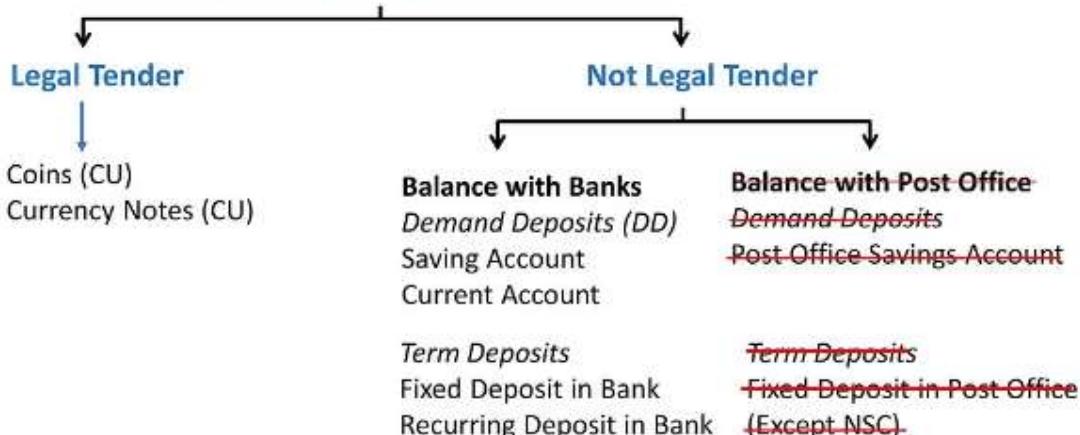
M3

In M3, We include Net time deposits of commercial banks also with M1

$M3 = M1 + \text{Net time deposits of commercial banks}$

$M3 = CU + DD + \text{Term Deposits of Bank}$

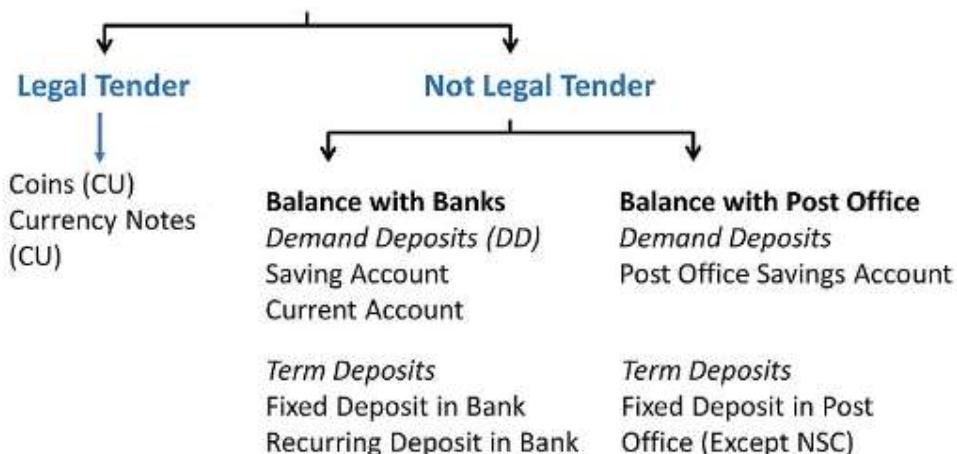
(No post office here deposits here)

What is Covered in M3**M4**

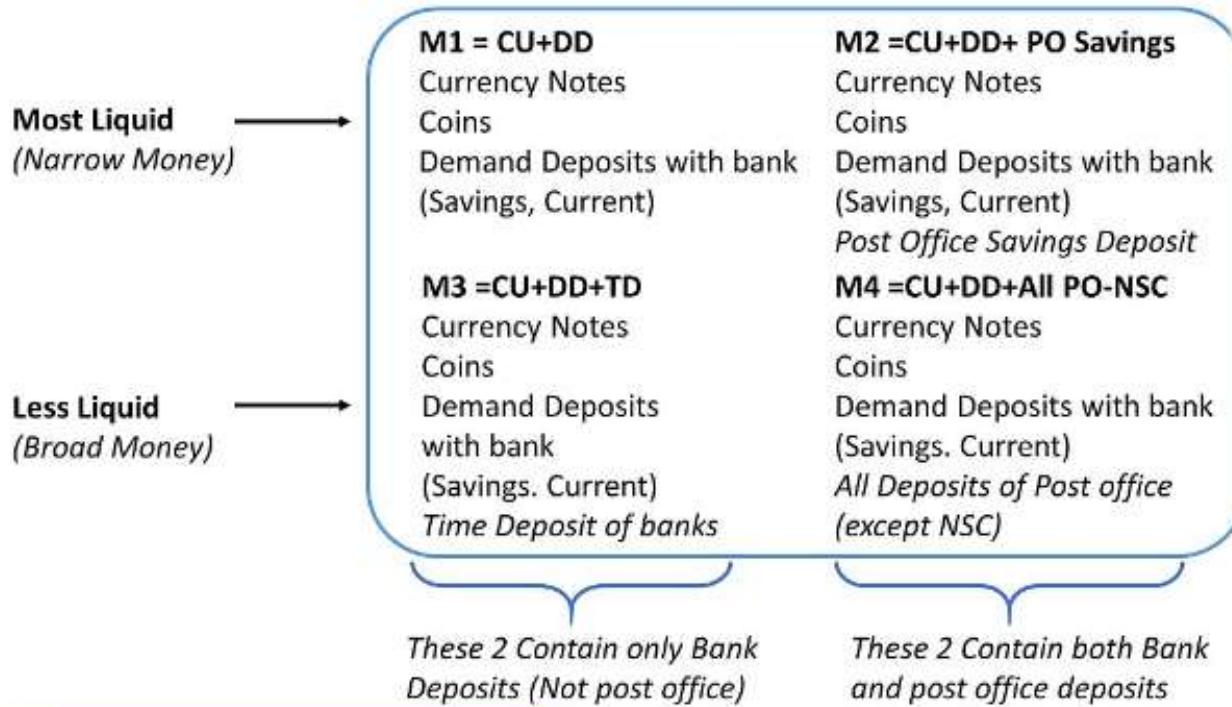
In M4, we include M3+ total deposits with Post office savings organizations (however, National savings Certificate is not included)

$M4 = M3 + \text{Total Deposits of Post Office}$

(hence, it includes all forms of money)

What is Covered in M4

Comparison Chart of M1, M2, M3 & M4



Which method mostly used by RBI?

M3

It is also called

Aggregate Money Resource

Different Measures of Money Supply

M1 → CU+ DD

(Currency Notes and Coins +Demand Deposits of Commercial banks)

M1 +Savings Account with Post Office

M2 → (Currency Notes and Coins +Demand Deposits of Commercial Banks+ Savings Account of Post Office)

M3 → M1 + Net Time Deposit of Banks

(Currency Notes and Coins +Demand Deposits of Commercial Banks+ Term Deposits of Bank)

M4 → M3 + Total Deposits of Post Office (Excluding NSC)

(Currency Notes and Coins +Demand Deposits of Commercial Banks+ Term Deposits of Bank)+ All deposits of Post office

M1

M1 is total of currency notes and coins (CU)+ net demand deposits issued (DD)

$$M1 = CU + DD$$

M2

in M2, We include savings deposits with Post office savings banks also with M1

$$M2 = M1 + \text{Post office savings banks}$$

M3

in M3, We include Net time deposits of commercial banks also with M1

$$M3 = M1 + \text{Net time deposits of commercial banks}$$

M4

In M4, we include M3 + total deposits with Post office savings organizations (however, National savings Certificate is not included)

$$M4 = M3 + \text{Total Deposits of Post Office}$$

Which one of above is most liquid

M1 is most liquid, M2 little less, M3 even more less and M4 is least liquid

Which is most commonly used method of legal supply

M3

It is also called aggregate monetary resources

What is broad money and narrow money?**Narrow money**

Money which is most liquid is called Narrow money

M1 and M2 are called Narrow money

Broad Money

It is amt of money in economy which includes both highly liquid and less liquid forms

M3 and M4 are called Broad money

Let's understand Difference between Broad Money and Narrow Money

Difference -Broad Money and Narrow Money

Narrow Money

It includes *only liquid form* of money which can be withdrawn anytime

It includes Cash,
Currency Notes and
Demand Deposits

Example

M1 and M2

Broad Money

It includes *both liquid and less liquid form* of money

Apart from Cash , Currency Notes and
Demand Deposits
It also includes Demand Deposits

Example

M3 and M4

Comparison M1,M2 ,M3 AND M4

**Most Liquid
(Narrow Money)**

M1

Currency Notes
Coins
Demand Deposits with bank
(Savings, Current)

**Less Liquid
(Broad Money)**

M3

Currency Notes
Coins
Demand Deposits
with bank
(Savings. Current)
Time Deposit of banks

M2

Currency Notes
Coins
Demand Deposits with bank
(Savings, Current)
Post Office Savings Deposit

M4

Currency Notes
Coins
Demand Deposits with bank
(Savings. Current)
All Deposits of Post office
(except NSC)

Difference between Central bank and Commercial Bank

There are 2 types of banks

- Banks which do Public Dealing
Example- PNB, SBI, ICICI
These are called Commercial Banks
- Banks which do not do Public Dealing
Example- RBI in India
It is called Central Bank

Central Bank vs Commercial Bank



Reserve Bank of India
(Central bank)



State Bank of India
(Commercial Bank)

Questions

*In which Bank can we open an account?
SBI (Commercial Bank)*

*Which bank can give loan to us?
SBI (Commercial Bank)*

*Which bank can give loan to SBI?
RBI(Central Bank)*

*Which Bank can issue Currency?
RBI (Central Bank)*

**Commercial Bank is
Bank of Public
(Deals with Public)**

**Central bank(Reserve Bank) is
bank of bank**

What is borrowing Rate of bank

Suppose Bharat Makes Fixed Deposit (FD) in Bank of Rs 100000 @ 6%



Bharat	<i>Deposit Rs 100000</i>	BANK
It is like a Loan Given to Bank (Assets)		It is a Loan taken from Public called Term Deposits (Liability)
B will Receive Interest of 6000		Bank will pay Interest of 6000
<i>It is Interest Income for B</i>		<i>It is Interest expense</i>
<i>What is Rate of interest of FD 6%</i>		<i>What is Borrowing Rate of bank 6%</i>

Note

Same case applicable in case of
Savings Account also (Demand Deposits)

What is Borrowing Rate

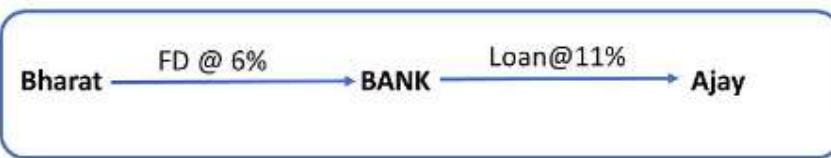
(Rate of Interest at which Bank
borrows Money from others is
called **Borrowing Rate**)

How does a Bank earns money?

- A bank takes money from public at low rate of interest
- It gives loan to Public and businessman at high rate of interest
- Remaining is its income

Example

Suppose Bharat deposits Rs 100000 FD in Bank @ 6%
Bank uses this money to give loan to Ajay @ 11%



*On FD,
Bank pays interest*

$$\begin{aligned} \text{Interest Expense} \\ = 100000 * 6\% \\ = 6000 \end{aligned}$$

*On Loan,
Bank Receives Interest*

$$\begin{aligned} \text{Interest Income} \\ = 100000 * 11\% \\ = 11000 \end{aligned}$$

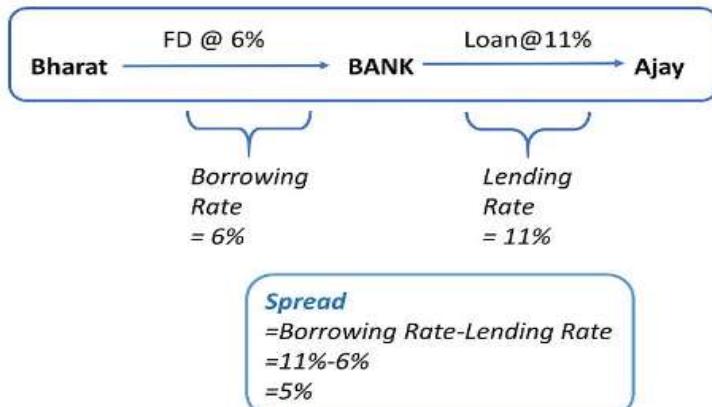
$$\text{Profit of Bank} = 11000 - 6000 = 5000$$

What is borrowing Rate of Bank in this case?

- Borrowing Rate of banks is Rate of Interest offered by banks to deposit holder
- Borrowing Rate in our example = 6%

What is Lending Rate of Bank in this case?

- Lending Rate is the Rate charged by bank on lending money
- Lending Rate in our example = 11%



What is Spread?

- Spread means Difference between Lending Rate and borrowing Rate
- Spread in our case = $11\% - 6\% = 5\%$
- **Note-** More the spread, more the profit of bank

What does bank check while giving loans?

Bank checks-

- Credit worthiness of person (whether person will be able to repay loan)
- Collateral (Security in form of property offered)
- Repayment Capacity
- Financial Ratios

Suppose a Customer C approaches bank for Loan of Rs 500000



In this case, Bank will check

Credit Worthiness of C

Whether C has Repaid Past loans on time

Collateral of C

Whether C is offering any security as a guarantee for Repayment like property papers

Repayment Capacity of C

Whether C will generate enough income to repay back the loan and interest
Bank will check Income Tax Returns, Bank Statements and Profit and loss Balance sheet

Financial Ratios of C

Bank will check whether C's Balance sheet Profit and loss and Calculate Ratios like Current Ratio, Net Current Assets

Different Functions of Commercial Bank

Accepting Deposits



Example

- Saving Account
- Current Account
- Fixed Deposit



On this
Bank Pays
Interest Expense

Advancing Loans



Example

- Housing loan
- Car Loan
- Overdraft



On this
Bank Receives
Interest Income

Agency Function



Example

- Purchase Sale of Foreign Currency
- Collection of Tax
- Purchase Sale of Shares



On this
Bank Receives
Commission Income

Types of Deposits:

1. Demand Deposit: Funds held in demand deposits can be withdrawn at any time on demand without any advance notice to the depository institution. Demand deposits can be demanded by an account holder any time and there is no fixed term of maturity for demand deposits. Banks issue cheques on this kind of deposits and cheques can be drawn on these deposits and hence demand deposits are also called cheque-able deposits.

2. Time Deposit: Funds held in time deposits can be withdrawn only by giving an advance notice to the depository institution. The deposits are held for a specified time period or maturity. Banks do not issue cheques on this kind of deposits and are hence non cheque-able deposits. These are also called term deposits.

Types of Accounts:

1. Current Account: It is always a demand deposit A/c and the bank is obliged to pay the money on demand. There is no limit on number of transactions and value of transactions and these are the most liquid deposits. Current account is used mainly for business purpose/ companies and never used for saving purpose. No interest is paid by banks on these accounts and the banks charge certain service charge on these accounts. Banks provide convenient operational facilities on these accounts and also issue cheque books.

2. Savings Account: This account is mainly for individuals. These are also demand deposits but there are restrictions on the number of transactions and the value of transactions during a specified period. Banks generally prescribe minimum balances in the accounts in order to offset the cost of maintaining and servicing such deposits. The deposits in these accounts earn interest.

3. Recurring Deposit Account: These are term deposits which are suitable for people who do not have lump sum amount of savings but are ready to save small amount every month or quarterly or half yearly. Such deposits earn interest on the amount already deposited as applicable to fixed

deposits. It is best suited for child's education or marriage purpose. Maturity is generally between 6 months to 10 years.

4. Fixed Deposit Account: These are term deposits with tenure varying from 7 days to 10 years. These deposits are for fixed term but can be withdrawn prematurely by giving an advance notice to the bank and some penalty

What are the Functions of Commercial Bank

1. Accepting Deposits

Banks accept deposits in several forms like:

(i) Current Account/ Demand Deposits

- These are the deposits that are repayable by bank on demand
- They can be withdrawn by cheque
- They do not have an interest rate

(ii) Time/ Fixed Deposits

- These are the deposits in which the demand is deposited for a fixed period of time
- They do not have a chequeable facility
- They have a high interest rate

(iii) Savings Deposits

- These deposits have combined features of Demand and Fixed Deposits
- They have a chequeable facility
- Their rate of interest is lower than Fixed deposits

2. Advancing of Loans

Different types of loans and advances made by commercial banks are:

(i) Cash Credit

It refers to the loan given to the borrower against their current assets like shares, stocks etc

(ii) Demand Loans

A demand loan (DL) is a secured loan that has to be repaid by the borrower upon the lender's demand. **Usually, the tenure of these loans can range from a minimum of seven days to a maximum of one year.** Individuals and businesses mostly use these loans to meet their short-term financial requirements.

(iii) Short-term Loans

They are given as personal loan against some security

3. Agency Functions

Commercial banks also perform some agency functions. For these services they charge some commission from their clients

Example:

1. Transfer of Funds
2. Purchase and Sale of Foreign Exchange
3. Income Tax Consultancy
4. Purchase and Sale of securities
5. Letters of Reference

Understanding Balance sheet of a Commercial Bank

When we deposit amount in Bank

- It is Assets for us (as it is our property)
- But will be liability for bank (as bank has to pay us back)

When we take loan from bank

- It is liability for us (as we have to pay it back)
- But it is asset for the bank

Suppose a company has Rs 10000 in ICICI Bank Current Account

It also has FD of 20000 in ICICI Bank

It also has taken a loan of 80000 from ICICI Bank

Balance Sheet of a Company

BALANCE SHEET			
Liabilities	Amt	Assets	Amt
		Bank	10000
		FD	20000
Loan	80000		

For a Business

*Loan taken is liability
FD and Bank A/c are our Assets (Property)*

Balance Sheet of ICICI Bank

BALANCE SHEET			
LIABILITIES	AMT	ASSETS	AMT
Demand Deposits	50000	Loan	60000
Term Deposits	10000		

For the Bank

*Loan given is Asset
Money of Public in Current A/c is Demand Deposit (Liability)
Money of Public in FD A/c is Term Deposit (Liability)*

Different Assets and Liabilities of a Commercial Bank

BALANCE SHEET			
LIABILITIES	AMT	ASSETS	AMT
Share Capital		Vault Cash	
Loan taken from Central Bank if any		Deposits with Central Bank	
Demand Deposits		Loans	
Term Deposits		Investment in Government Securities	
Total		Total	

Initial Money Invested

Sometimes bank borrows money from RBI

Saving Account, Current Account

Fixed Deposits/ Recurring Deposits

Cash kept in Bank for Withdrawal by customers

Amount deposited by Bank with RBI

Loan Given to Public

Amt invested in Government Bonds

Procedure followed to Issue Currency

Who issue Currency in An Economy?

It is issued by Central bank

Who issue Currency Notes and Coins in India

- Coins are minted by Govt of India
- Rs 1 Currency Notes are also issued by Govt of India
- All Remaining currency notes are issued by Central Bank (RBI)



When RBI issues Currency Notes, is it Asset or Liability for RBI?

- It is a liability for RBI
- because it is signed by RBI Governor as 'I promise to pay'
- Since, it is promise to pay, it is liability for RBI

Who issues this Note?

Reserve Bank of India (Central Bank)

What line does it contain?

It contains a line

I promise to pay the bearer the sum of 500 Rupees

This is Signed by Governor

Promise to Pay

RBI has to pay
So, It means it's a liability of RBI

Different Transactions between Central Bank and Commercial Bank

There are mainly 2 types of transactions

- Loan Transactions**

Commercial Bank takes loan from Central Banks

- Deposit Transactions**

Commercial banks deposit their surplus funds with Central Banks

Loan Transaction between Central Bank and Commercial Banks

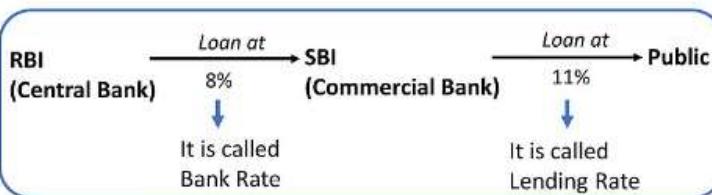
Central Bank Gives loans to Commercial Banks

Commercial Bank use this amount for lending to Public

Example

Suppose RBI provides Loan to SBI @ 6%

SBI provides loan to public @ 11%



Is Loan given by Central Bank Asset or Liability?

For Central Bank

Loan given
It is an Assets

For Commercial banks

it is Loan taken
Liability

Deposit Transaction between Central Bank and Commercial Banks

Public deposit their money in Savings Account and FD of Banks

Similarly commercial banks deposit their surplus money with Central Bank



Deposit Transaction between Government and Central Bank

Commercial banks deposit their surplus funds with Central Bank. Sometimes, Government also deposits their surplus funds with Central Bank.

Different Deposits of Central Bank (RBI)



Note

Both these deposits are Liabilities of Central Bank

Suppose Government earns Revenue of Rs 1000 Crore from tax and other sources

Out of this, It spends Rs 900 Crore on welfare of public

So it is left with Surplus of 100 Crore

Now, Government deposits these surplus money with Central Bank (RBI)

These are called Treasury Deposits

Government

Revenue 1000

Less

Expenditure 900

Surplus 100

→ **Central Bank**

*Treasury
Deposits*

Is this Liability or Assets of Central Bank?

It is Liability

as

RBI has to pay back these deposits to Govt

Money Supply

- In an economy, money consists of mainly currency notes, coins and deposits of public in banks. In India coins and currency notes are issued for circulation by the Reserve Bank of India (RBI), which is the monetary authority (or Central Bank) in India.
- One-rupee note and all coins and subsidiary coins, the magnitude of which is relatively small, are minted/printed by the Government of India, while all the other currency notes are printed by the RBI.
- All the currency notes and coins are put into circulation only through the RBI, which is the sole authority for the issue of currency and coins in India.
- The One Rupee note is signed by the finance secretary (and printed by Govt.) as a testimony that it is the base unit of the currency system.
- Coins and One Rupee note are minted/printed by the government of India and hence constitute the liability of Government of India.
- As part of the circulation process, RBI buys the one rupee note and minted coins from the Government of India and hence the coins and one rupee note come under the asset section of RBI's balance sheet.
- All banknotes (except one rupee note) issued by RBI are backed by assets such as gold, Government Securities and Foreign Currency Assets, as defined in Section 33 of RBI Act, 1934. "I promise to pay the bearer the sum of Rupees ..." denotes the obligation on the part of the RBI towards the holder of the banknote that the RBI is liable to pay the value of

banknote. This liability of RBI is further guaranteed by Government of India as per Section 26 of the RBI Act, 1934.

- The value of the currency notes and coins is derived from the guarantee provided by the Central Government on these items. Every currency note bears on its face a promise from the RBI that if someone produces the note to RBI or any other commercial bank, RBI will be responsible for giving the person purchasing power/value equal to the value printed on the note.
- The same is also true for coins. Currency notes and coins do not have intrinsic value i.e. the piece of paper in case of rupee note or the iron in case of coin does not have the value of the material but it derives its value from the promise of RBI. Currency notes and coins are therefore called fiat money. They are also called legal tenders as they cannot be refused by any citizen of the country for payment of any debt.

Currency = Notes + Coins

Currency in Circulation = Currency with the Public + Currency with the banks

The total stock of money in circulation among the public at a particular point of time is called money supply.

RBI publishes figures for four alternative measures of money supply. They are as follows: $M1 = \text{Currency with the Public} + \text{Demand deposits of public with banks}$

$M2 = M1 + \text{Savings Deposits with Post Office Savings Bank}$

$M3 = M1 + \text{Time deposits of public with banks}$

$M4 = M3 + \text{Total deposits with Post Office Savings Bank}$

Only deposits of public (includes businesses) held by the banks are part of money supply and inter-bank deposits are excluded. Cash reserves of the commercial banks are not treated as a component of money supply, because cash held by the creators/suppliers of money (RBI, Government and Banks) is never treated as a component of money supply.

- $M1$ is the most liquid and $M4$ is the least liquid.
- $M1$ and $M2$ are called narrow money and $M3$ and $M4$ are called broad money.
- $M3$ is the most commonly used measure of money supply and is also called "aggregate monetary resources".
- The numbering from 1 to 4 is in decreasing order of liquidity.
- ***Now mostly $M1$ and $M3$ terms are used by RBI***

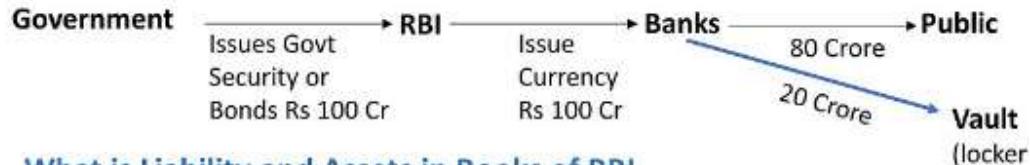
Procedure Followed By Central Bank To Issue Currency

When Govt wants to print a currency,
it gives securities to the RBI (called Govt Security)
against which RBI issues currency

Example

Suppose Govt issues Securities for Rs 100 Crore to RBI
RBI issues currency notes of Rs 100 Crore and gives it to bank.

Bank issues 80 Crore notes to Public and keep 20 Crore in its Safety Vault



What is Liability and Assets in Books of RBI

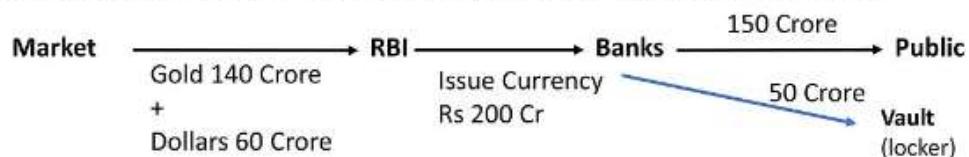
BALANCE SHEET			
LIABILITIES	AMT	ASSETS	AMT
Currency Held by Public	80	Government Securities	100
Vault Cash held by Commercial banks	20		
Total	100	Total	100

Currency Issued against Gold & Foreign Exchange

Sometimes, Central Bank purchases Gold and Foreign exchange from market against which it issues currency

Example

Suppose RBI purchase gold from Market of Rs 140 Crore and Gold of 60 Crore. Against this 100 Crore , it issues currency to Public of 200 Crore as show below



What is Liability and Assets in Books of RBI

BALANCE SHEET OF RBI			
LIABILITIES	AMT	ASSETS	AMT
Currency Held by Public	150	Gold	140
Vault Cash held by Commercial banks	50	Foreign Currency	60
Total	200	Total	200

Money Circulation

Now let's see how money circulates between individuals/public, banks and RBI. Suppose an individual possesses physical gold worth Rs. 500. He deposits this physical gold with RBI and RBI issues him currency note worth Rs. 500. (Alternatively, it can also be said that, RBI purchased Rs. 500 gold from the market and issued Rs. 500 note to the public/ individual).

It can be represented as following:

Individual	Commercial Bank	RBI
	Assets	Liability
Rs. 500 Note		

Individual	Commercial Bank	RBI
	Assets	Liability
Rs. 200 Note + Rs. 300 in A/c	Vault Cash = Rs. 300	Deposits of Public = Rs. 300
	Rs. 300	Rs. 300

Money Supply = Rs. 500

Suppose the individual thinks that he requires only Rs. 200 for his cash transactions and deposits Rs. 300 in bank for safety purpose and to earn interest.

This can be represented as following:

Individual	Commercial Bank	RBI
	Assets	Liability
Rs. 200 Note + Rs. 300 in A/c	Vault Cash = Rs. 300	Deposits of Public = Rs. 300
	Rs. 300	Rs. 300

Individual	Commercial Bank	RBI
	Assets	Liability
Rs. 200 Note + Rs. 300 in A/c	Vault Cash = Rs. 300	Deposits of Public = Rs. 300
	Rs. 300	Rs. 300

Money Supply = Rs. 500

Suppose the bank requires only Rs. 100 to meet the day-to-day cash demands of the public then it can deposit the rest Rs. 200 with RBI. This can be represented as:

Individual

Rs. 200 Note
+
Rs. 300 in
A/c

Commercial Bank

Assets	Liability
Vault Cash = Rs. 100	Deposits of Public = Rs. 300
Deposits with RBI = Rs. 200	
Rs. 300	Rs. 300

Money Supply = Rs. 500

RBI

Assets	Liability
Gold = Rs. 500	Currency held by Public = Rs. 200
	Vault Cash held by banks = Rs. 100
	Deposits of bank = Rs. 200
Rs. 500	Rs. 500

Suppose govt. collects Rs. 50 as tax from the individual and keeps this money with RBI.

Individual

Rs. 150 Note
+
Rs. 300 in
A/c

*Money
Supply =
Rs. 450*

Commercial Bank

Assets	Liability
Vault Cash = Rs. 100	Deposits of Public = Rs. 300
Deposits with RBI = Rs. 200	
Rs. 300	Rs. 300

RBI

Assets	Liability
Gold = Rs. 500	Currency held by Public = Rs. 150
	Vault Cash held by banks = Rs. 100
	Deposits of bank = Rs. 200
	Deposits of Govt. (Treasury Deposits) = Rs. 50
Rs. 500	Rs. 500

The RBI may sell some part of its gold assets to purchase foreign exchange reserves or government securities. This can be represented as:

Individual Commercial Bank

Rs.
150
Note
+
Rs.
300 in
A/c

Assets	Liability
Vault Cash = Rs. 100	Deposits of Public = Rs. 300
Deposits with RBI = Rs. 200	
Rs. 300	Rs. 300

RBI

Assets	Liability
Gold = Rs. 100	Currency held by Public = Rs. 150
Foreign Exchange Reserve = Rs 200	Vault Cash held by banks = Rs. 100
Govt. Securities = Rs. 200	Deposits of bank = Rs. 200
	Deposits of Govt. (Treasury Deposits) = Rs. 50
Rs. 500	Rs. 500

Money Supply = Rs. 450

The total liability of the Monetary Authority (RBI) of the country is called Monetary Base or High Powered Money or Reserve Money [M0]. And in the above example Monetary Base or High-Powered Money is Rs. 500 and money supply is Rs. 450.

Money Supply and Monetary Base are two distinct terms; money supply being the money with the public either in cash or in deposits with banks and Monetary Base [M0] is the total liability of RBI.

Lets take another example:

Different Liabilities of Central Bank

Deposits from Bank

- Surplus funds with banks are deposited with Central Bank
- So it is a liability for Central Bank

Sample Balance Sheet of Central Bank

BALANCE SHEET -RBI			
Liabilities	Amt	Assets	Amt
Cash with Public	90000	Gold	25000
Cash with Bank Locker	20000	Foreign Exchange	20000
Bank deposit amt with RBI	10000	Government Securities	100000
Govt deposit amt with RBI	37500	Loan to Commercial Banks	12500
Total	157500	Total	157500

Liabilities of Central Bank are called High Powered Money

Currency and Coins held by Public

- Currency Notes are issued by Central Bank
- These are promises to bearer to the value equal to amt mentioned in note
- So, it is also liability

Vault Cash held with commercial banks

- Cash held by different banks in locker is called Vault Cash
- These are also liability for Central Bank as they have been issued by Central Bank

Different Assets OF Central Bank

Govt Securities

- Government securities are like a loan to Government
- When Govt wants to print a currency, it gives securities to the Central Bank (called Govt Security)
- against which Central Bank issues currency
- So this Govt security is like a loan by Central Bank to govt

Gold and Foreign Exchange

- Central Bank purchases Gold and Foreign exchange from market against which it issues currency

Loan to Banks

- Central Bank lends money to various commercial banks for which it earns interest
- Since, it is loan given. It is an asset

What is High Powered Money or Monetary Base [M0]

The total liability of Central Bank is called high monetary money or monetary base. It includes following-

- Currency Notes in Circulation with Public
- Vault Cash with Banks
- Deposits held by Different banks with Central Bank
- Deposits held by Government with Central Bank

Difference between Money and High Powered Money

Money	High Powered Money
It includes CU +DD (Currency +Demand Deposits of Public)	It includes Currency Notes +Deposits of banks Deposits of Govt <i>(It doesn't include demand deposits of Public)</i>

Money Creation & Money Multiplier

Currency Deposit Ratio(CDR)

Currency Deposit Ratio (cdr) = Currency held by Public /Deposits of public in banks.

It is the Ratio of
Money held by Public in Currency
to
Money held by Public in Deposits

$$\text{Currency Deposit Ratio} = \frac{\text{Money held by Public in currency}}{\text{Money held by Public in Deposits}}$$

$$CDR = \frac{CU}{DD}$$

Example

Suppose a person earns Rs 100000 Salary in Cash

He spends Rs 80000 in cash

He deposits balance Rs 20000 in his bank account

In this case

$$\text{Currency Deposit Ratio} = \frac{\text{Money held by Public in currency}}{\text{Money held by Public in Deposits}} = \frac{80000}{20000} = 4$$

CDR equal to 1 means whenever an individual gets some amount of cash say Rs. 100, then he will keep Rs. 50 as cash and Rs. 50 as deposit in banks, so that the ratio of cash in hand and deposits in banks is $Rs.50/Rs.50 = 1$

Does CDR always Remain Same ?

No, It keeps on fluctuating. Example- It increases during festive season (as people spend more).

Reserve Deposit Ratio(RDR)

Reserve Deposit Ratio (rdr) = Reserves of Banks / Deposits of public in banks

Lets say, RDR equals to 0.2 or 20% means whenever an individual deposits certain sum of money say Rs. 100 with the bank, the bank will have to keep Rs. 20 as reserve money and the rest Rs. 80 they can lend to someone else.

"Reserve money" of banks can be in the form of vault cash in banks or they can deposit with RBI or can keep with Government

Explanation for Reserve Deposit Ratio

We know that

Bank Receives Deposits and Give them as loans to Public

Suppose a Bank Received 100 Lacs Deposits

It cannot give whole 100 Lacs as loan

It has to keep certain amount as Reserve

Suppose Reserve Deposit Ratio is 10%

Loan Amount = 100 lacs

Reserve to be kept = 10% of 100 lacs = 10 lacs

Banks can give loan of $100 - 10 = 90$ Lacs

*Less the RDR
More amount available to give loans*

Suppose Reserve Deposit Ratio is 20%

Loan Amount = 100 lacs

Reserve to be kept = 20% of 100 lacs = 20 lacs

Banks can give loan of $100 - 20 = 80$ Lacs

*More the RDR
Less amount available to give loans*

Example



It means 20000 kept as Reserve by Bank

NOTE:

- More the CDR, more is the cash with the Public.
- More the RDR, less is the amount with banks to give loans.

Where are these Reserves kept?

These are kept as

Vault Cash *(Cash kept in bank locker)*

Liquid Assets like Gold *(Gold can be sold anytime)*

Reserves with Central bank *(Banks keep money with RBI)*

Now we will understand the mechanism of money creation by the monetary authority i.e. RBI. Suppose RBI wishes to increase the money supply in the economy. Let us assume that RBI purchases some assets, say, government bonds or gold worth Rs. H from the market and in turn issues the currency note worth Rs. H to that person (P1).

So, in this situation, money supply is H and monetary base is also H. Now, since we have assumed that CDR is 1 in the economy, the first person (P1) will keep half of the money as cash and half he will deposit with the bank.

And if the bank kept all the deposited money in cash form in its vault, then the money supply will be H.

	Currency with Public	Vault Cash	Deposits of Public	Total Money Supply
P1	H/2	H/2	H/2	H

If RDR is 20%, the bank will keep only 20% of the deposited money in its vaults as cash (reserve money) and the rest it will lend to some other person (P2).

So, now the first person has money H (H/2 as cash and H/2 in the deposit form) and the second person (P2) has money 0.8 (H/2) i.e. 0.4 H.

So, the total money supply in the economy increases from H to $H + 0.4H = 1.4H$.

This has been possible because banks have been given the liberty to keep only a fraction of the deposited money as reserve in their vaults and the rest they can lend to others. (This is called "*fractional reserve banking*").

So, additional money is getting created through fractional reserve banking. This has been represented in the following table

	Currency with Public	Vault Cash	Deposits of Public	Total Money Supply
P1	H/2	0.2 (H/2) ←	H/2	H
P2	0.8 (H/2) ← money creation			

Now the person P2 will again keep only half of the money which he has got from the bank in cash form and the rest he will deposit with the bank. The bank will again keep only 20% of the deposited money as reserve in its vault and the rest it will lend to a third person (P3). The third person P3 will again keep only half of the money which he has got from the bank in cash form and the rest he will deposit with the bank and this process will go on endlessly in the economy. This is represented in the following table:

	Currency with Public	Vault Cash	Deposits of Public	Money Supply
P1	H/2	0.2 (H/2) ←	H/2	H
P2	1/2(0.8 (H/2)) ←	0.2/2 (0.8 (H/2)) ←	1/2(0.8 (H/2))	0.8 (H/2)
P3	0.8/2 (0.8 (H/2)) ←	.	.	.
P4
⋮	⋮	⋮	⋮	⋮
Sum	1/2 (5H/3)	0.2/2 (5H/3)	1/2 (5H/3)	5H/3

(Total) Money Supply = $5H/3$

Monetary Base [M0] = H

$$\text{Money Multiplier} = \frac{\text{Money Supply (M3)}}{\text{Monetary Base (Reserve Money M0)}} = \frac{5H/3}{H} = 5/3$$

So, with H monetary base and H money supply initially, the RBI has been able to increase/create the money supply to $5H/3$ through fractional reserve banking. So, money supply is now $5/3$ times the monetary base, hence the **Money Multiplier** is $5/3$.

If RBI wants to further increase the money supply then it will reduce the RDR from 0.2 and if it wishes to reduce the money supply then it will increase the RDR.

As we know, bank reserves consist of two things – cash in their vaults and deposits of banks with RBI. So RDR is divided into two parts CRR (kept with RBI) and SLR (kept with banks).

NOTE: At present, reserve deposit ratio (RDR) = 22.5 % (CRR = 4.5 %, SLR = 18%)

Inflation

Inflation is defined as the rate of rise in the cost of goods and services.

Let's take an example:

If the cost of Almonds was 1500 per kg last year and currently it is 1800 per kg, then inflation in the rate of Almonds will be:

Increase in cost: $1800 - 1500 = 300$

Hence inflation in almonds: $(300/1500) * 100 = 20\%$

Deflation- When the overall price level decreases in such a way that inflation rate becomes negative, it is called deflation. It is the opposite of Inflation.

Dis-inflation- It is the slowdown in the rate of inflation.

For example: If cost of apples per Kg is: Rs 160 in 2019, Rs 158 in 2018, Rs 156 in 2017, and Rs 154 in 2016,

Then Inflation in the year 2017 is: $[(156-154)/154] * 100 = 1.30\%$

Inflation in the year 2018 is: $[(158-156)/156] * 100 = 1.28\%$

Inflation in the year 2019 is: $[(160-158)/158] * 100 = 1.26\%$

This means that the rate of Inflation has reduced over the years but the price of apples have increased. This shows the trend of disinflation.

Causes of Inflation

Consider two scenarios:

1. If the salary of a person increases from 50,000 to 60,000 then he might think of buying more goods like a guitar which he wasn't able to buy earlier. So the demand for guitar will increase and the seller of the guitar has only few guitars in his shop, therefore he will increase the cost of guitar. Thus, Inflation sets into the Guitar market. This is termed as Demand pull Inflation.
2. When there is a shortage of commodities like cereals, food products etc. in the market, but the demand remains constant. Then also the seller sells these items at a very high rate. This is termed as Cost Push Inflation.

Therefore, major causes of Inflation are-

- Demand Pull factors
- Cost push factors

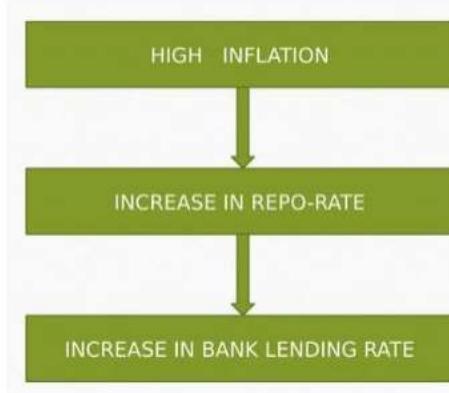
Reasons behind Demand Pull Inflation

It is generally due to increase in the purchasing power i.e., more money in the hands of people.

1. Government Expenditures: Under Janani Suraksha Yojana, the government gives Rs 6000 to the lactating mothers (who have delivered babies). These new mothers will surely buy Johnson's baby products for their babies and since the demand for these products Increases, it will raise the cost of these goods. Similarly, under various schemes like pensions, widow allowances and loan waivers etc. the government gives thousands of crores of money to various beneficiaries. Thus, people get extra income and hence raise the demands for various goods in the market which leads to Inflation.

Effects of Inflation

1. Effect on bank rates-



2. Deficit Financing: In Deficit financing the government gets loans from various sources to fund its expenditures like the Janani Suraksha Yojana etc. Hence this extra money reaches the people and raises demand thus raising inflation.

3. Black Money: When government officers take bribes, their money in hand (and purchasing power) would increase and this would increase Inflation. Also, if we hide our incomes to save tax, we have more money which otherwise would have gone to the government. Hence demand increases and inflation increases.

4. High Population: More the number of people more is the demand.

5. Increase in Foreign Investment: If the foreign investors like Apple invest in India, more people will get jobs. They would receive high salaries thus raising their purchasing power and demands.

6. Excess Liquidity: Liquidity means money supply. Money supply in the market (i.e. ultimately with the people) increases because of monetary policies of the RBI such as decreasing interest rates.

Reasons for Cost Push Inflation

This is generally due to the shortage of commodities.

1. Seasonal Irregularities (Monsoon)- Any variability in monsoon would affect crop production and can lead to price distortions.

2. Hoarding- Hoarding of essential goods by distributors in their warehouse to reduce its supply and cause an artificial price rise is one of the main reasons behind cost push inflation.

3. Cartelization- It is the fixing of prices by the sellers to avoid competition in the market. This leads to artificial price rise since there is no bargaining available in the market.

4. Increase in diesel prices- This increases the transportation cost of the commodities and increases the cost of goods.

5. Increase in the cost of imported goods- for example if the cost of Samsung phones which are imported from South Korea are increased then the price in the local markets increases.

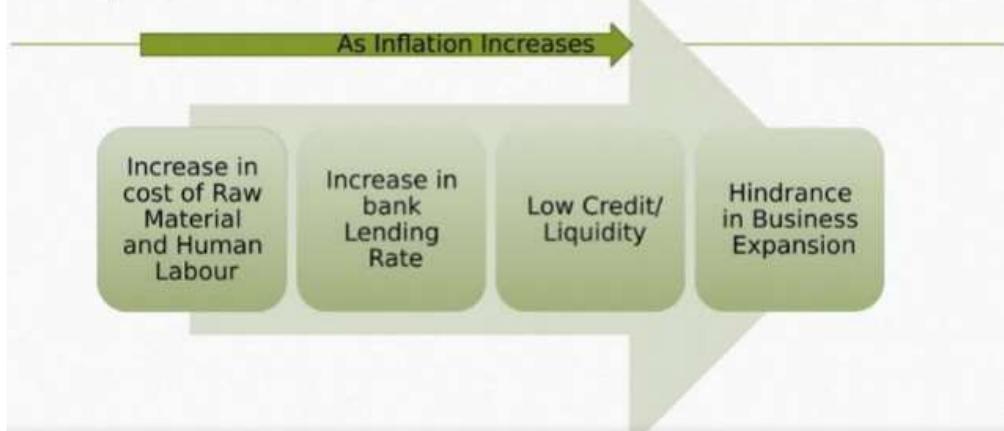
2. Effect on government

Impact of Inflation on Government Development Projects and Schemes



3. Impact of Inflation on Industries

Impact of Inflation on Industries



4. Impact of Inflation on Growth of the Country

Impact of Inflation on Growth



METHODS FOR MEASURING INFLATION

There are 2 methods to measure Inflation.

1. Consumer Price Index (**CPI**)
2. Wholesale Price Index (**WPI**)

Consumer Price Index (CPI)

It measures and indicates changes in the price level of market basket of Consumer goods and services purchased by households. Here is a list of few commodities that we purchase from the market:

- ♣ Food
- ♣ Beverages
- ♣ Clothes
- ♣ Fuel
- ♣ Vehicles
- ♣ Electronics, etc.

The priority order of above items as per their importance is:

Food > Fuel > Beverages > Clothes > Electronics > Vehicles

In CPI, the price of all such commodities used by consumers i.e., people are combined together and different goods are given different importance as per their importance and priority. Thus, all these commodities together constitute the Consumption basket of CPI. The consumption basket has hundreds of products that we buy throughout the year. Through the CPI, the citizens and the government come to know about the rate of increase in the prices of daily goods that people buy.

CPI measures the change in prices paid by the Ultimate consumers in the retail market. Since different classes of consumers' consumption Patterns vary; there can be differences in the price Increase in the basket of commodities consumed by Poor people and rich people.

So, in India, we earlier had three CPI indices for Different class of Consumers, and later in 2010 we Designed 3 new CPI Indices. There are different series of CPI which are calculated on the monthly basis:

- **CPI – Industrial Workers (CPI -IW):** This index measures the change in the price of commodity basket consumed by the industrial workers
- **CPI – Agricultural Labourers (CPI -AL):** This index measures the change in the price of commodity basket consumed by the agricultural labourers
- **CPI – Rural Labourers:** This index measures the change in the price of commodity basket consumed by the rural labourers

These indices are published monthly by Labour Bureau under the Ministry of Labour and Employment. Since the above three indices covered only a segment of the population and not the overall nation, three more indices of CPI were designed-

- **CPI – Rural:** This index measures the change in the price of commodity basket consumed by the rural Population
- **CPI – Urban:** This index measures the change in the price of commodity basket consumed by urban population
- **CPI – Combined:** It is computed by combining CPI Rural and CPI Urban Index

Note-The base year for the above three indices is 2011-12 and are published monthly by the National Statistical Office (NSO) under Ministry of Statistics and Programme Implementation.
RBI uses CPI-Combined to monitor Inflation

CPI-IW

The CPI-IW is mainly used for determining dearness allowance (DA) paid to central/state government employees and workers in the industrial sectors besides measuring inflation in retail prices, fixation and revision of minimum wages in scheduled employments.

CPI-IW is compiled and maintained by the Labour Bureau, an attached office of the Ministry of Labour & Employment.

Advantages of using CPI

CPI deals with the retail prices which affect everyone's pocket. If the price of 1 KG onion rises from Rs 30 to Rs 80, the monthly budget of common people would be impacted by it. CPI therefore determines the standard of living of the people as it includes the cost of those goods with which people are directly concerned unlike mineral resources like coal etc. So if CPI is used as inflation indicator and suddenly it rises too much, then the government can make arrangements for cheap food availability the lowering the prices or by means of subsidies.

Since CPI directly affects people's pockets, it has an impact on their investment behaviour. For example, if the food prices go too high, then people would have to spend more amount to buy food. Thus, they will save less in banks, invest less in mutual funds and other insurance schemes. Hence if CPI is used as an indicator of Inflation, RBI and government can make quick decisions to reduce inflation.

How is Consumer Price Index calculated?

The CPI is calculated with reference to a base year, which is used as a benchmark. The price change pertains to that year. Remember, when you calculate the CPI, note that the price of the basket in 1 year has to be first divided by the price of the market basket of the base year. Then, it is multiplied by 100.

Consumer Price Index formula:

CPI = (Cost of basket divided by Cost of basket in the base year) multiplied by 100

Wholesale Price Index (WPI)

It measures and indicates changes in the price level of wholesale market i.e. goods that are sold in bulk and traded between organizations instead of consumers. We know that goods cost less in the wholesale market than in the retail shops.

However, normally people cannot buy goods from the wholesale market as these goods are sold only in bulk. Every commodity before reaching the public, first goes to a wholesaler who then distributes the goods the various local shops.

WPI is released by office of Economic Advisor, under Ministry of Commerce & Industry.

Difference between CPI and WPI:

1. CPI = WPI + Cost of Transportation + retailer's margin
2. The commodity basket of CPI is less than the WPI basket.

For example: Minerals are not directly consumed by the people hence they are not included in the CPI basket.

3.CPI includes services too while WPI doesn't.

For example- You have to pay fees for coaching in any institute, hence teaching service is a consumption service and unlike other goods it is not brought into the wholesale market first and then distributed to coaching centres. Services are directly given to the coaching centres.

Advantages of using WPI

1. It covers many more goods than the CPI
2. The data is available weekly, while CPI data is available monthly. Hence, faster decision making is enabled by using the WPI.
3. WPI is calculated on all India basis while CPI is calculated for specific centres and then aggregated to all India Index.

Hence WPI gives a better picture of the Inflation condition prevailing across India. Note- Since 2015, on the recommendation of Urjit Patel Committee the government has mandated use of CPI for inflation targeting.

Measures to control Inflation

- RBI uses Monetary Policy to control Inflation by regulating the liquidity in the market.
- Government uses Fiscal Policy to increase or reduce government spending and expenditures.
- Controlling Hoarding of commodities thereby increasing the flow of goods in the market which reduces the cost push factors of Inflation.
- Increasing the Irrigation facilities to help the farmers against the irregularities of the seasonal changes and monsoon to maintain adequate yield of food products in the market.

Monetary Policy

Monetary Policy is the process by which monetary authority (RBI) of a country controls the creation and supply of money in the economy.

The primary objective of the RBI's monetary policy is to **maintain price stability while keeping in mind the objective of growth.**

The RBI implements the monetary policy through open market operations, bank rate policy, CRR, SLR, reserve system, credit control policy, moral persuasion etc.

OBJECTIVE OF MONETARY POLICY

- To maintain **economic and financial stability** – by targeting healthy inflation range.
- To ensure **adequate financial resources** for the purpose of development.
- Ensuring **price stability** in market by maintaining optimum inflation level.
- **Adequate flow of credit** to productive sectors of the economy for supporting economic growth and achieving financial stability.

MONETARY POLICY COMMITTEE (MPC)

MPC is a **statutory body** created under **Monetary Policy Framework Agreement between the RBI and Central Government in 2016.**

- MPC is entrusted with the **responsibility of fixing the repo rate (policy rate)** required to **contain inflation** as defined in the Monetary Policy Framework Agreement.

- The meetings of the MPC are held at least 4 times a year and it publishes its decisions after each such meeting.
- MPC has 6 members, three from RBI (including the RBI Governor) and 3 appointed by the Government of India.
- All the members have one vote and in the event of equality of votes, the Governor gets a second or casting vote.
- The decision of the MPC is binding on RBI.
- MPC has the authority to decide the repo rate only and not CRR or SLR.

Composition of MPC

MPC shall consist of 6 members:

- **RBI Governor** as its ex officio chairperson,
- Deputy Governor in charge of monetary policy,
- An officer of the Bank to be nominated by the Central Board,

Three persons to be appointed by the central government.

- This category of appointments must be from “persons of ability, integrity and standing, having knowledge and experience in the field of economics or banking or finance or monetary policy”.

INFLATION TARGETING

- **Inflation target** is decided by **Union Government** after consulting with the RBI Governor.
- The present mandate of the committee is to maintain **4% annual inflation** with bandwidth of **ceiling 6%** and a **floor of 2%**.
- **If Target fail:** If inflation not kept in **4% +/-2% zone for 3 consecutive quarters** then the **Committee must send report** to Govt. with reasons and remedies and an estimated time period within which the Target would be achieved.
- The inflation is the “**Consumer Price Index (CPI) – Combined**” published by **Ministry of Statistics and Programme Implementation (NSO- National Statistical Office)**

The following are the major instruments/tools that RBI uses for conducting its monetary policy:

- Qualitative Tools
- Quantitative Tools

Qualitative Tools:

(1) Loan to Value Ratio Control: If someone wants to buy a bike worth Rs. 60000 and takes a loan for that he will have to give collateral to the bank as security against the loan. The RBI mandates the amount of collateral required to take a loan of Rs. 60000. Suppose Rs. 1 lakh collateral was required to take a loan of 60000. You can keep property papers worth Rs. 1 lakh and take the loan. However, if the RBI says that only Rs. 20,000 loan for collateral of Rs. 1 lakh can be taken, then you may not take the loan. In this way RBI controls the amount of loan distributed to people by banks.

(2) Consumer Credit Control: Again, if one wants to purchase a bike worth Rs. 60000, the Honda Company asks them to pay a down-payment of 10% and the rest as loan. Now if RBI mandates that a down-payment of 30% is required to buy the bike one may not have 30% in hand to pay the

down-payment. Hence the person would not buy the bike. In this way RBI regulates consumer behaviour.

(3) Rationing: It involves asking the banks to mandatorily lend to some sector, more than the others. For example, the RBI may ask to raise the agricultural credit from 18% to 30% through priority sector lending thereby making more funds available in that sector.

(4) Moral Suasion: Sometimes even after the RBI reduces the Repo rate the banks do not reduce the lending rates for loans. Hence benefits of repo rates do not reach the people and RBI cannot target inflation. In this situation the RBI governor may speak in interview with news channel or at some conference that he is worried about the inflation situation in the country and will take firm actions for achieving inflation reduction. In this way RBI indirectly intimidates the banks to follow policy rates or later the RBI will take some strict action against them.

(5) Direct Action: Now, if even after such intimidation banks do not heed the RBI, it will take actions like penalty on banks etc. to get them to heed the RBI.

Quantitative Tools

Repo Rate:

- When RBI lends short term loans to banks for overnight (1 day) or a period of 7, 14 or 28 days it is termed as Repo.
- **Repo rate is related to ‘repurchase option’ or ‘repurchase agreement’**
- RBI takes into custody some g-sec bonds as security (collateral).
- After this short term, banks have to Re-Purchase these g-sec bonds back from RBI after giving an interest which is called Repo Rate.
- In other words, commercial banks borrow money from the Reserve Bank of India by selling securities or bonds with an agreement to repurchase the securities on a certain date at a predetermined price.
- **Current Repo Rate (September, 2022) is 5.40 % .**
- **Repo Rate is called the “Policy Rate”. Repo Rate and Reverse Repo Rate comes under “Liquidity Adjustment Facility (LAF)”.**

Reverse Repo-

- When banks lend to RBI for a short-term period, it is called Reverse Repo. Banks take g-sec bond as security from RBI.
- After the short-term duration, RBI buys back the g-sec bonds after giving an interest which is Reverse repo Rate. The Reverse Repo Rate helps the RBI get money from the banks in times of need. In return, the RBI offers attractive interest rates to them.
- The banks also voluntarily park excess funds with the central bank as it provides them with an opportunity to earn higher interest on surplus money lying idle.
- **Current Reverse-Repo Rate (September, 2022) is 3.35 %**

How Reverse Repo Rate controls the flow of money into the system?

- An increase in the Reverse Repo Rate provides an incentive to the banks to park their surplus funds with the central bank on a short-term basis, thereby reducing liquidity in the banking system.

- In short, the RBI absorbs surplus money from banks against the collateral of eligible government securities on an overnight basis. This happens under the Liquidity Adjustment Facility or LAF under the Reverse Repo Rate.
- The Reverse Repo Rate is lower than the Repo Rate to discourage banks from keeping surplus funds with RBI

Bank Rate-

- It is the rate at which RBI lends long term credit to banks.
- Bank Rate is charged against loans offered by the central bank to commercial banks, whereas, Repo Rate is charged for repurchasing the securities sold by the commercial banks to the central bank.
- No collateral is involved while charging Bank Rate but securities, bonds, agreements and collateral is involved when Repo Rate is charged.
- Repo Rate is always lower than the Bank Rate.
- Bank rate is now used for calculating penalty on default in the cash reserve ratio (CRR) and the statutory liquidity ratio (SLR). For example, the current penal rate on shortfall in reserves is Bank Rate plus 3 percent.
- **Current Bank Rate (September, 2022) is 5.65 %**

NDTL: Net Demand & Time Liabilities

Deposits of public are the liability of banks. The public's demand deposits are demand liability of the bank and time deposits are time liability of the banks and the total of demand and time deposits of the public is called the Net Demand and Time Liabilities (NDTL) of the banks.

Long Term Repo Operation (LTRO):

- RBI lends to banks @repo rate only up to 0.25% of bank's NDTL. RBI further lends from time to time above the repo rate up to 0.75 percent of overall NDTL in the banking system. And in this case the interest rate is generally decided by auction i.e., if banks want more money, the interest rate will go higher, if few banks are competing for RBIs money, then interest rate will be less but it is always above the repo rate. RBI, while conducting the auction clearly specifies that bids below and equal to repo rate will be rejected).
- This is called "long term repo operation (LTRO)" which means RBI gives money for a fixed long term. The LTRO is generally at variable rate decided by the auction which is above repo rate but it is generally done at repo rate.
- As banks get long-term funds at lower rates, their cost of funds falls. In turn, they reduce interest rates for borrowers.
- **Note:** Repo is available on a daily basis for banks but LTRO is for long term and done less frequently only when RBI notifies.

Marginal Standing Facility (MSF):

- It is a facility introduced in 2011, under which scheduled commercial banks can borrow additional amount of overnight money (over and above what is available to them through repo rate) from the Reserve Bank by dipping into (by making use of) their SLR portfolio up to a limit at a penal rate of interest.
- This provides a safety valve against unanticipated liquidity shocks to the banking system. When banks take loan from RBI at Repo rate, banks need to keep Govt.

- Securities with RBI, but this security is in addition to the requirement of SLR. Banks cannot keep SLR securities to avail loan from RBI at Repo Rate.
- But under MSF, banks can borrow money/cash from RBI by dipping into the SLR reserve. This means the banks can keep 3% of the SLR securities with RBI (i.e., the SLR can go down up to 3% below the normal SLR limit) and can borrow cash from RBI. This is called Marginal Standing Facility (MSF).
- **MSF Rate = Repo Rate + 0.25%**
- **Also, MSF Rate = Bank rate**

Reserve Requirements (Fractional Reserve Banking):

Cash Reserve Ratio (CRR)

- The amount of cash that the scheduled commercial banks are required ***to maintain with RBI*** with respect to their NDTL (on a fortnightly basis) is called CRR. One of the basic reasons of keeping CRR with RBI is to provide safety to the public deposits. ***Scheduled Commercial Banks are required to maintain CRR as per the Section 42(1) of the RBI Act, 1934*** (To secure the monetary stability in the country, RBI is authorized to prescribe CRR for SCBs, without any min or max value). ***Currently CRR is 4.50 % (September, 2022)***

Statutory Liquidity Ratio (SLR)

- The amount of reserves that the scheduled commercial banks are required ***to maintain with themselves on a daily basis*** in safe and liquid assets such as government securities, gold and cash with respect to their NDTL is called SLR.
- Scheduled Commercial Banks are required to maintain SLR as per the Banking Regulation Act 1949.
- **The maximum limit for SLR is 40%.**
- ***Currently SLR is 18.00 % (September, 2022)***

Need of CRR & SLR

- The requirement of CRR and SLR is to make public deposits safe and liquid and enable RBI to control the amount of money that banks can create.
- It ensures that banks have a safe cushion of assets to draw on when account holders want to be paid.
- In absence of the CRR and SLR requirements, to make more profits bank may lend most of the deposits and if there is a sudden rush to withdraw, banks will struggle to meet the repayments.
- **All Commercial and Cooperative Banks (either scheduled or non-scheduled) are required to maintain CRR and SLR.**
- ***For scheduled banks, the maintenance of CRR is governed through The Reserve Bank of India Act 1934 and for Non-Scheduled banks CRR is governed through Banking Regulation Act 1949.***
- ***Banking Regulation Act 1949 (Section 24) governs maintenance of SLR for all banks (scheduled and non-scheduled) commercial and cooperative.***

Government Securities (G-Sec)

A Government Security (G-Sec) is a tradable instrument issued by the Central Government or the State Governments.

G-Secs carry practically no risk of default and, hence, are called risk-free gilt-edged instruments. (Govt. issues only debt securities).

G-Secs are issued through auctions conducted by RBI. Auctions are conducted on the electronic platform called the E-Kuber, the Core Banking Solution (CBS) platform of RBI. Commercial banks, scheduled Urban Cooperative Banks (UCBs), Primary Dealers (PD), insurance companies and provident funds are members of this platform. Foreign Portfolio Investors (FPIs) also participate in this market. Individuals (retail investors) can also participate directly in the Govt. securities market.

Open Market Operations (OMO):

- Sale or purchase of government securities by RBI in the open market to banks/financial institutions for increasing or decreasing money supply in the economy is called open market operations.
- If there is excess liquidity, RBI resorts to sale of securities and sucks out the rupee liquidity.
- Similarly, when the liquidity conditions are tight, RBI buys securities from the market, thereby releasing liquidity into the market.
- It is done on E-Kuber platform.

What happens when RBI sells government securities?

Consider this simple example:

<u>Total Assets with a Bank</u>	<u>OMO</u>	<u>Worth of Govt Securities with the Bank</u>	<u>Amount available for lending</u>
100	None	20	80
100	RBI sells securities worth Rs 10, And Bank buys it	$20 + 10 = 30$	$80 - 10 = 70$

You can clearly observe that amount available for lending has come down i.e. money supply has contracted.

Effect of Inflation on CRR/SLR, Repo rates, OMO

1) Effect on Reserve ratios-

INFLATION	RESERVE RATIOS (CRR-SLR)
Increases	Increases
Decreases	Decreases

2) Effect on Repo rates and Bank rates

INFLATION	REPO RATE	MONEY SUPPLY	Effect on Inflation
Increases	Increases	Decreases	Reduces
Decreases	Decreases	Increases	Increases

3) Effect on Open Market operations

INFLATION	G-sec (Government Securities)	Effect on Inflation
Increases	RBI will sell G-sec to banks	Reduces
Decreases	RBI will buy G-sec from banks	Increases

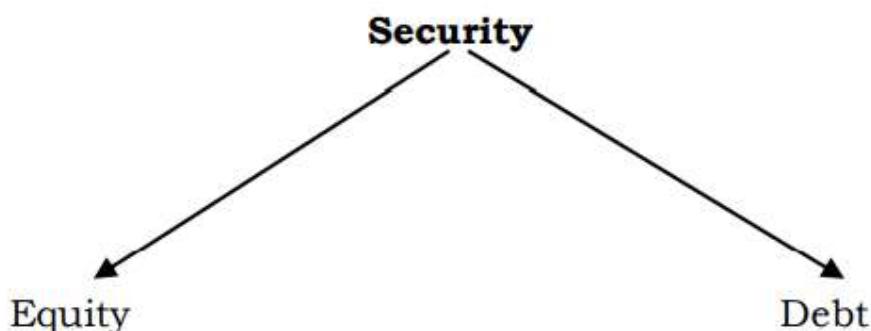
UNDERSTANDING SECURITIES & FINANCIAL MARKETS

SECURITIES

Securities are financial instruments (receipts/slips) which promises return (payment) in future and which are tradable.

For example, suppose somebody deposited Rs. 1 lakh in his account and got an account statement/ pass book. The person who is holding the account statement will receive interest in future but he is not allowed to sell this paper (account statement) in the market. Hence the account statement is not considered as a security in a strict sense.

Securities can be broadly categorized into two categories viz. equity and debt.



1. **Equity security (stock/ shares)** represents ownership held by shareholders (owners) in a company/ corporation. Holders of equity security receive profit/ dividend and capital gains (share price appreciation). Equity securities entitle the holder to some control of the company on a proportionate basis i.e. the equity holders get voting rights and thus some control of the business.
2. **Debt security** represents money that is borrowed and must be repaid with terms that define the amount borrowed, interest rate and maturity date. Holders of debt security receive interest and repayment of the principal.

Note: The entity (company) that issues the securities is known as the issuer of security.

Whenever a person invests (puts money) in a company/ project, then this investment can be done broadly in two ways :

1. By purchase of equity securities. In this case the investor puts the money in the company and gets a share in the ownership of the company. In this case the person does not get any fixed return but receives profit/ dividend based on the performance of the company. This is the form of purchase of equity securities of the company by the investor.

2. By purchase of debt securities. In this case the investor puts the money in the company at a fix interest rate for a specific period of time and receives interest (regularly) and principal back at the end of maturity period. This is the form of purchase of debt securities of the company by the investor.

To understand securities in a better way let us take an example of a newly registered company "XYZ Private Limited".

- The company maintains its account in the form of a balance sheet (shown below) and the assets and liabilities of the company in the balance sheet are always equal. Initially the company does not have any money/capital and has an account opened in a particular bank to keep its money.
- The owner/entrepreneur initially puts up some money say Rs. 1 crore in the company (which will be deposited in the company's account) and the company in return issues him an 'ownership document'/ share.
- The cash in the account of the company will be an asset for the company as the company can do anything with that cash of Rs. 1 crore.
- Against this amount the company will be issuing a document to the owner which will represent 100% ownership in the company, and will be represented on the liability side of the company as a statement "owner's money" or "shareholders money".
- The ownership document or the share is asset for the owner but will act as liability for the company.

This transaction will look like the following:

<u>"XYZ Pvt. Ltd."</u>	
Asset	Liability
Cash = Rs. 1 cr	Owner's Money = Rs. 1 cr
Rs. 1 cr	Rs. 1 cr

If the company is expanding its business and wants more funds then it may approach a bank. Suppose the bank gave loan to the company worth Rs. 2 crore. The cash that the company got will be an asset for the company but the company will have to sign a "loan document" representing Rs. 2 crore loan to the company and this loan document will be a liability for the company (represented on the liability side as Bank Loan) and asset for the Bank. This transaction will look like:

"XYZ Pvt. Ltd."

Asset	Liability
Cash = Rs. 1 cr Cash = Rs. 2 cr	Owner's Money = Rs. 1 cr
	Bank Loan = Rs. 2 cr
Rs. 3 cr	Rs. 3 cr

If the company wants more funds, then it may approach the individual people i.e. retail market to put in money into the company at a particular/fixed interest rate (similar to the way people put money in banks).

Suppose the company approached 1 lakh individuals who could invest Rs. 100 each (total = Rs. 1 crore) for 5 years in the company at a fixed interest rate of 10% (just assume that banks were offering 9% interest rate, so company offered 1% more).

People have decided to put money in the company rather than banks as the company was offering higher interest rate as compared to the banks. This transaction will increase the assets of the company by Rs. 1 crore and the liabilities of the company will also increase by 1 crore.

The company will issue paper "slips" worth Rs. 100 to the individuals which will be assets for the individuals but will act as liability for the company. The slips will look like the following:

"Slips"

XYZ Pvt. Ltd.	Bank Interest Rate = 9%
Value = Rs. 100	
Time = 5 years	
Interest Rate = 10%	

- Now, after some time, if the banks increase their interest rate to 12% due to changes in the economic conditions then the people holding the "slips" will try to get rid of the slips as the slip is offering them just 10% interest rate.
- But if they would go in the market to sell the slips, nobody would be willing to purchase these slips in the market at Rs. 100 because why anybody will purchase the slips at 10% interest rate if they can deposit Rs. 100 in banks and can earn 12% interest rate.
- So, the slip holders will offer the slips at a discounted/lower price if they want it to be sold in the market. But what shall be that lesser price.
- Anybody will be willing to purchase the slips if they can earn higher interest rate on slips as compared to what is being offered in the market i.e. 12%. Suppose a purchaser purchases this slip in Rs. 80 from the market.

Let us see his earning or interest rate:

$$\begin{aligned}
 \text{Money spent by the purchaser in purchasing the slip} &= \text{Rs. 80} \\
 \text{Annual interest received by the purchaser} &= \text{Rs. 10 (10% of Rs 100)} \\
 \text{Effective Interest rate earned by the purchaser} &= \text{Rs. 10/Rs. 80} = 12.5\%
 \end{aligned}$$

Hence the purchaser will purchase this slip in Rs. 80 as he is getting a higher return (which is also called yield) of 12.5% as compared to the bank interest rate of 12%.

Why the person who had initially purchased the slip will sell the slip in Rs. 80? Because he thinks that if the bank interest rate rises further to say 13% or 14%, nobody would be willing to purchase the slip even in Rs. 80. (All trading activity happens based on future projections).

These slips are called bonds. So, bonds prices in the market decrease when the bank interest rate rises. And the bonds prices in the market increase when the bank interest rate falls. The company's balance sheet will look like:

"XYZ Pvt. Ltd."

Asset	Liability
Cash = Rs. 1 cr	Owner's Money = Rs. 1 cr
Cash = Rs. 2 cr	Bank Loan = Rs. 2 cr
Cash = Rs. 1 cr	Bonds = Rs. 1 cr
Rs. 4 cr	Rs. 4 cr

If the company converts its cash to purchase building and machinery then the balance sheet will look like:

"XYZ Pvt. Ltd."

Asset	Liability
Building1 = Rs. 1 cr	Owner's Money = Rs. 1 cr
Building2 = Rs. 2 cr	Bank Loan = Rs. 2 cr
Machinery1 = Rs. 1 cr	Bonds = Rs. 1 cr
Rs. 4 cr	Rs. 4 cr

Now, suppose the company is making profit and more and more people want to invest in the company and become owners. Let us assume that one lakh people invested Rs. 100 each (total Rs. 1 crore) to become owners in the company and the company purchased machinery with this Rs. 1 crore cash.

The balance sheet will look like:

"XYZ Pvt. Ltd."

Asset	Liability
<p>Building1 = Rs. 1 cr Building2 = Rs. 2 cr Machinery1 = Rs. 1 cr Machinery2 = Rs. 1 cr</p>	<p>Owner's Money = Rs. 1 cr Owner's Money = Rs. 1 cr</p>
Rs. 5 cr	Bank Loan = Rs. 2 cr Bonds = Rs. 1 cr

Now the value of the owners in the company will be Rs. 2 crore representing 100% ownership. And the new owners would like to hold the ownership/share document in proportion to their ownership. So, the ownership document that the initial entrepreneur was holding (whose value has now become Rs. 2 crore) will be divided into two lakh pieces.

So now, 100% ownership = Rs. 2 crore = 2 lakh shares x Value of each share
 Hence, value of each share = Rs. 100

The entrepreneur will be holding 50% ownership and one lakh shares of Rs. 100 each. And the new one lakh owners will be holding combined 50% ownership with one share each worth Rs. 100.

Now, if the company's assets increase either by increase in the valuation of the building or because the company is making profit then the value of each share will increase. For example, if the company makes Rs. 2 crore of profit, then this profit will be company's assets (deposited in company's account) and the value of two lakh shares will become Rs. 4 crore, so the share price will increase to Rs. 200 per share. **Hence company's share price increases with increase in profit.**

The balance sheet will look like:

"XYZ Pvt. Ltd."

Asset	Liability
<p>Building1 = Rs. 1 cr Building2 = Rs. 2 cr Machinery1 = Rs. 1 cr Machinery2 = Rs. 1 cr Cash (from profit) = Rs. 2 cr</p>	<p>Shareholder's Money = Rs. 4 cr <i>(Two lakh shares X Rs. 200 each)</i></p>
7 cr	<p>Bank Loan = Rs. 2 cr Bonds = Rs. 1 cr</p>

Equity

Debt

In the above example, investors are investing/putting money in the company in the following two ways:

- at a particular/fixed interest rate and gets the debt security
- at profit or loss and becomes owner and gets equity security

So, against the total assets, the company issues either debt or equity securities to the investors and the same are represented in the company's account book on the liability side.

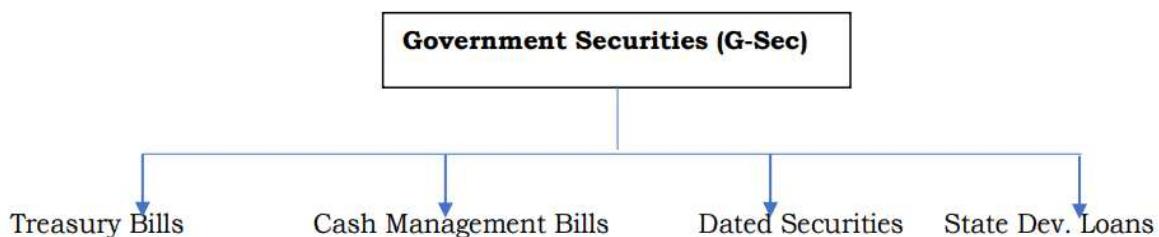
Government Securities (G-Sec)

A Government Security (G-Sec) is a tradable instrument issued by the Central Government or the State Governments.

G-Secs carry practically no risk of default and, hence, are called risk-free gilt-edged instruments. (Govt. issues only debt securities).

G-Secs are issued through auctions conducted by RBI. Auctions are conducted on the electronic platform called the E-Kuber, the Core Banking Solution (CBS) platform of RBI. Commercial banks, scheduled Urban Cooperative Banks (UCBs), Primary Dealers (PD), insurance companies and provident funds are members of this platform. Foreign Portfolio Investors (FPIs) also participate in this market. Individuals (retail investors) can also participate directly in the Govt. securities market.

There are four kinds of government securities:



- 1. Treasury bills or T-bills:** These are short term debt instruments issued by the Government of India for a maturity of less than one year. Treasury bills are zero coupon securities and pay no interest. Instead, they are issued at a discount and redeemed at the face value at maturity. For example, a 91-day Treasury bill of ₹100/- (face value) may be issued at say ₹ 98.20, that is, at a discount of say, ₹1.80 and would be redeemed at the face value of ₹100/-. (Treasury bills are traded in money market).
- 2. Cash Management Bills (CMB):** In 2010, Government of India, in consultation with RBI introduced a new short-term instrument, known as Cash Management Bills (CMBs), to meet the temporary mismatches in the cash flow of the Government of India. The CMBs have the generic character of T-bills but are issued for maturities less than 91 days.
- 3. Dated Securities:** Dated central government securities have a tenor of more than one year up to 40 years. They can be of different categories:
 - **Fixed rate bonds:** Interest rate is fixed till maturity
 - **Floating rate bonds:** The interest/coupon rate is not fixed and can be linked to the yield of Treasury bills
 - **Inflation indexed bonds:** Interest and principal both are protected against inflation and can be linked with CPI or WPI
 - **Special Securities:** Under the market borrowing program, the Government of India also issues, from time to time, special securities to entities like Oil Marketing Companies, Fertilizer Companies, the Food Corporation of India, etc. (popularly

called oil bonds, fertiliser bonds and food bonds respectively) as compensation to these companies in lieu of cash subsidies.

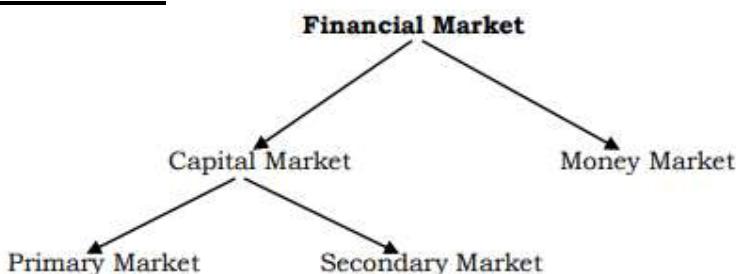
- **Bank recapitalization bonds:** Government of India has also issued Bank Recapitalisation Bonds to specific Public Sector Banks in 2018.
- **Sovereign gold bonds (SGB):** SGBs are unique instruments, prices of which are linked to commodity price viz Gold. SGBs are also budgeted in lieu of market borrowing.

4. **State Development Loans (SDL):** State Governments also raise loans from the market which are called SDLs with maturity more than one year. SDLs issued by the State Governments also qualify for SLR.

Govt. Securities Market:

- This market is regulated and managed by RBI. When Govt. (Central or State) wants money, the RBI raises money for them by issuing securities/bonds in the Govt. Securities Market.
- First time the Govt. securities are issued in the Govt Securities Market (basically primary market transaction) and then secondary market transactions also happen in the same market.
- All the four types of Govt securities i.e. "Cash Management Bills", "Treasury Bills", "Dated Securities" and "State Development Loans" are traded in the Govt. Securities Market.
- Since the maturity of "Dated Securities" and "State Development Loans" are more than one year, these Govt. securities are also traded in Capital Market like BSE/NSE. Since the maturity of "Cash Management Bills" and "Treasury Bills" are less than one year, these Govt. securities are also traded in the Money Market.

Financial Markets



A financial market is a market that brings buyers and sellers together to trade in financial securities or assets such as stocks, bonds, derivatives, currencies etc. Financial markets are broadly of two types:

1. **Capital Market:** Financial markets for buying and selling debt and equity securities. In this market securities of medium and long term of more than one year are bought and sold. Capital markets are of two types:

(i) **Primary Market:** It refers to the capital market where securities are created. It is in this market that companies sell new shares and bonds for the first time (Initial Public Offering, IPO). In this market transaction is between the issuer (company) of security and the investor. In the securities

example above, the market in which the company issued bonds for the first time to one lakh investors is the primary market.

(ii) Secondary Market: Once the securities have been issued by the issuer in the primary market, it gets traded in the secondary market among the investors. In this market, investors trade the previously issued securities among themselves without the involvement of the issuer of security (company). Example, Bombay Stock Exchange. In the securities example, the market in which the investors started buying and selling the bonds among themselves is a secondary market.

2. Money Market: A segment of the financial market in which financial instruments with high liquidity and very short maturities (less than one year) are traded. Money market instruments are basically debt instruments and include Treasury Bills, Cash Management Bills, Commercial Paper, Certificate of deposit. The players who can trade in the money market are financial institutions, commercial banks, central banks and highly rated corporate/companies.

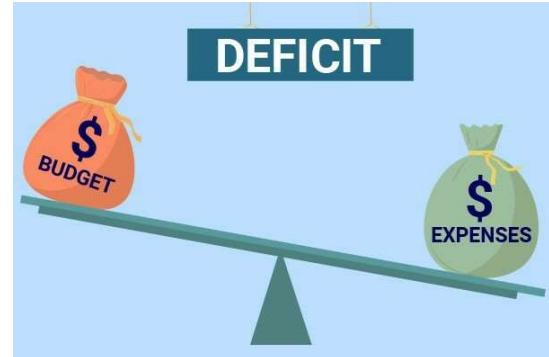
CHAPTER 22

This Chapter will Demystify the following Concepts:

- ✓ Budget
- ✓ Functions of budget
- ✓ Public Goods & Private Goods
- ✓ Public Provision & Public Production
- ✓ Components of budget
- ✓ Types of Receipt: Revenue & Capital
- ✓ Types of Expenditure: Revenue & Capital
- ✓ Balanced, Surplus & Deficit Budget
- ✓ Revenue, Fiscal & Primary Deficit
- ✓ Deficit Financing
- ✓ Government Debt
- ✓ Ricardian Equivalence
- ✓ Deficit Reduction

What is Budget?

A budget is an estimation of revenue and expenses over a period of time



What is Government Budget?

It is a document prepared by government containing item wise details of estimated Revenue and expenditure of government over next financial year

Constitutional Requirement of Budget

As per Article 112 of Constitution, It is compulsory to present statement of Estimated Receipts and Expenditures of Govt for every financial year.

Important Points About Govt Budget

- *It is Prepared on Estimated Basis and not actual basis*
- *It is prepared for 1 year.* We follow Financial Year (not calendar year)
Example- Budget for Financial year 2020-21 means Budget for Period starting 1 Apr 2020 to 31 Mar 2021
- *It is Prepared by all types of Governments-* Central Govt, State Govt and Municipality
However, we will study about Central Govt budget which is called Union Budget
- *It is presented by Finance Minister in Parliament every year around February*

Example

- Budget for Financial year 2020-21 means Budget for Period 1 Apr 2020 to 31 Mar 2021. It is Presented in Advance in Feb 2020

- Budget for Financial year 2021-22 means Budget for Period 1 Apr 2021 to 31 Mar 2022. It is Presented in Advance in Feb 2021

FUNCTIONS OF BUDGET

1. Allocation Function

- Government wants to allocate resources towards public goods like National Defense, Roads, Judiciary.
- If govt wants to increase production of certain goods and services, so it gives tax concessions on these goods
- Also, govt wants to restrict use of certain goods, for this it increases tax on these goods
- Additionally, govt can directly produce goods in some areas like water supply, sanitation etc. as these are non-profitable.

What are Objectives of Budget?

They are derived from functions of budget

Functions of Budget

Allocation Function	Distribution Function	Stabilization Function
Proper Allocation of Resources to make Public goods	Fair Distribution of Income between Rich and poor	Stabilize Economy during recession/inflation

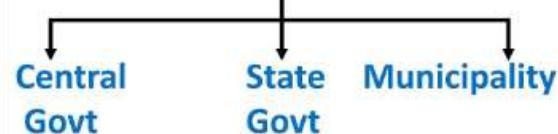
Main Objectives of Budget

Proper Allocation of Resources to make Public Goods	Proper Distribution of Income of Resources to make Public Goods	Stabilization of Economy during recession/inflation
Rich and Poor		

Govt decreases its spending in budget to reduce demand of goods.

Which Government Prepares Govt Budget in India?

Different Types of Governments In India



Budget made by them is called

Union Budget



Budget made by them is called

State Budget



Budget made by them is called

Municipal Budget

2. Distribution Function

Govt wants to ensure fair distribution of income and reduce inequality between rich and poor. So, it charges more tax for rich in the budget and give subsidies and tax concessions to the poor

3. Stabilization Function

In case Country is going through recession and decline in demand. Govt increases its public spending in budget to create more demand of goods. In case country is going through inflation.

Functions of Budget

Allocation Function	Distribution Function	Stabilization Function
It means Proper Allocation of Resources to make Public goods	It means Ensuring Fair Distribution of Income of economy to make Public goods (Road, Bridges etc.)	It means Stabilize Economy during Recession/inflation

These are called Revenue and expenditure Measures of govt in budget

4. Economic Growth

- Govt can spend more on infrastructure like electricity, roads, dams etc.
- This helps in increase of production
- Also, govt gives tax concessions to sectors where there are chances of more growth
- Example-Tax benefits to Export sector and Software Companies

5. Management of Public Enterprises

- Business owned by Governments are called Public Enterprises
- Example-PSU like SBI, ONGC, BSNL
- Govt gets dividend income from these companies
- Also, if these are not profitable, govt can go for disinvestment and sell its shares
- In both cases, it is a source of Receipt for Govt which can be used to make different expenditure

6. Remove Regional Disparities

- Some areas of India are less developed while others are more developed
- So in order to encourage growth in these areas, govt can give tax concessions or subsidies
- This will lead to development of backward areas

Difference between Public Goods and Private Goods

What are Private Goods?

Any goods which are meant for consumption of a particular individual or group of individuals.

And another person is restricted from using it.

Example-

Suppose a person purchases a car. Only that person has the right to use that car

Any other person can't use the car without his permission

Hence, car is a Private good

Note- All products purchased by households and business are private goods

Example - Clothes, Vehicles, TV, Mobile etc.

What are Public Goods?

Public goods are goods which are available for consumption to all members of society. All people are free to use it.

Example- Roads, Bridges etc.

In this case, all members of public are free to use these roads and bridges. So, it is a Public Good.

Important Points of Public Goods

1. They are Non-Rivalrous

- One person can increase his satisfaction from goods without reducing satisfaction of other person from the same goods



Difference between Public Goods and Private Goods

Private Goods	Public Goods
PROPERTIES	PROPERTIES
RIVALROUS (Provides satisfaction to only one person)	NON-RIVALROUS (Provides satisfaction to all)
EXCLUDABLE (Person can exclude someone from sitting in their car)	NON-EXCLUDABLE (Any person can use the Public bridge)
GENERALLY PROVIDED BY PRIVATE SECTOR (Made by Private car Company)	GENERALLY PROVIDED BY GOVERNMENT (Public Provision made by Govt)

- Example- Any person can use the road any number of time, it does not affect other person's use of road

2. They are Non-Excludable

- No person can be excluded (stopped) from using the goods
- Example-A Road prepared by govt can be used by anyone

3. Generally Provided by Govt

- Since these goods are non-rivalrous and non-excludable (free to use for anyone), it is difficult to collect fees for same
- Hence, it is not profitable to make these goods for Private enterprises
- So, these goods are generally provided by Govt in budget

Difference between Private Goods and Public Goods

Private Goods	Public Goods
Private Goods refers to any goods which are meant for consumption of a particular individual or group of individual and other person are restricted from using it.	Public goods are goods which are available for consumption to all members of society
They are Rivalrous in Nature (Provides satisfaction to only one person and restricts satisfaction to other persons)	They are Non-Rivalrous in Nature. One person can increase his satisfaction from goods without reducing satisfaction of other person from the goods.
They are Excludable (Other persons are restricted from using the goods)	They are non-Excludable. No person can be excluded (stopped) from using the goods.
They are Generally provided by Private Sector as it is profitable to them to sell it and collect fees	They are Generally not provided by Private Sector So they are provided by govt in budget (Public Provision is made for the same)

What is Meaning of Public Provision?

- Public Provision means provisions for goods and services which are financed by Govt Budget and they are free to use by any person
- In easy language, it means those goods and services which are provided free of cost to everyone by the govt.

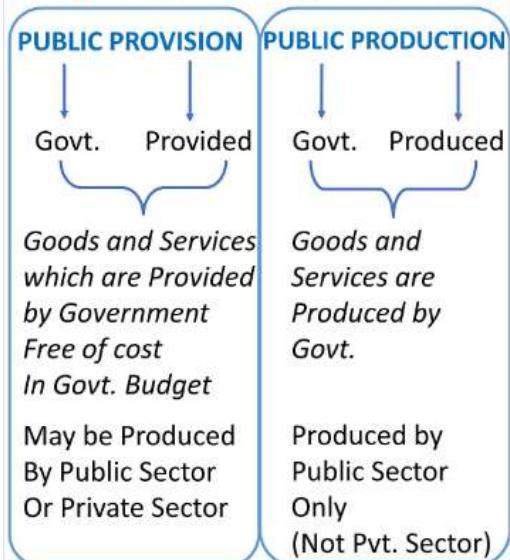
Example

Public Goods like Bridges, Dams are provided free of cost by Govt by making a provision for them in budget

Note

Goods may be produced by public sector or private sector. Money is paid by govt for the same.

Difference between Public Provision and Public Production



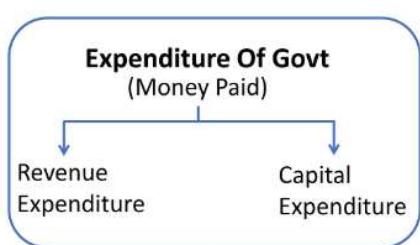
Difference between Public Provision and Public Production

Public Provision	Public production
All expenses are paid by govt	All goods and service are produced by govt
These may be produced by anyone (Private sector or Public Sector)	They are produced by Public Sector (Govt)

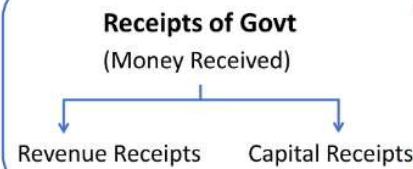
Components of Govt Budget

There are 2 types of Budget:

- Revenue Budget
- Capital Budget

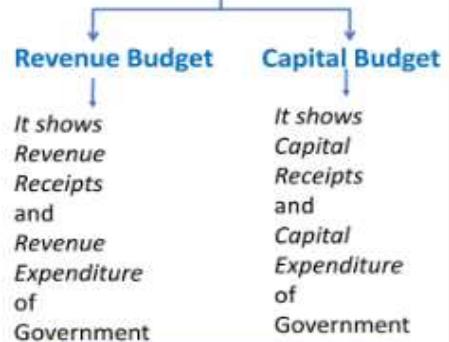


Types of Receipts and Payments in Budget



Parts of Government Budget

(As per Article 112 of Constitution)



Hence we can say
Receipts are of 2 types

1. Revenue Receipts
2. Capital Receipts

Similarly
Expenditure is also of 2 types

1. Revenue Expenditure
2. Capital Expenditure

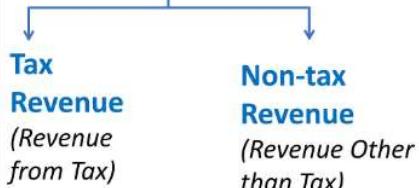
Revenue Receipts of Government

Those Receipts of Govt which are non-Redeemable (which cannot be reclaimed from govt) are called Revenue Receipts. They are recurring (repeating) in nature.

It is of different types

- Tax Revenue
- Non-Tax Revenue

Types of Revenue Receipts



Example

Tax Collected by Government from Public

Public $\xrightarrow{\text{Tax}}$ Govt

Example

Aid Received By Government from Foreign Country

USA $\xrightarrow{\text{Aid}}$ Govt

Types of Receipts in Budget



It refers to Receipts which are not redeemable (which cannot be Returned or reclaimed)

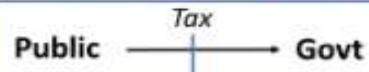
It Receipts which increase liability Or Reduce Financial Assets

Tax Revenue

They are proceeds of different taxes which are levied by Central Govt like GST, Income Tax.

These taxes can be Direct Tax or indirect Tax.

Types of Tax Revenue



This Tax Revenue may be from Direct Tax or Indirect Tax

Tax

Direct Tax

Person pays tax from own pocket

Example

Income Tax

Corporation Tax
(Income tax for Companies)

Indirect Tax

Person collect tax from customer, pays to government

Example

Earlier → VAT, Service Tax
Excise applicable
Now → Replaced by GST

Direct Tax

- Income Tax is charged on Individuals (Called Personal Income Tax) as well as on Companies (called Corporate Tax)
- Higher the Income, Higher the tax Rate

Indirect Tax

- Earlier different taxes were imposed like Service Tax (on services), Central Sales Tax (on sale of goods) and Excise (on Manufacturing)
- Now, all these are replaced by GST from 1 July 2017
- Exception: On certain goods, still Vat and Excise is applicable and not GST like Petrol, Diesel
- Also on import, export of goods; Custom Duty is charged by Govt which also is part of tax Revenue

Non-Tax Revenue

It contains following:

Cash Grants

- Govt receives cash grants (aid) from different countries and organizations like UNO

Dividends and Profit

- Central Govt owns shares of many PSU (Public sector Undertaking) like SBI, ONGC, BHEL
- Profits of these PSU are given to Central Govt in form of Dividends

Interest Received

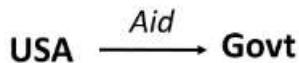
- Central Govt gives loans to State govt etc. on which it earns interest

Fees and other Receipts

- Govt charges fees for Different Services like Fees for Company Registration etc.
- It also charges late fees and penalties for late deposit of taxes etc.

Example 1 -Aid

Aid /Cash Grant Received by Government from Foreign Country



Example 2 -Dividend

Dividend (Profit share) received by Government from PSU



Summary-Revenue Receipts

(Receipts of Govt which are Non-Redeemable)

Tax Revenue
(Revenue from Tax)

Direct Tax
For Individuals
Personal Income Tax

For Companies
Corporation Tax

Indirect Tax
Earlier
Excise, Service Tax ,CST

Now
GST

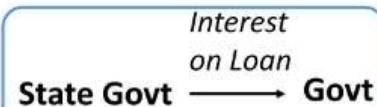
Non-tax Revenue
(Revenue Other than Tax)

4 Types

- Cash Grant(Aid)→**
From Outside Countries
- Dividend→**
From PSU
- Interest Income→**
On Loans Given
- Fees→**
From Public, Business

Example 3 –Interest Received

Interest received by Govt on loan given to State govt



Example 4 –Fees Received

Govt Receives fees from Public for providing different services



What are Capital Receipts

Receipts of Govt which Increase Liability or Reduce Financial Assets

Hence,

Capital Receipts are of 2 types

- Receipts which Create Liability*
Example-
Loan taken from public



- Receipts which Reduce Asset*
Example-
Recovery of Loan Given



Example of Capital Receipts which Increase Liability

1. Borrowings from Public

-Loan raised from Public by issuing govt bonds

2. Borrowings from RBI, Financial Institutions and Banks

-This is done through sale of T-Bills, CMBs, Dated Securities etc.

3. Borrowings from Foreign Govt and International Institutions

Example -Loan taken from Japan to make bullet Train

4. Saving Schemes

-Sale of National Savings certificate, Post office savings schemes

Example of Capital Receipts which Reduce Financial Assets

Recovery of Loan Granted by Central Govt

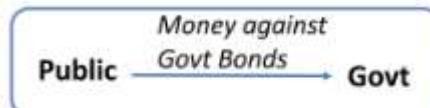
- Suppose loan granted by Central govt to State govt. It is Asset in balance Sheet of Central Govt
- Suppose State govt repays this loan. It is Reduction of Financial Assets of Central govt
- So, it is a capital receipt.

Disinvestment

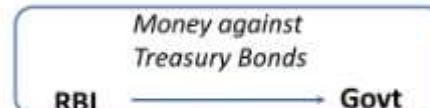
- Disinvestment means Sales of shares of public sector undertakings (PSU). Govt owns shares of various companies like SBI, ONGC, BHEL.
- So, these are asset to Central Govt.
- Suppose govt sells these shares, it is reduction of financial asset. Hence, it is a capital receipt.

Different Capital Receipts which Create Liability

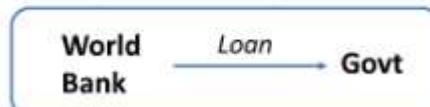
Borrowings from Public by Govt



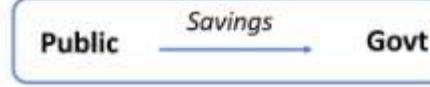
Borrowings from RBI



Borrowings from Foreign Govt/Foreign Institution



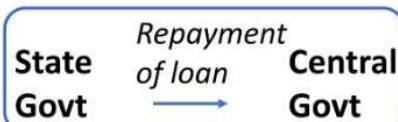
Saving Schemes
(Post Office Savings Scheme, NSC)



Example 1 –Repayment of Loan

Loan given by Central Govt to State govt is asset,

*When it is repaid,
it is reduction of financial asset*

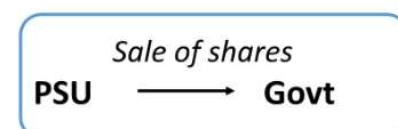


various companies like SBI, ONGC,

Example 2 –Disinvestment

*When Govt invest money in PSU,
It is Financial Asset for Govt.*

*When Govt Sells its share in PSU
(does disinvestment), It is called
Reduction of Financial Asset*



Difference between Capital and Revenue Receipts

Difference between Revenue & Capital Receipts

Revenue Receipts	Capital Receipts
They are Non-Redeemable (They do not have to be Returned)	They are Redeemable (They have to be Returned)
<i>Example</i> USA $\xrightarrow{\text{Aid}}$ Govt	<i>Example</i> USA $\xrightarrow{\text{Loan}}$ Govt
They are recurring in nature <i>Example</i> Public $\xrightarrow{\text{Tax}}$ Govt <i>Tax will be collected again and again</i>	They are non recurring <i>Example</i> Public $\xrightarrow{\text{Bonds}}$ Govt <i>Public may not invest again in Bonds</i>

What is Capital Expenditure

It refers to expenditure which lead to Creation of Assets or Reduction in Liability of Government.

Examples:

Physical Assets: Purchase of Building or furniture by the Government.

Financial Assets: Loans given by Central Government, Purchase of shares of a company

Reducing financial Liabilities: Repayment of Loans taken by Central Government.

What are Revenue Expenditures

- It refers to expenditure which do not create asset or reduce liability. It is a recurring expenditure
- These are normal day to day expenses of Government.
- Examples: Salary Payment, Administrative Expenses, Grants given to states & other countries, Purchase of Weapons by the Govt, Interest Payment and Subsidy given by the govt.

It includes:

1. Expenses for Normal functioning of govt department

(like Salary to Employees, Office expenses)

2. Interest Payment on Debt

(Loan taken by Central govt on which it has to pay interest)

3. Grants given to State Govt and others

(Grants are non-returnable, hence they are not asset)

4. Subsidies

It is a kind of financial aid given by govt to keep price of commodity low

Example - Cooking Gas cylinder whose cost is 600 is sold for 500 in market (as 100 Subsidy is given by govt)

5. Defense Expenditure

Expenditure on purchase of different weapons and paying salary of army, navy, air force, etc.

Balanced, Surplus and Deficit Budget

We know that in Budget we have Receipts and Expenditure.

- If Receipts are equal to Expenditure, it is Balanced Budget
- If Receipts are More than Expenditure, it is Surplus Budget
- If Receipts are less than expenditure, it is a Deficit Budget

Hence, we can say that Budget is of 3 types:

1. Balanced Budget
2. Surplus Budget
3. Deficit Budget

What is Deficit Budget

RECEIPTS	1000
PAYMENTS	1100
SURPLUS DEFICIT	0 100

If Govt Receipts
are **less than**
Govt Expenditure
it is called
Deficit Budget

Here, Govt spend
more than
it collects

It is most
common case

What is Surplus Budget

RECEIPTS	1000
PAYMENTS	800
SURPLUS	200

If Govt Receipts are
more than
Govt Expenditure
it is called
Surplus Budget

Here, Govt spends
less than
Money it collects

It is also
Rare Case

What is Balanced Budget

RECEIPTS	1000
PAYMENTS	1000
SURPLUS	0

*If Govt Receipts
are equal to
Govt Expenditure
it is called
Balanced Budget*

*In this case.,
Govt spends
exactly equal to
Money it collects*

It is Rare Case

What is Revenue Deficit?

It is excess of Revenue expenditure over Revenue Receipts

Revenue Deficit = Revenue Exp - Revenue Income

It includes only those transactions which affect current income and expenditure of govt.

How to Calculate Revenue Deficit?

Revenue Receipts	3000
Capital Receipts	2000
Total Receipts	5000
Revenue Expenditure	3200
Capital Expenditure	2100
Total Expenditure	5300

Answer

Revenue Expenditure	3200
Less	
Revenue Receipts	2000
Revenue Deficit	1200

Note-

To Calculate Revenue Deficit, we take only Revenue items and not Capital Receipts and Exp.

EFFECT OF REVENUE DEFICIT

Revenue Expenditure	3200
Less	
Revenue Receipts	2000
Revenue Deficit	1200

Effect

- Option 1
Govt Dissaves
- Option 2
Govt Borrows
- Option 3
Govt cuts Expenditure

What happens If Govt Dissaves in case of Revenue Deficit

Revenue Deficit

↓
Govt Dissaves
(Use savings of Other sectors)

↓
Capital Receipt use to Pay Revenue Exp

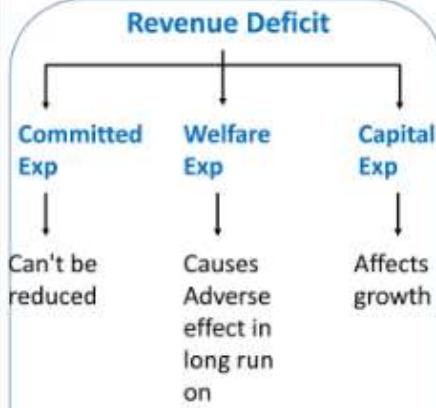
Example
Funds received from Sale of PSU
Used to pay Salaries
To Govt Employees

Note: Dissave means to use savings for current expenses.

What happens If Govt Borrows in case of Revenue Deficit



What happens If Govt cuts Expenditure in case of Revenue Deficit



How To Reduce Revenue Deficit?

We can Increase Revenue Receipts (like by Increasing Taxation)

Example

Suppose my Revenue Deficit is 100 as shown below

Revenue Receipts	1000
Revenue Expenditure	1100
Revenue Surplus	0
Revenue Déficit	100

Answer

Increase Revenue Receipts by 100

Revenue Receipts	1000 + 100 = 1100
Revenue Expenditure	1100
Revenue Surplus	0
Revenue Déficit	100

Second Method to Reduce Revenue Deficit?

We can increase Revenue Expenditure (like by Decrease Govt Expenditure on Welfare Projects)

Example

Suppose my Revenue Deficit is 100 as shown below

Revenue Receipts	1000
Revenue Expenditure	1100
Revenue Surplus	0
Revenue Déficit	100

Answer

Increase Revenue Expenditure by 100

Revenue Receipts	1000
Revenue Expenditure	1000 + 100 = 1100
Revenue Surplus	0
Revenue Déficit	0

Fiscal Deficit

It is difference between Total Govt Expenditure and total receipts excluding borrowings.

Hence, in this case,

We take total expenditure (both Revenue and Capital)

We take total Receipts (both Revenue and capital) but we do not include Capital Receipts which create debt (loan).

Note-

Capital Receipts normally include following:

- Recovery of loan given by Central Govt to State govt etc.
- Sale Proceeds from Disinvestment (Amt Received from sale of shares of PSU)
- Loan taken by Central Govt (from RBI, Outside country, Public)
- In this case, first 2 are called Non-Debt Creating Capital Receipts
(*We take them while calculating Fiscal Deficit*)
- And last one is called Debt Creating Capital Receipt
(*We exclude it while calculating Fiscal Deficit*)

WHAT IS FISCAL DEFICIT?

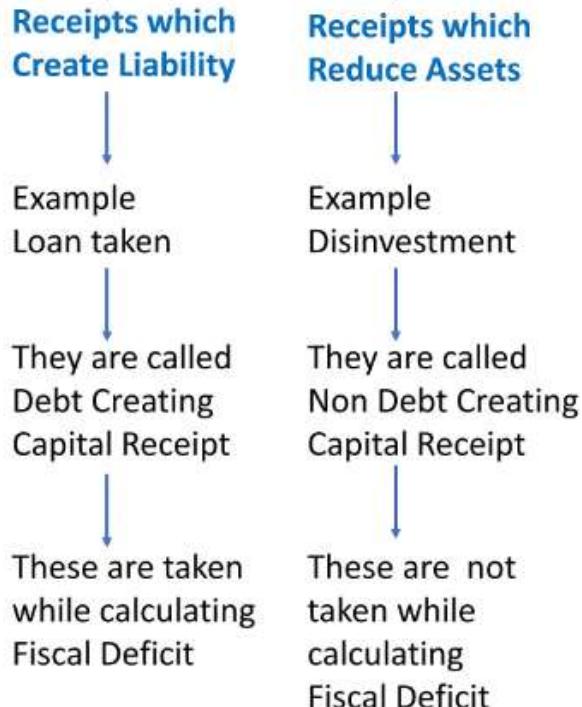
It is difference between total Receipts and Total Expenditure Excluding borrowings

ADD	REVENUE EXP CAPITAL EXP TOTAL EXPENDITURE
Less	REVENUE RECEIPTS CAPITAL RECEIPTS (Non Debt)* FISCAL DEFICIT



*Here we take all capital receipts
But do not include borrowings

Type of Capital Receipts



Example 1 How to calculate Revenue and Fiscal Deficit

RECEIPTS	
Revenue Receipts	3000
Capital Receipts (Non-debt)	2000
Capital Receipts (Debt)	1000
Total	6000

EXPENDITURE	
Revenue Exp	4500
Capital Exp	1500
Total	6000

Revenue Deficit

$$\begin{aligned}
 &= \text{Revenue Exp} - \text{Revenue Receipts} \\
 &= 4500 - 3000 \\
 &= 1500
 \end{aligned}$$

Fiscal Deficit

$$\begin{aligned}
 &= \text{Total Exp} - \text{Revenue Receipts} - \\
 &\quad \text{Capital Receipt (non debt)} \\
 &= 6000 - 3000 - 2000 \\
 &= 1000
 \end{aligned}$$

Example 2

CALCULATE REVENUE DEFICIT AND FISCAL DEFICIT

REVENUE RECEIPTS

Tax Revenue	100
Non Tax Revenue	200
Total	300

CAPITAL RECEIPTS

Recovery Of Loans Given	50
From Sale of	250
PSU(disinvestment)	
From Borrowings	400
Total	700

REVENUE EXPENDITURE

CAPITAL EXPENDITURE

Calculation of Revenue Deficit

Revenue Expenditure	600
Revenue Receipts	300
Revenue Deficit	300

Calculation of Fiscal Deficit

Revenue Exp	600
Capital Exp	400
Total Expenditure	1000

Revenue Receipts	300
Capital Receipts (Non-debt)	300
Total Receipts	600

Fiscal Deficit	400
-----------------------	------------

NOTE

Borrowings	400
Fiscal deficit	400
hence,	

$$\text{Fiscal Deficit} = \text{Borrowings}$$

What is Revenue Deficit and
Fiscal Deficit

What is Primary Deficit?

It is difference between Fiscal Deficit of Current year and Net Interest Payments

FORMULA

PRIMARY DEFICIT

= FISCAL DEFICIT - NET INTEREST LIABILITY
 = FISCAL DEFICIT - (INT PAYMENT ON LOAN TAKEN - INT RECEIVED ON LOAN GIVEN)

How to Calculate Revenue, Fiscal and Primary Deficit

RECEIPTS

Revenue Receipts	3000
(Int Income 200, Others 2800)	
Capital Receipts (non Debt)	2000
Capital Receipts (Debt)	1000
TOTAL	6000

EXPENDITURE

Revenue Exp	4500
(Interest Exp 500, Other Exp 4000)	
Capital Exp	1500
TOTAL	6000

Calculation of Revenue Deficit

Revenue Expenditure	4500
Revenue Receipts	3000
Revenue Deficit	1500

Calculation of Fiscal Deficit

Revenue Exp	4500
Capital Exp	1500
Total Expenditure	6000
Revenue Receipts	3000
Capital Receipts (non Debt)	2000
TOTAL RECEIPTS	5000
FISCAL DEFICIT	1000

Calculation of Primary Deficit

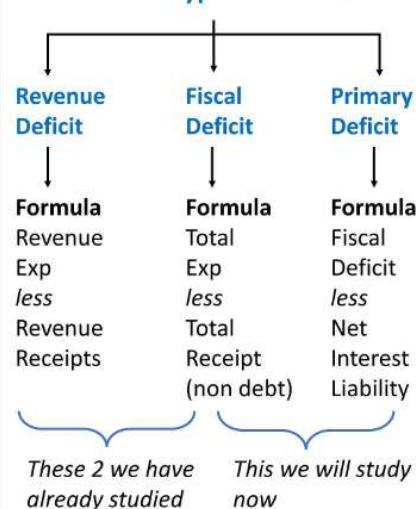
Fiscal Deficit	1000
Less Net Interest	300
Liability	
Primary Deficit	700

Note-

This Int Income of 200 and int expense of 500 is of loan given last year

So, Net Interest liability of $500 - 200 = 300$ is also of last year

Different Types of Deficit



What are Budgetary Deficit?

We have already studied that Budgetary Deficit is excess of Expenditure over Receipts.

Example- Revenue Deficit, Fiscal Deficit, Primary Deficit.

How to Finance Budgetary Deficit

EXPENDITURE	1000
LESS	
RECEIPTS	800
DEFICIT	200

How to Finance this Deficit?
(How to meet the shortfall)

Option 1
Increase Taxation

Option 2
Increase Borrowing

Option 3
Print Currency

Option 1 -Increase Taxation

	Earlier	Now
Expenditure	1000	1000
Less		
Receipts	800	1000
Deficit	200	0

Govt increase taxes

This Increases
Govt Revenue
(Receipts)

Deficit Reduced

Note-
This Method
is not popular
as people don't like
to pay more taxes)

Option 2 -Increase Borrowings

Expenditure	1000
Less	
Receipts	800
Deficit	200
Borrowings	200
Deficit After Borrowings	0

Govt takes loan
And pay interest

This interest is
extra expense

It adds to Deficit
of Next year

Option 3 -Print Currency

Expenditure	1000
Less	
Receipts	800
Deficit	200
Less Currency Printed	200
Balance Deficit	0

Govt issues
treasury bonds
to RBI

RBI prints
currency

Increase
Money
Supply in
Economy

Causes
Inflation

How are Budgetary Deficit Financed

To fill the gap between Expenditure and Receipts, Government normally does one of the following-

1. *Taxation*

Govt increases its Taxes (This increases Govt Receipts)

2. *Borrowing (Debt)*

Govt takes loans from Public or Foreign Institutions

This increases its debt and interest liability

3. *Printing Money*

Govt asks RBI to print money

When Govt wants to print a currency, it gives securities to the RBI (called Govt Security) against which RBI issues currency

Which of above 3 methods is mostly used by Govt?

- Borrowing Method is mainly used by Govt.
- Govt increases its debt by raising bonds on which it has to pay interest.
- If govt continues to borrow every year, it has to pay more and more interest on it
- To Pay this interest, govt has to take more loan and this circle continues

Is Debt and Deficit Stock or Flow?

- We know that Stock is measured at a particular point of time
Debt is measured annually as on 31 March, hence it is a Stock
Example- Debt as on 31 March 2021
- Flow is always defined over a period of time
Hence, Deficit is a Flow as it is measured for a particular period
Example- Budgetary Deficit for year 2020-21

Is Debt and Deficit Stock or Flow?

Stock	Flow
It is a variable which is measured at Particular point of time	It is a variable which is measured Defined over a period of time
Example Debt	Example Deficit

Debt as on 31 March 2021

↓

Particular Point of time as on 31 March 2021 (STOCK)

Deficit for year 2020-21

↓

Transactions for the Period 1 Apr 2020 to 31 Mar 2021 (FLOW)

Deficit is a Flow which adds to Stock of Debt

We know that,

Debt is measured annually as on 31 March, hence it is a Stock.

Also,

Deficit is a Flow as it is measured for a particular period

More the Deficit, More the Govt has to borrow to meet the deficit. Hence, Deficit leads to increase in Debt.

So, we can say that, Deficit is a flow which adds to stock of Debt

Government Debt is a Burden because of following reasons

- When a govt borrows, it issues bonds to Public. On these bonds, Govt will have to pay interest in future.
- To Pay this interest, Govt will have to increase taxes in future.
- When govt will increases taxes in future, income of people in future will reduce.

Why Govt Debt is Burden



- Because purchasing power will fall, consumption will also fall (as less amount will be available to be spent in future)
- Less consumption means less production in future and hence less GDP
- Because GDP will fall, Savings of people will fall
- So, there will be less capital formation and less growth. Hence, we can say Debt is a Burden on future generation

Counterview - Govt Debt is not a Burden

- Debt does not matter because we owe it to ourselves
- If Govt borrows from Public, it will have to pay interest to Public
- This Interest will be Income of Public
- Hence, income of public will increase
- Because income of people increases, they will save more for their future generations
- Hence Increase in Public Saving will offset Increase in Govt dissaving
- This counter view is called **Ricardian Equivalence**

What is Ricardian Equivalence?

- It is an economic theory given by famous economist David Ricardo
- As per this theory, Taxation and Borrowing are equivalent means of financing budget deficit
- In case of budget deficit, Govt can either increase borrowing which will be repaid by future generation by paying more taxes or
- Govt can increase taxes today and use the money to make more govt expenditure.
- *If Govt increases borrowing today.* It will lead to interest liability on govt. To Pay this interest, Govt will increase taxes in future. People will expect that govt will raise taxes in future, so they will save more today by cutting their spending.
- *If Govt Increases taxes today,* Person's disposable income will reduce. Hence, they will be able to save less. However, Govt will be able to save more.
- In both cases, overall savings remain the same.

What is Ricardian equivalence?

It is an Economic theory by David Ricardo→



As per this theory
In case of budget deficit
Govt can do either Taxation or Borrowing
Both have equal effect

Hence there are 2 Options
With Govt in case of Budgetary Deficit

Option 1
Increase Taxation

Option 2
Borrowings

Ricardian Equivalence Option 2

If Govt Increases taxes today

More taxes by Govt
↓
Less income left by People to spend
↓
People disposable income Reduced
↓
Less Saving by People But more saving for Govt due to increased taxes
↓
More Govt Expenditure

Summary

Govt can increase taxes today and use the money to make more govt expenditure

Ricardian Equivalence Option 1

If Govt increases borrowing today

More borrowing by Govt
↓
More interest to be paid by Govt
↓
To Pay interest Govt will Increase Tax
↓
People know about increased taxes
↓
People cut their spending
↓
People's income increases
↓
More tax to be paid

Summary

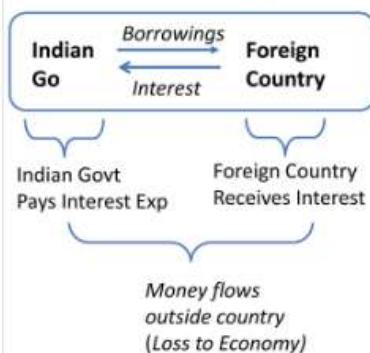
Govt can either increase borrowing which will be repaid by future generation by paying more taxes

NOTE:

- If Govt takes debt from within the country (from public), It does not matter, As Increase in Debt will lead to More Income and Savings for public

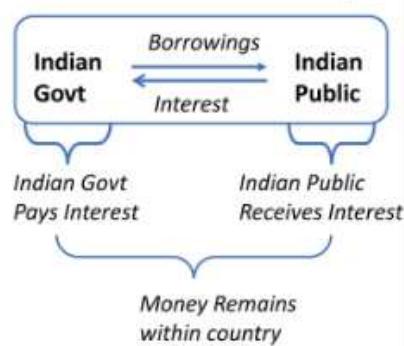
Counterview-

Debt is a Burden if taken from Outside Country



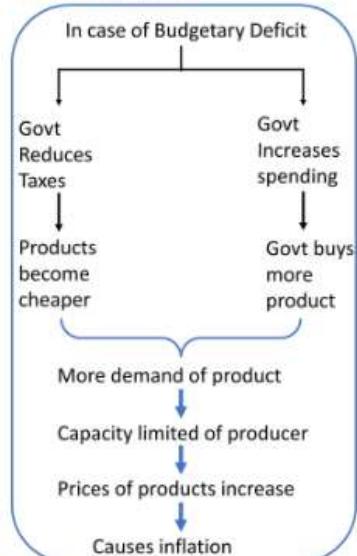
- If Govt takes debt from outside country, It matters as we have to pay interest to outside country. It will be an expense for our economy and income for foreign country.

If Govt Takes Debt Within Country



No Effect on Economy

How Budgetary Deficit causes inflation?



Are Budget Deficits Inflationary?

- Budgetary Deficit are caused either due to Reduction in Taxes or Increase in Spending of Govt.
- If Govt Reduces taxes, Disposable income increases. Hence, Demand for product increases.
- In case of increase in spending by govt, Govt will buy more products, so Demand for Product increases which will eventually lead to increase in prices or inflation.

COUNTERVIEW

Budget does not cause Inflation

- Budgetary deficit leads to increase in demand
- But Producers have surplus capacity
- So, they are able to fulfill this demand without increasing prices

Budget Deficit Leads To Decrease In Investment



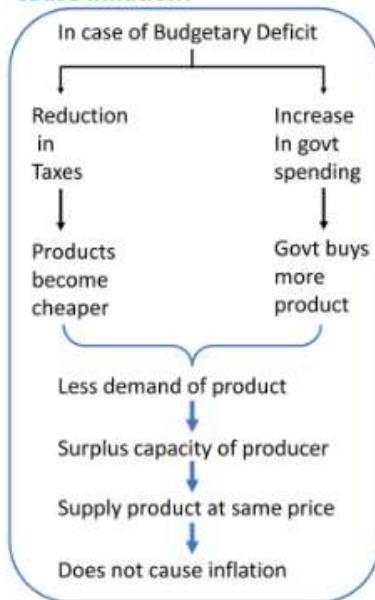
Budgetary Deficit leads to Decrease in Investment

- Budgetary Deficit leads to Decrease in Investment in Private Sector.
- In case of Budgetary deficit, Govt borrows by issuing bonds to public.
- These govt bonds compete with bonds of private companies. Hence, Private bonds get less subscription because of govt bonds.
- This leads to less money available to private sector for investment

Counterview

- In case of Budgetary deficit, Govt borrows money and use this money to make investment in infrastructure.
- This leads to increase in production and more income in economy. Hence, more money is available to private sectors also for Investment.

How Budgetary Deficit does not cause inflation?



Deficit Reduction: How to Reduce Budgetary Deficit?

We know that Deficit = Expenditure - Receipts

Hence, Deficit can be Reduced by either Reducing Expenditure or Increasing Receipts.

How to Reduce Budgetary Deficit ?

Suppose Govt Deficit is 200 as shown below

Govt Expenditure	1000
Less	
Govt Receipts	800
Deficit	200

How to Reduce this Deficit?

Option 1
Reduce Govt Expenditure

Option 2
Increase Govt Receipts

Option 1 How to Reduce Govt Expenditure

Make Govt Scheme More Efficient

Example
Cash Transfer Reduces Corruption

This is a Good idea

Reduce Govt Programs

Example
Reduce Expenses on Education, Wealth

This is not advisable as it has adverse effect on growth

Option 2 Increase Govt Receipts

Increase Taxes

Note
Direct Tax affects paid by Rich
Indirect tx like GST paid by all

Better to increase Direct Tax like Income tax

Make Disinvestment

Example
Sale of Loss Making PSU (Disinvestment)

Good idea as it prevents govt loss

Deficit Reduction by Reducing Expenditure

Making Govt schemes more efficient

- Govt gives number of subsidies like food subsidy (free ration to poor people)
- In this case, there is lot of corruption and very less subsidy actually reach the common man
- So in this case, govt can launch bank transfer directly to poor person's account instead of giving subsidy
- This will save money of govt and help in meeting revenue deficit

Reducing Govt Programs in Vital Areas

- Govt spending in vital areas like health, education, agriculture is very important
- Cutting back expenses in these areas will have adverse effect on economy in long run

Deficit Reduction by Increasing Receipts

Govt can Increase Taxes to Meet Deficit

- There are 2 types of taxes-Direct and Indirect
- It is better to increase direct taxes (like income tax) because it is progressive in nature (more tax on rich, less or no tax on poor)
- If indirect taxes like GST are increased, they are regressive in nature (affect both rich and poor equally)

Govt can Make Disinvestment

- Govt can sell its shares in public sector undertaking to receive money which can be used to meet Budgetary deficit

CHAPTER 23

This Chapter will demystify the following Concepts:

- ✓ **Open Economy & Closed Economy**
- ✓ **Linkages in Open Economy**
- ✓ **Balance of Payment**
- ✓ **Types of Accounts in BOP**
- ✓ **Transfer Payments**
- ✓ **Trade Deficit & Surplus**
- ✓ **Types of Investment**
- ✓ **Official Reserve Transaction**
- ✓ **Autonomous Transaction**
- ✓ **Accommodating Transaction**
- ✓ **Foreign Exchange**
- ✓ **Methods of determining Exchange Rate**
- ✓ **Appreciation & Depreciation of Domestic Currency**
- ✓ **Purchasing Power Parity Theory**
- ✓ **Devaluation of Currency**
- ✓ **Fixed versus Flexible Exchange Rate**
- ✓ **Managed Float**

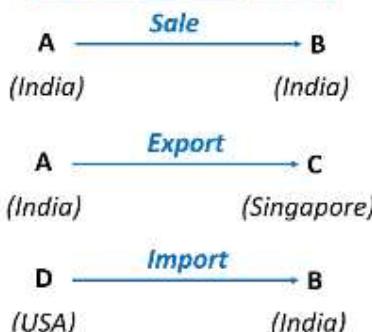


Difference Between Open Economy and Closed Economy

Closed Economy

It is an economy which has no interactions with outside world.
There are no economic relations or dealing with outside world.
There are no imports and exports. All trades are internal (within)

What is an Open Economy?



What is an Open Economy

It is an economy where

- *There are transactions both within and outside country.*
- *There are import and export*

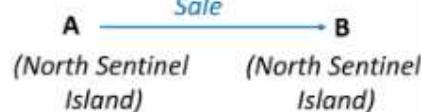
Open Economy

- It is an economy which has interactions with outside world.
- There are economic relations with different countries.
- There are exports and imports as well as internal trade.



North Sentinel Island

*It is world's remotest tribe
There is no interaction with
Outside World
All transactions within the tribe.*



What is a Closed Economy

It is an economy where

- All transactions within the country
- No interaction with Outside world

Closed Economy	Open Economy
No interaction with outside world	There are interactions with outside world
No Economic relation outside country	There are economic relations with different countries
Only Internal Trade is done	There are exports and imports as well as internal trade
It is an unrealistic concept (not normally found).	It is mostly found now a days and almost all countries in world are open economies (some more open and some less).

Closed Economy & Open Economy

Closed Economy	Open Economy
No Interaction or Economic Relation with Outside world	There is interaction & Economic Relation with Outside world
There is only Internal Trade	There is Internal Trade+ Export Import
It is unrealistic Concept	It is Mostly found
No country is completely closed economy	All countries are Open Economies <i>Some more Open Example-USA Some less open Example-North Korea</i>
There is no Linkage	<i>There are 3 types of linkage: Product Market Financial Market Labor Market Linkage</i>

Linkages in Open Economy

In Open Economy, there are 3 types of linkages with outside world.

Product Market Linkage

- Consumer and Firms can choose whether to buy goods and service from domestic goods and foreign goods
- They can buy local products or imported products

Financial Market Linkage

- Investors can choose whether to invest in domestic assets or foreign assets
- They can purchase shares of Indian companies or foreign companies

Labour Market Linkage

- Labour can choose where to work, whether in India or outside India
- Firm can also choose where to set up their factories, within India or outside India

Is India Open Economy or Closed Economy?

- India is an Open Economy as we have trade with other countries.
- India's import and export form significant proportion of GDP
- However, we are less open as compared to other countries who have higher proportion of trade.

Also in India, all 3 types of linkages are available

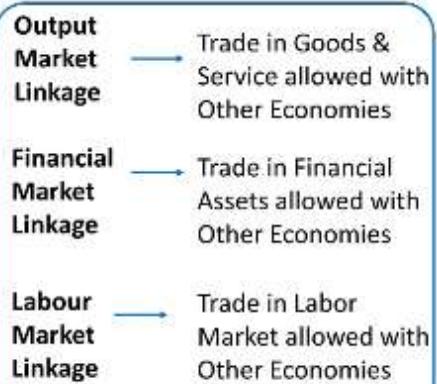
- We can choose between Indian products or imported products (Product Market Linkage)
- We can invest in Indian stock market or Foreign stock market (Financial Market Linkage)
- We can choose to work in India or Outside India (Labour Market Linkage)

Characteristics /Properties Of Open Economy

What is Open Economy?

It is an economy which trades with other economies in goods, services and financial assets

It has 3 types of linkages



Why is India an Open Economy



We can choose to invest in Indian Companies or Foreign Companies
(Financial Market Linkage)

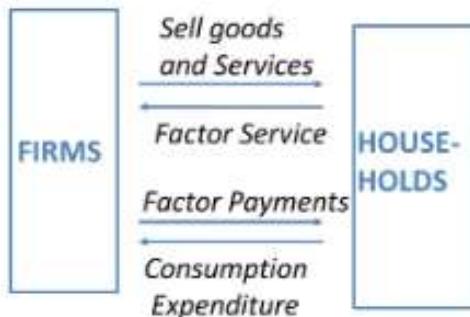


We can choose to buy Indian product or foreign product
(Product Market Linkage)



We can choose to work in India or Outside India (Labour Market Linkage)

Domestic Trade & Circular flow of Income Circular flow of Income



Note:-

Incase of domestic trade
Money Remains within country
As both Firm and household are
from within country

How does Foreign Trade Affect Circular Flow of Income?

Import



Here, Money is flowing out of India
Hence we can say,
Import leads to Leakage from
Circular flow of Income

Export



Here, money is flowing into
India due to exports
Hence we can say,
Export leads to Injection into
Circular flow of Income

What is Balance of Payment?

- It is an economic record of transactions in Goods, Services and Asset between Residents of Country and Rest of World in an Accounting year.
- Amount Received from foreign countries are credited (shown as positive figure)
- Amount paid to Foreign Countries are Debited (shown in negative)

Receipts (Inflow)

it covers Money Received from Different foreign Trade transactions

Example

Export of Goods
Export of Service
Investment Rec
Loan Taken

They are Credited In BOP

Payments (Outflow)

it covers Money Paid for different foreign Trade transactions

Example

Import of Goods
Import of Service
Investment Made
Loan Given

They are Debited in BOP

Different Transactions in Balance of Payment -Example

Transaction in Goods	Inflows/Outflows	Debited/Credited
Import of Goods	Outflows	Debited
Export of Goods	Inflows	Credited

Transaction in Services	Inflows/Outflows	Debited/Credited
Import of Service	Outflows	Debited
Export of Services	Inflows	Credited

Transaction in Assets	Inflows/Outflows	Debited/Credited
Investment Made Outside India	Outflows	Debited
Loan taken from Outside India	Inflows	Credited

Types of Accounts in Balance of Payment	
Current Account	Capital Account
It records trade of goods, services and transfer payments	It records International transaction of assets or liabilities
Example Export Import of Goods/Services	Example Loan taken from outside Country
Gift/Donation Received paid Outside Country	Loan given Outside country
Salary Received/Paid outside country	Investment Made in Foreign Assets

Note-This is called BOP Classification

TRADE IN GOODS

(Export, Import of Goods)

We know that Export means Selling Goods outside country &

Import Means Purchasing goods from Outside country.

Trade Balance = Export of Goods - Import of Goods

Example:

Suppose country exported goods of 500 crores

It Imported goods for 300 Crores

In this case, Trade balance = Export - Import = 500-300 = 200 Cr

Types of Account in Balance of Payment

It has 2 type of account - Capital Account and Current Account.

What is Current Account?

Current Account is sum total of the following:

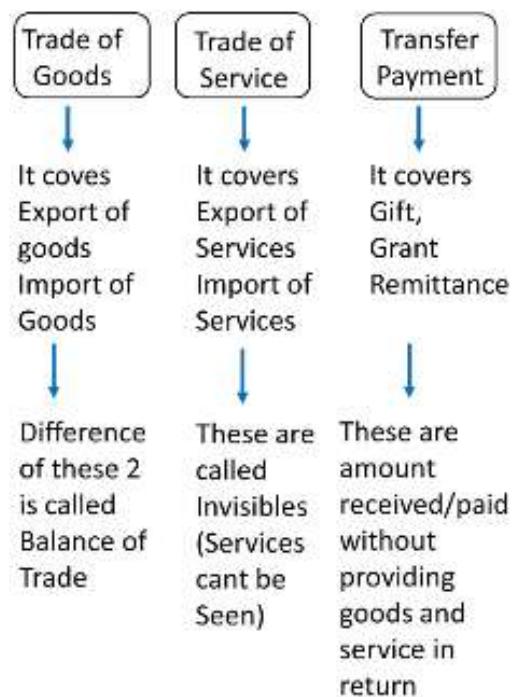
- Export Import of Goods: *This is called*

Trade Balance

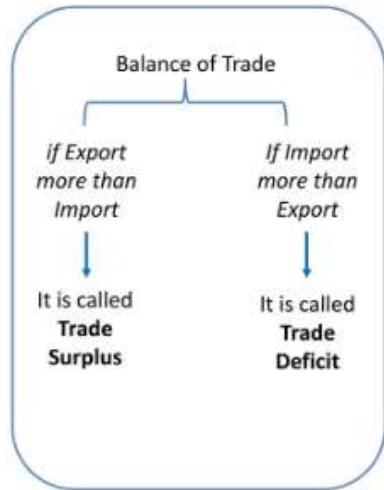
- Export/Import of Services: *These 2 are called Invisibles*
- Transfer payments (Unilateral Transfers)

Current Account in Balance of Payment

It records trade of goods, services and transfer payments



Difference between Trade Surplus and Trade Deficit



What is Trade Surplus

If Balance of Trade is Positive, it is called Trade Surplus

Export of Goods	1000
Export of Service	800
Total	1800

Import of Goods	600
Import of Service	200
Total	800

Calculation of Balance of Trade

Total Exports of goods	1000
Total Import of Goods	600
Balance of Trade	400
Trade Surplus	400

What is Trade Deficit

If Balance of Trade is Negative, it is called Trade Deficit

Export of Goods	1000
Export of Service	800
Total	1800

Import of Goods	1100
Import of Service	200
Total	1300

Calculation of Balance of Trade

Total Exports of goods	1000
Total Import of Goods	1100
Balance of Trade	-100
Trade Deficit	100

TRADE IN SERVICES

Export, Import of Services

Like Goods, Services may also be exported/ imported.

Example: Software Companies in India provide technical service to USA

Similarly, we can take Service from Outside country also.

Example: A company in India takes consultancy from an architect based in France

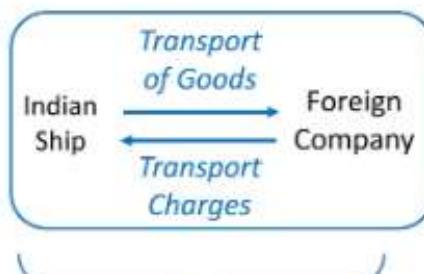
Note - Unlike goods, Services cannot be seen. Hence, they are called Invisibles or Invisible Trade.

Net Factor Income

- These are Income earned by Factors of Production like compensation to employees, dividend to shareholder, interest on loan and profit to entrepreneurs (Factors of Production)
- We take Net income = Income Earned less Income Paid

Example 2

An Indian Ship Transport Goods of Foreign Company & earns Transport charges

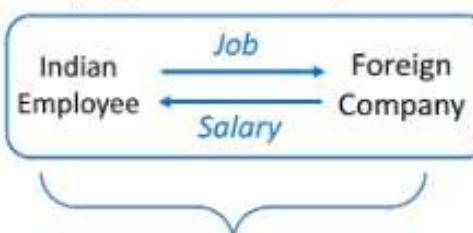


*This is Non Factor Income
(Income other than land, labour, capital, entrepreneurship)*

Different Example of Export of Services

Example 1

An Indian employee works in Foreign Company and earns Salary



*This is Factor income
(Income from Factor of Production called Labour)*

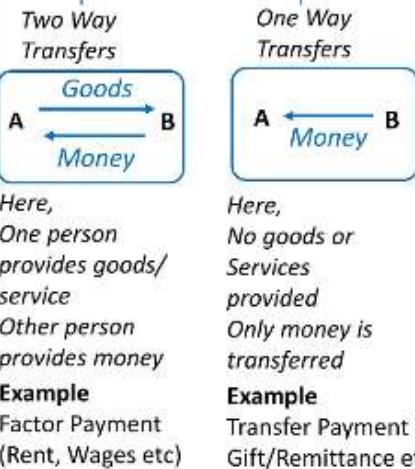
Difference between Visible and Invisible Trade



Different types of Trade in Services

Factor Income	Non Factor income
This income is earned by Factor of Production	This income is earned other than by Factor of Production
Example It is normally of 4 types	Example It is normally of 3 types
Land → Rent income	Shipping → Transportation charges
Labor → Wages	Banking → Bank charges
Capital → Interest	Insurance → Insurance Premium
Entrepreneurship → Profit share	

Types of Transfer



Transfer payments (Unilateral Transfers)

It includes **amount received** by residents **for free** (without making any present or future payment in return). They are also called One-way Transfers.

Example: Gift/Grant and remittances Received from Outside country.

What is Trade Surplus and Deficit?

- If exports of country are more than Import, it is called Trade Surplus.
- If Imports of a country are more than Export, it is called Trade Deficit
- Here, we consider only goods not services

What is Current Account Surplus/Deficit?

In a current account, there are 3 types of income

1. Net Export of Goods (Export-Import of Goods)
2. Net Export of Services (Export - Import of Services)
3. Unilateral Transfers

If total of all 3 is positive, it is a Current account surplus

If total of all 3 is negative, it is a Current account deficit

Example 1

A gift given by Indian citizen to his Canadian Friend



Example 2

USA Govt gave aid for Covid Relief to India.



Note

It is also called Unilateral Transfers

Difference between Trade Surplus & Current Account Surplus

Receipt	
Export of Goods	1000
Export of Service	800
Remittance Received	500
Total	2300
Payments	
Import of Goods	600
Import of Service	200
Gift Given	700
Total	1500

Trade Surplus (Balance of Trade)
 $=\text{Export of Goods} - \text{Import of Goods}$
 $=1000 - 600 = 400$

Current Account Surplus
 $=\text{Trade in Goods} \quad 1000 - 600 = 400$
 $+\text{Trade in Service} \quad 800 - 200 = 600$
 $+\text{Unilateral Transfers} \quad 500 - 700 = -200$
Total **800**

Difference between Trade Deficit & Current Account Deficit

Receipt	
Export of Goods	1000
Export of Service	800
Remittance Received	500
Total	2300
Payments	
Import of Goods	1600
Import of Service	1200
Gift Given	700
Total	3500

Trade Deficit
 $=\text{Import of Goods} - \text{Export of Goods}$
 $=1600 - 1000 = 600$

Current Account Deficit
 $=\text{Trade in Goods} \quad 1000 - 1600 = -600$
 $+\text{Trade in Service} \quad 800 - 1200 = -400$
 $+\text{Unilateral Transfers} \quad 500 - 700 = -200$
Total Deficit **1200**

Can a country have trade deficit and current account surplus?

Yes.

A country may have Import of goods more than exports, hence trade deficit

However, if may have positive invisibles (Net Export of services and Transfer Income) to have current account surplus

Example:

Net Export of Goods (Export - Import of goods) **-5000 (Trade Deficit)**

Net Export of Services (Export - Import of Services) **6000**

Unilateral Transfers **1000**

Current Account Surplus **2000**

Can we have Trade Deficit & Current Account Surplus?

Receipt	
Export of Goods	1000
Export of Service	900
Remittance Received	300
Total	2200
Payments	
Import of Goods	1600
Import of Service	200
Gift Given	100
Total	1900

Trade Deficit

$$= \text{Import of Goods} - \text{Export of Goods} \\ = 1600 - 1000 = 600$$

Current Account Surplus

$$= \text{Trade in Goods} \quad 1000 - 1600 = -600 \\ + \text{Trade in Service} \quad 900 - 200 = 700 \\ + \text{Unilateral Transfers} \quad 300 - 100 = 200 \\ \text{Total} \quad 300$$

What are Invisibles?

Trade in Services
and
Transfer Payments
are called Invisibles

For Calculation of
Current Account Surplus/Deficit
We consider 3 things

1. Total Exports of goods
2. Total Import of Goods
3. Trade Deficit

These 2
are
called
invisibles
as we
cant
physically
see them

Capital Account

It includes capital flows from rest of world minus Capital flows to rest of world

These include Transactions between Residents and Rest of World which causes change in asset/liability status of government or Residents

Example of Capital Account Transactions:

Borrowings are of following 2 types

1. External Assistance

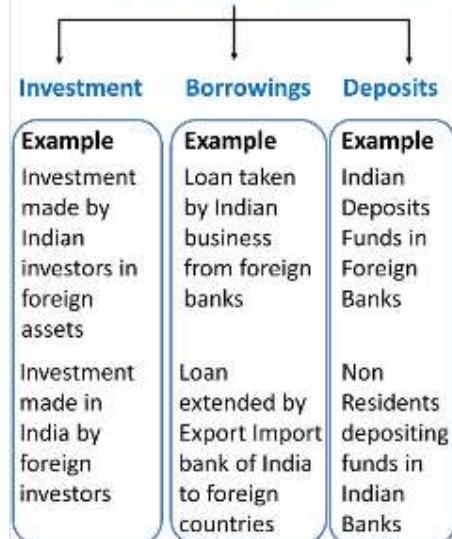
It includes loan taken from foreign governments

2. External Commercial Borrowings

It includes Borrowings from Foreign Banks or other institutions

These borrowings may be of govt or of private sector

Different Types of Capital Account Transactions



External Commercial Borrowings Calculation

Loan by EXIM Bank	
India to Foreign Companies	5000
Loan to Indian Companies by Foreign Banks	6000
Answer	
Loan Received	6000
less	
Loan Given	5000
External Commercial Borrowing	1000

Note-

We calculate Net ECM
 Loan Received
 less
 Loan Given

Difference between External Assistance and External Commercial Borrowings

External Assistance	External Commercial Borrowings
It includes loan taken from foreign governments	It includes Borrowings from Foreign Banks or other institutions
Note This loan is not for Commercial purpose (Taken by Govt)	Note This loan is for Commercial purpose (Taken by Govt or Private Sector)

What are External Commercial Borrowing

EXTERNAL COMMERCIAL BORROWINGS

↓
 Foreign country ↓
 Business purpose ↓
 Loan

It refers to commercial loans taken by Residents from Non Residents

Important Points

- This loan is for business purpose (and not foreign aid)
- This loan is normally taken by industries and companies
- These loans may be short term or long term

What is External Assistance



Important Points

- This loan is not for commercial purpose
- It is for helping different countries at time of financial crises or in case of calamity
- It is given by one govt to another (not business)

We calculate Net External Assistance
 Aid /Assistance Received
 less
 Aid/Assistance Given

How to Calculate External Assistance

Loan given by Indian Govt to Afghanistan Govt for Infrastructure Development 7000

Loan received by Indian Govt from USA Govt for Covid Relief 8000

Answer

Aid /Assistance Received	8000
less	
Aid/Assistance Given	7000

External Assistance (net) 1000

Note-

We calculate Net EA
 Aid Received
 less
 Aid Given

Investment is of following types:

Foreign Direct Investment

Investment Made by person in foreign country like (Setting up of business/factory in foreign country)

Foreign Portfolio Investment

Investing in shares of Foreign Countries or purchase of bonds of foreign country.

It may also include Investment in Real estate or other assets of foreign country.

Different Types of Investments (FDI and FII)

Foreign Direct Investment (FDI)	Portfolio Investment (FII)
It means Setting up a New business in Foreign Country (Establishing Factory, Shop, Office)	It means Purchasing Shares of Foreign Companies Investing in Assets (Deposits, Land) etc of Foreign Countries
It is less liquid (Amount invested cannot be withdrawn easily)	It is more liquid (Amount invested can be withdrawn easily)
It is more beneficial to the country where investment made as it generates employment	It is less beneficial to the country where investment made as no new employment generated

What is Net Capital Flow?

It means capital flows from rest of world minus Capital flows to rest of world.

If net capital balance is positive, it means there is capital surplus

If net capital balance is negative, it means there is capital deficit

How to Calculate Net investments

It is difference between Investment Received and Investment Made

Example	Amount
• Purchase of Shares in US Companies Shares by Indian Investors	1000
• Purchase of land in USA by Indian Citizen	1500
• Adani India purchased coal mines in Australia	200
• Investment in Indian Stock Market by Dubai Investors	3000
• Amt invested in Bullet Train Project by Japan	4000

Particular	Amount
Investment Made	7000
Less	(3000+4000)
Investment Received	2700
	(1000+1500+200)
Net Investment	4300

Difference between Balance of Payment Surplus, Deficit & Equilibrium

BOP Surplus	BOP Deficit	BOP Equilibrium
Sum total of Capital & Current Account is Positive	Sum total of Capital & current Account is Negative	Sum total of Capital & current Account is 0
it leads to Increase in Forex Reserves	it leads to decrease in Forex Reserves	There is no change in Forex Reserves

Got has extra money of 400 it ask RBI to buy Foreign Exchange (Dollars) or Gold upto amount of Surplus

This is called *Official Reserve Transactions*

What does Central bank do in Case of Balance of Payment Deficit?

Current Account Surplus	1000
Capital Account (Deficit)	-1100
Balance of Account Surplus	-100

Got has shortage of 100 it ask RBI To sell Foreign Exchange (Dollars) or take loan from IMF, World bank

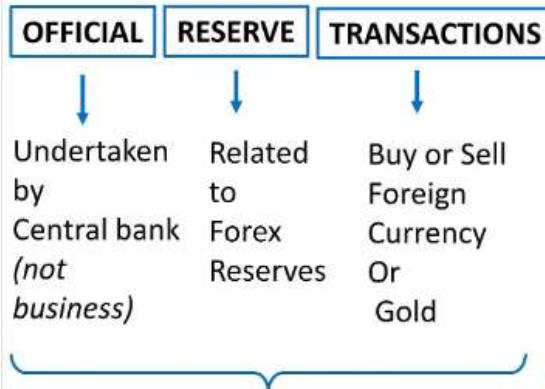
This is also *Official Reserve Transactions*

WHAT ARE OFFICIAL RESERVE TRANSACTIONS?

They are transactions undertaken by Monetary Authority (Central Bank or RBI) to manage Official Reserves of Foreign Exchange in case of Balance of Payment Surplus or Deficit.

The reserves are drawn by selling foreign currencies in the exchange market during deficit, foreign currencies are purchased during surplus.

What are Official Reserve Transactions?



Autonomous Transactions and Accommodating Transactions

Foreign transactions can be categorized as Autonomous or Accommodating transactions

Autonomous Transactions

- They are transactions which are undertaken for profit motive
- These are normally undertaken by Private sectors
- These are undertaken irrespective of status of BOP

Example:

If a businessman wants to purchase goods and imported goods are cheaper as compared to Indian goods, he will go ahead and purchase imported goods.

He will not consider the fact that it will lead to increase in import and negative BOP

These transactions can take place in both Capital and Current Account.

Official Reserve Transactions

Balance of Payment Surplus	Balance of Payment Deficit
Central bank either	Central bank either
Buys Foreign Exchange or	Sells Foreign Exchange or
Buy Gold	Takes loan from IMF, World bank

Note

The Above Transactions are called **Accommodating Transactions**
It is because
 these transactions are undertaken to Accommodate or manage Balance of Payment Surplus or Deficit and not for Profit Motive

Autonomous Transactions

Suppose India is Facing Balance of Payment Deficit

Current Account Surplus	1000
Capital Account (Deficit)	-1100
Balance of Payment Surplus	-100

A businessman wants to take loan of 300 crores

He has 2 options

Take loan from Indian Bank @ 11%

or

Take loan from USA Bank @ 3%

OPTION 1-Loan of 300 taken from Indian Bank @ 11%

	Before taking loan	After taking loan
Current Account Surplus	1000	1000
Capital Account (Deficit)	-1100	-1100
Balance of Payment Surplus	-100	-100

This loan has no effect on Balance of Payment as loan is from India

OPTION 2- Loan of 300 taken from Foreign Bank @ 3%

	Before taking loan	After taking loan
Current Account Surplus	1000	1000
Capital Account (Deficit)	-1100	-1400
Balance of Account Surplus	-100	-400

This loan Increases Balance of Payment Deficit (Not beneficial for India)

Which Option will the businessman choose ?

Businessman will choose option 2 and take loan from foreign bank as it is providing loan at less interest. But this loan will increase deficit in BOP.

Accommodating Transactions

They are transactions which are not undertaken for profit motive. These are normally undertaken by Government sectors. These are normally undertaken if BOP is in negative.

AUTONOMOUS TRANSACTION

They are international transactions which are undertaken for profit motive

They are undertaken by Private Sector

They are undertaken irrespective of effect on Balance of Payment

ACCOMODATING TRANSACTIONS

They are international transactions which are undertaken to cover BOP Surplus/Deficit

They are undertaken by Monetary Authority (Central Bank, RBI)

They are undertaken after seeing status of Balance of Payment Surplus/deficit

Example:

There is current account deficit of -300 and capital account surplus of 200

In this case, Bill of payment = $-300 + 200 = -100$

So govt will engage in official reserve transactions (sell its foreign exchange transactions) This will lead to decline in forex reserve. They take place only in Capital Account.

Accommodating Transactions

Suppose India is Facing Balance of Payment Deficit

Current Account Surplus 1000

Capital Account (Deficit) -1100

Balance of Account Surplus -100

What will RBI do in this case?

OPTION 1

RBI will Sell Foreign Currency of 100 to meet deficit

Option 2

RBI will borrow 100 from IMF/World Bank etc.

Note

Above transactions are not undertaken for Profit Motive.

They are undertaken to accommodate or manage Balance of Payment Deficit .So it is called **Accommodating Transactions**

What is Currency?

It is medium of exchange of goods and services.

Example- Dollar, Rupee etc.

What is Foreign and Domestic Currency?

- Currency which is used in own country is called Domestic Currency
- All currencies other than domestic currency is called Foreign Currency
- Hence, in India INR (Indian National Rupees) is Domestic Currency and Pound, Dollar etc. are Foreign Currency

In what currency Foreign Trade happens?

- Foreign currency generally happens in international accepted currencies like Dollars or Euros.
- Domestic Currencies like INR are usually not accepted for foreign trade.

Hence Domestic Currency needs to be converted for doing foreign Trade.

What is Foreign Exchange Rate?

It is the price of one currency in terms of another.

What is Foreign Exchange Market?

It is the market in which national currencies are traded with one another. It has 3 major Participants:

1. Commercial Banks
2. Foreign Exchange Brokers and Authorized Dealer
3. Monetary Authority (RBI in India)

What is Foreign Exchange Rate?

It is the price of one currency in terms of another

Example 1

Exchange Rate of Dollar is
Rs 75 per Dollar

It means
1 Dollar = Rs 75

In other words, we can also say that
Rs 75 = 1 Dollar

Rs 1 = 1/75 Dollar

Rs 1 = 0.013 Dollar

Example 2

Exchange Rate of Pound is
Rs 100 per pound

It means
1 Pound = Rs 100

In other words, we can also say that
Rs 100 = 1 Pound

Rs 1 = 1/100 Pound

Rs 1 = 0.01 Pound

What is Foreign Exchange Market?

Foreign Exchange Market

Different Currencies
Place For Trading

It is the market in which national currencies are traded with one another

It has 3 major Participants:

Commercial Banks	Only these two deal With Public
Foreign Exchange Brokers (Money Changers)	
Monetary Authority (RBI)	They do not deal with Public directly

Do All Countries have Same Currency?

No

Each Country has different Currency

Example



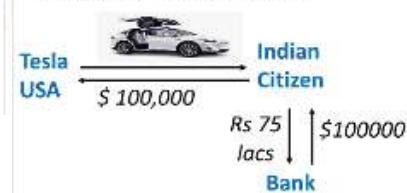
Indian Rupee

This currency is accepted in India

Example of Foreign Exchange Conversion

Suppose an Indian Citizen wants to purchase Electric Car from Tesla USA. Car Cost is \$100,000

How will payment be made?



Tesla will ask money in Dollar
Indian Citizen will convert its Rupees into Dollars through bank/
moneychanger at Exchange Rate
Suppose 1 \$ =Rs 75
 $\$100000 = 75 * 100000 = 75 \text{ lacs}$

Suppose a Person wants to exchange his Rupees with Dollar, he will approach his Bank/Money Exchange Agent. Similarly, RBI also holds foreign currency and purchases and sells it regularly

What is the Purpose of Foreign Exchange?



It facilitates **International Trade** by linking currencies
(We need to convert our currency to import or export or travel)



It enables **Comparison of International Cost and price**
(Suppose a Car cost 100,000 Dollar in USA, It will cost Rs75,00,000 in India)

What is purpose of Foreign Exchange Rate/Market?

It links currencies of different countries.

(What is the cost of one currency in terms of other?)

It enables comparison of international cost and price

(Suppose we purchase a Burger for 5 Dollar in USA, It costs $70 \times 5 = 350$ in India)

What causes Demand of Foreign Exchange?

Foreign Exchange is required for

1. Import of Goods and Service
2. Sending Gifts/Unilateral Transfers Abroad
3. Investment Abroad (Purchase of Assets abroad)
4. Tourism (People visiting abroad have to purchase foreign currency)
5. Speculation (People buy foreign currency if they expect its price to go up)

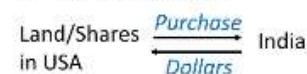
What Causes Demand for Foreign Exchange?

(Why do we need Foreign Currency like Dollars)

For Importing Goods



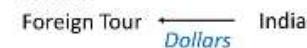
For Purchasing Assets



For Sending Gifts (Unilateral Transfers)



Tourism



Relation between Foreign Exchange Rate and Foreign Exchange Demand

Demand for Foreign Exchange is inversely proportional to Rate of Foreign Exchange

If Rate of Foreign Exchange Rises, It leads to Decrease in Demand of Foreign Exchange.

Foreign Exchange Demand For Speculation

Suppose Dollar Rate is 75/\$

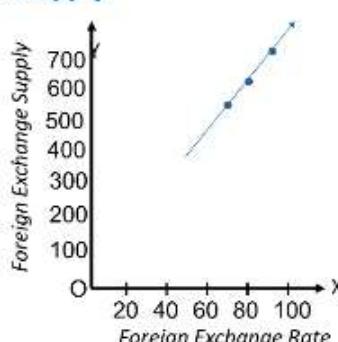
A speculator expects it to become 80/\$ in future

So we will buy foreign exchange today and sell in future
Buying today increases demand for Foreign exchange

Dollar Rate Current	75/\$	Speculator purchase \$1000 and sells them in future
Expected in future	80/\$	
		Sales Purchase Profit
		80000 75000 5000

This Purchase increase Demand for Foreign Exchange

Foreign Exchange Rate and Supply



On X Axis, we show Foreign Exchange Rate

On Y Axis, we show Foreign Exchange Supply

As the Rate increases, Supply also Increases
Hence, Supply Curve has Upward Slope

Relation between Foreign Exchange Rate & Demand



Imported Car Cost \$ 100,000

Year 2021

Suppose Exchange Rate is Rs70

What is Cost of Car in Rupees?

$$\begin{aligned} \text{Cost} &= 100,000 \times 70 \\ &= \text{Rs } 70,00,000 \end{aligned}$$

Price is less
More Cars sold
More Demand

When Exchange Rate increases
Demand of Foreign Exchange Decreases

Year 2022

Suppose Exchange Rate increases to Rs 80. What is Cost of Car in Rupees?

$$\begin{aligned} \text{Cost} &= 100,000 \times 80 \\ &= \text{Rs } 80,00,000 \end{aligned}$$

Price is more
Less Cars will be sold
Less Demand

If Rate of Foreign Exchange Decreases, It leads to Increase in Demand of Foreign Exchange.

What causes Supply of Foreign Exchange?

Foreign Exchange flows into home country because of:

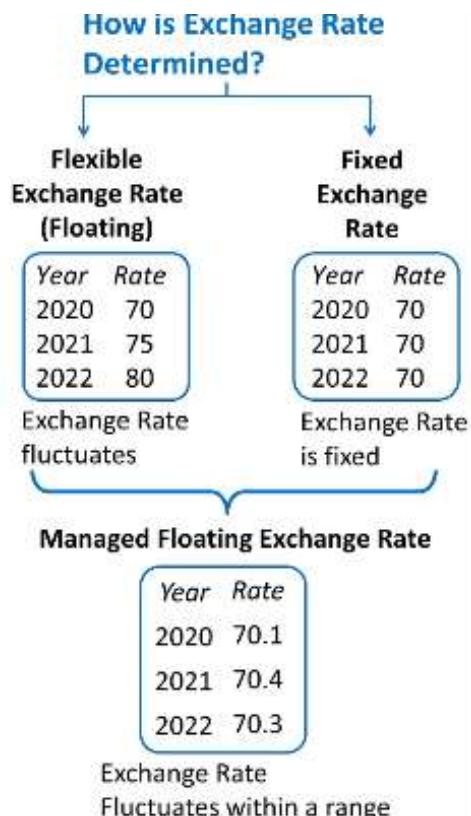
1. Export of Goods and Services
2. Receiving gifts/unilateral transfers from outside country
3. Investment Made in India by Foreigners
4. Tourism in Domestic Country (People visiting India have to sell their foreign currency)
5. Speculation (People sell foreign currency if they expect its value to go down)

Relation between Foreign Exchange Rate and Foreign Exchange Supply:

Supply for Foreign Exchange is directly proportional to Rate of Foreign Exchange

If Rate of Foreign Exchange Rises, It leads to Increase in Supply of Foreign Exchange

If Rate of Foreign Exchange Decreases, It leads to Decrease in Supply of Foreign Exchange



Foreign Exchange Rate & Supply



Tour to India Cost Rs 140000

Year 2021

Suppose
Exchange Rate is
Rs70
What is Cost of
Tour in Dollars
Cost =
140000/70
=\$2000

Price is more
Less Tour sold
Less Demand of
Foreign Exchange

Year 2025

Suppose
Exchange Rate
increases to Rs
100. What is Cost
of Car in Rupees?
Cost =
140000/100
=\$1400

Price is less
More Tour sold
More Demand of
Foreign Exchange

When Exchange Rate increases
Supply of Foreign Exchange Increases

What are Different Methods of Determining Exchange Rate?

There are 3 methods to determine currency exchange rate:

1. Flexible or Floating Exchange Rate
2. Fixed Exchange Rate
3. Managed Floating Exchange Rate

Flexible or Floating Exchange Rate

It is a system where Exchange Rate is determined by Market Forces of Demand and Supply.

In this case, Central Bank does not intervene (interfere) in determining exchange rate.

How is Foreign Exchange Rate Determined?

It is Determined at a Point where Demand and Supply Curve Intersect each other

Schedule Representation of Flexible (Floating Exchange Rate)

Foreign Exchange Rate	Foreign Exchange Demand	Foreign Exchange Supply
70	900	500
71	800	600
72	700	700
73	600	800

This Decreases with Increase in Rate
This Increases with Increase in Rate

Here Demand=Supply
This is how Foreign Exchange Rate Determined

What is Flexible or Floating Exchange Rate

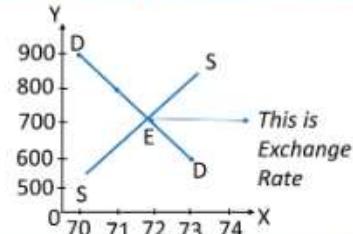
Year	Exchange Rate
2020	70
2021	75
2022	80

In this case, Exchange Rate is determined by forces of Demand and Supply

Demand of Foreign Exchange
More the Exchange Rate
Less the Foreign Exchange Demand (it is Inversely Proportional)

Supply of Foreign Exchange
More the Exchange Rate
More the Foreign Exchange Supply (it is Directly Proportional)

Graph Representation of Flexible (Floating Exchange Rate)



Graph

On X Axis, we show Foreign Exchange Rate

On Y Axis, we show Foreign Exchange Demand/ Supply
Demand Curve has Downward Slope
But Supply Curve has Upward Slope

At Point of Intersection of Supply Curve and Demand Curve Exchange Rate is Determined

Appreciation and Depreciation of Domestic Currency

What is Depreciation and Appreciation of Domestic Currency?

Depreciation of Domestic Currency
↓
Decrease In Price of Indian Rupees

Appreciation of Domestic Currency
↓
Increase In Price of Indian Rupees

Example

Exchange Rate of \$ increased from 70 to 75 per dollar

Earlier	Now
\$1 = Rs 70	1 \$ = Rs 75
Rs 1 = 1/70	Rs 1 = 1/75
= \$0.0142	= \$0.0133

Value of Indian Rupee decreased
So this is **Depreciation** of Domestic Currency (Rupees)

Depreciation and Appreciation of Domestic Currency ?

Depreciation

It means Increase in price of foreign currency or Decrease in price of domestic currency

Foreign Currency (\$) becomes expensive

Example
Dollar increased from 70 to 75

Appreciation

It means Decrease in price of foreign currency or Increase in price of domestic currency

Foreign Currency (\$) becomes cheaper

Example
Dollar decreased from 75 to 72

What causes Depreciation of Domestic Currency?

It means Increase in price of Foreign Currency as compared to Indian Currency

Example

Suppose Exchange Rate is Rs 70

After 1 year, it Increases to Rs 75

It means Value of Dollar has increased as compared to Indian Rupee

We can also say that, Value of Indian Rupees has depreciated (decreased) as compared to US Dollar

Both Depreciation and Appreciation possible under Flexible Rate only

Reason for Depreciation of Domestic Currency

It is caused by Increase in Demand of Foreign Exchange or Decrease in Supply of Foreign Exchange.

What is Depreciation of Domestic Currency

It means
Increase in price of foreign currency
or
Decrease in price of domestic currency

In this case
Foreign Currency (\$) becomes expensive

Example

Dollar increased from 70 to 75
It means Rupee depreciated
from 0.0142 to 0.0133

Causes

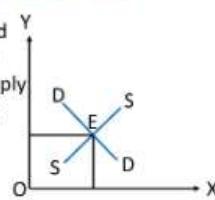
This is caused by
Increase in Demand
or
Decrease in Supply
of Foreign Exchange

Hence there
are
2 Cases
of Depreciation

Depreciation due to Increase in Demand Of Foreign Exchange

How is Exchange Rate Determined
under Flexible(Floating) Rate?

It is determined
at point where
Demand & Supply
curve intersect
It is at Point
E in this case



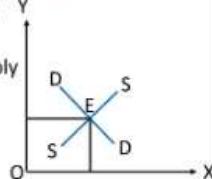
What if there is Increase in Demand of Foreign Currency?

In this case,
Demand curve
moves Rightwards
Now Demand &
Supply curve
meet at E1.
It is new
exchange rate

Depreciation due to Decrease in Supply of Foreign Exchange

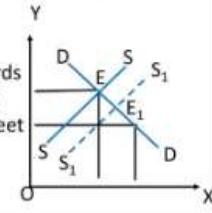
How is Exchange Rate Determined
under Flexible(Floating) Rate?

It is determined
at point where
Demand & Supply
curve intersect
It is at Point
E in this case



What if there is Decrease in Supply of Foreign Currency?

In this case,
Supply curve
moves Rightwards
Now Demand &
Supply curve meet
at E1
It is new
exchange rate



What causes Appreciation (increase) of Domestic Currency?

- It means decrease in price of Foreign Currency as compared to Indian Currency. It is caused by Increase in Supply of Foreign Exchange.
- Example- Suppose Exchange Rate is Rs 70. After 1 year, it Decreases to Rs 65. It means Value of Dollar has decreased as compared to Indian Rupee.
- We can also say that, Value of Indian Rupees has appreciated (increased) as compared to US Dollar

What is Appreciation of Domestic Currency?

It means
Decrease in price of foreign currency
or
increase in price of domestic currency

In this case
Foreign Currency (\$) becomes cheaper

Example

Dollar decreased from 70 to 60
It means Rupee appreciated
from 0.0142 to 0.0166

Causes

This is caused by
Decrease in Demand
or
Increase in Supply
of Foreign Exchange

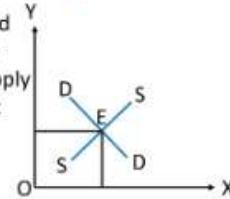
Hence there
are
2 Cases
of Appreciation

Case 1

Appreciation due to Decrease in Demand Of Foreign Exchange

How is Exchange Rate Determined
under Flexible(Floating) Rate?

It is determined
at point where
Demand & Supply
curve intersect
It is at Point
E in this case



What if there is Decrease in Demand of Foreign Currency?

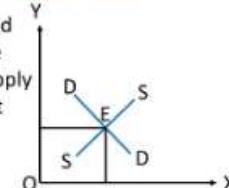
In this case,
Demand curve
moves Leftwards
Now Demand &
Supply curve
meet at E1.
It is new
exchange rate

Case 2

Appreciation due to Increase in Supply of Foreign Exchange

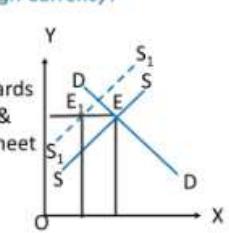
How is Exchange Rate Determined
under Flexible(Floating) Rate?

It is determined
at point where
Demand & Supply
curve intersect
It is at Point
E in this case



What if there is Increase in Supply of Foreign Currency?

In this case,
Supply curve
moves Rightwards
Now Demand &
Supply curve meet
at E1
It is new
exchange rate



What are the Factors Affecting Exchange Rate under Flexible Rate System?

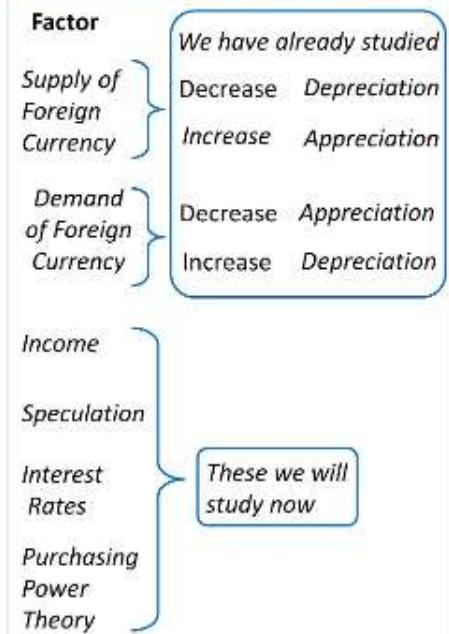
Following factors affect exchange rates

1. Demand of Foreign Exchange
2. Supply of Foreign Exchange
3. Income
4. Speculation
5. Interest Rates
6. Purchasing Power theory

What is Effect of income on Exchange Rates?

- When Income of Country Increases, People spend more and purchase more goods.
- Hence, they also purchase more imported goods.
- This leads to increase in Import. Due to this, demand for foreign currency exceeds. This leads to depreciation of domestic currency.

Factors affecting Exchange Rate under Flexible Rate System



Effect of Income on Exchange Rate



How does Speculation affect Exchange Rates?

People Speculate in Foreign Exchange to earn Profits

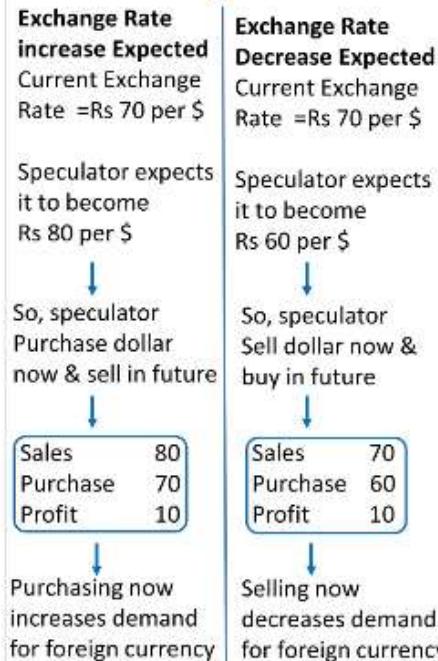
Example 1:

Suppose Exchange Rate of Dollar is currently Rs 70 per Dollar. Person feels that it will rise in future to Rs 80 per Dollar. So, they will Purchase Dollar today @ Rs 70 and sell it later at Rs 80. So, there is Increase in Demand of Foreign Currency

Example 2:

Suppose Exchange Rate of Dollar is currently Rs 70 per

Effect of Speculation on Exchange Rates



Dollar. Person feels that it will fall in future to Rs 60 per Dollar. So, they will Sell Dollar today @ Rs 70 and purchase it later at Rs 60. Selling now decreases demand of foreign exchange. So, there is decrease in demand of foreign currency.

What is the Effect of interest Rates on Exchange Rates?

Interest Rates are Different in each country. So, Investors move from countries having lower interest rate to countries having higher interest rates.

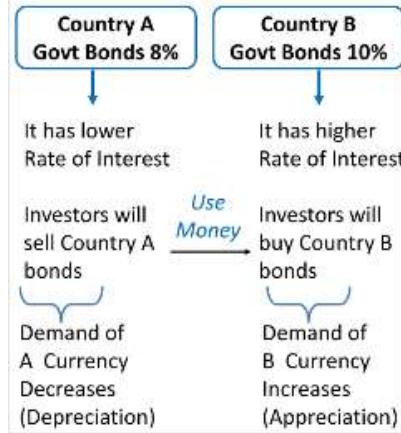
This leads to appreciation of currency of country having higher interest rates.

Example:

Suppose there are 2 Countries A and B. Both countries issue Govt Bonds. Interest Rate on Govt Bonds is 8% in A and 10% in B. Hence, there is Interest Rate Differential of 2%. B Country's Investors will prefer to invest in their own country rather than in Country A. Also, Investors in Country A will prefer to invest in Country B. So, they will purchase foreign currency of B Country. Hence, there will be more demand for B's currency and hence B Country currency will appreciate.

Effect of Interest on Exchange Rates

Suppose there are 2 Countries A and B
Country A issued Govt Bonds @ 8%
Investors of Country A buy this bonds.
Suppose Country B also issues Govt bonds but gives 10% interest
What will Investors do?



What is Purchasing Power Parity theory?

As per this theory, Exchange Rate adjust in long term in such a way that same products cost the same whether measured in domestic currency (Rupees) or whether measured in foreign currency (Dollars).

What is Purchasing Power Parity Theory?

PURCHASING POWER → Number of goods a unit of Money can buy
PARITY → Equal in Different countries
THEORY → Theoretical concept

As per this theory, Exchange Rate adjust in long term in such a way that same products cost the same whether measured in domestic currency (Rupees) or foreign currency (dollars)

Assumption

There are No Trade barriers
(people are free to Purchase goods from any country)

There are No Transportation Costs
(There is no cost of bringing goods from one country to another)

Suppose it costs Rs 400 to buy a shirt in India, and it costs \$8 to buy an identical shirt in US. To make an apples-to-apples comparison, we must first convert the INR into \$. If the exchange rate is 1\$ = 70 INR

Then Cost of Shirt in US is \$8, hence cost of same shirt in India will be $400/70 = \$5.7$
the PPP would, therefore, be $8/5.7$ i.e. 1.4

In other words, for every \$1 spent on the shirt in India, it takes \$1.4 to obtain the same shirt in US. Hence, there will be more demand for INR and less demand for Dollars.

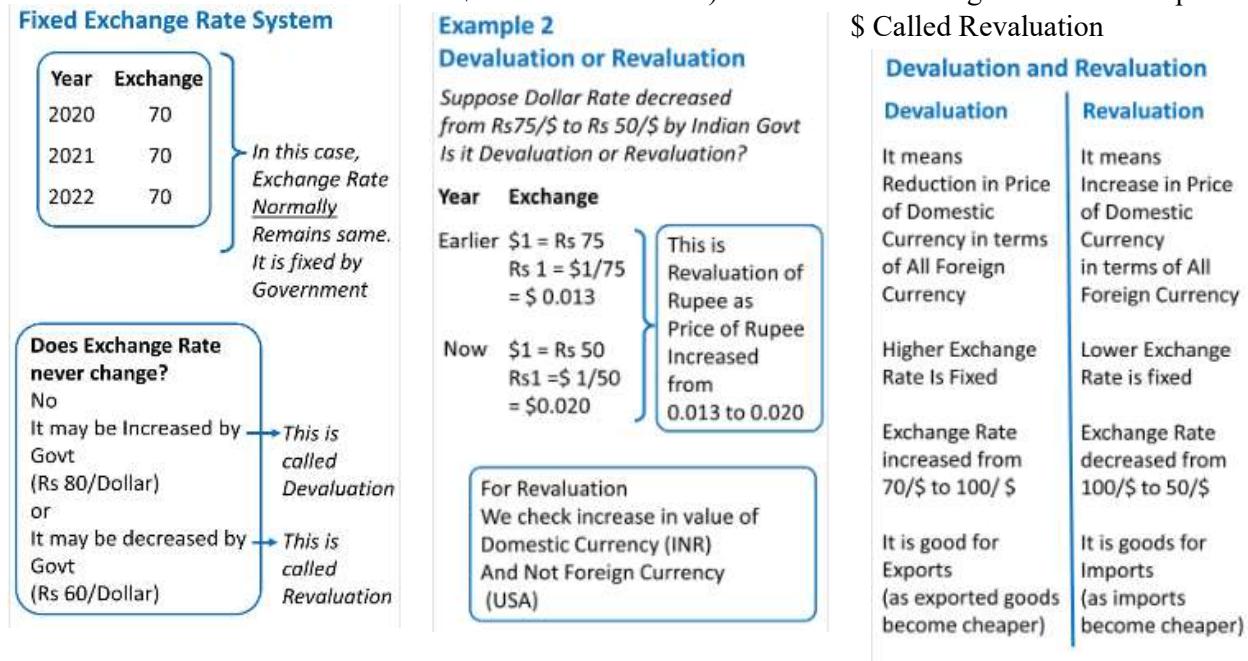
What is Purchasing Power Parity theory?

Suppose a Shirt cost Rs 400 in India and \$8 in USA
Cost of Dollar is Rs 70 per Dollar
Which shirt will sell more?



Fixed Exchange Rate System

- In this case, Exchange Rate of a currency is fixed by the Government. Exchange Rate does not fluctuate daily. Example- Suppose Govt fix exchange Rate at Rs 70 per \$, it will remain the same unless govt changes it.
- This is done to ensure stability in foreign trade. Govt may Increase the exchange Rate to 80/\$ (called Devaluation) or Decrease Exchange Rate to Rs 60 per \$ (called Revaluation)



When is Devaluation Done

- If Govt Wants to increase Exports, it will fix Higher Exchange Rate.
- Example - It will change Exchange Rate of Dollar from Rs 70 per \$ to Rs 80 per \$
- Hence, it will make domestic currency cheaper as compared to foreign currency and in turn domestic goods cheaper

- For doing this, Govt will Purchase Foreign Currency.

Devaluation and Revaluation Done by Govt (RBI)		Basis	Devaluation	Revaluation
How is Devaluation Done RBI Purchases Dollars from Market	How is Revaluation Done RBI Sells Dollars from Market	Meaning	It means Reduction in Price of Domestic Currency in terms of all foreign currency	It means Increase in Price of Domestic Currency in terms of all foreign currency
Increase in Demand of Dollars	Increase in Supply of Dollars		In this case, Higher Exchange Rate is fixed by Govt	In this case, Lower Exchange Rate is fixed by the govt
Dollar Exchange Rate Increases	Dollar Exchange Rate Decreases	Example	Exchange Rate increased from Rs 70 per \$ to Rs 80 per \$	Exchange Rate decreased from Rs 70 per \$ to Rs 60 per \$
Causes Devaluation Of Rupee	Causes Revaluation Of Rupee		Hence, Value of Rupee decreases as compared to dollar	Hence, Value of Rupee increases as compared to dollar
		Method	When the govt increases exchange rate	When the govt decreases exchange rate
			There is excess supply of foreign currency in market	There is excess demand of foreign currency in market
			So Govt buys foreign Exchange from the market	Govt Sells foreign Exchange in the Market

Summary

In fixed exchange Method, Govt keeps exchange rate fixed.

Exchange Rate does not fluctuate daily. This is done to ensure stability in foreign trade.

Govt may Increase Exchange Rate (Called Devaluation) or Govt may decrease Exchange Rate (Called Revaluation).

Difference between Fixed Exchange Rate and Flexible Exchange Rate

Fixed Exchange Rate	Flexible Exchange Rate
In this case, Exchange Rate is fixed by Government	In this case, Exchange Rate is determined by forces of demand and supply
Exchange Rate Remains fixed and does not fluctuate	Exchange Rate Fluctuates Daily
There may be Devaluation or Revaluation of Currency by the Govt	There may be Depreciation or Appreciation of Currency due to change in demand and supply of foreign currency
There is more stability of foreign trade	It is less stable as exchange rate keeps on changing
There is more role of Govt and Central Bank as it has to buy and sell foreign currency	There is less role of govt as exchange rate is automatically determined
This method is rarely used	This method is normally used by all developed countries

What is Managed Floating Exchange Rate System?

It is a mixture of Flexible or Floating Exchange Rate System and Fixed Exchange Rate System

In this system, Exchange Rate Fluctuates Daily on basis of changes in Demand and Supply

However, Exchange Rate Movements are moderated by Central Bank

Central Banks intervene if there is high fluctuation of foreign exchange by buying and selling foreign currency.

What is Nominal Exchange Rate?

The nominal exchange rate is the price of one unit of foreign currency in terms of domestic currency.

Example: Dollar Rate is 75/Dollar, It means one unit of foreign currency dollar is equal to 75 Rupees.

What is Real Exchange Rate?

It is relative price of foreign goods in terms of domestic goods

Real Exchange Rate =

Example

A Mc Donald's Burger cost Rs 100 in India. Same Burger cost \$2 in USA



Burger
Cost Rs 100



USA
McDonald's
Burger Cost \$2
(Exchange Rate
Rs 75 per \$)
Cost in Rupees
 $= 2 * 75 = 150$

It means a Burger costing 100 in India costs 150 in USA
So real Exchange Rate of USA is
 $150/100 = 1.5$

What is Nominal and Real exchange Rate?

Nominal Exchange Rate Rs 70 per \$

Real Exchange Rate 1.5

Normal Exchange Rate * Foreign Price/ Domestic Price

Definition Nominal and Real Exchange Rate?

Nominal Exchange Rate

It is Normal Exchange Rate
Price of one unit of Foreign Currency
in terms of domestic currency
Example -75/\$

Real Exchange Rate

It is relative price of foreign goods
in terms of domestic goods

Real Exchange Rate =

$$\text{Normal Exchange Rate} * \text{foreign Price/Domestic Price}$$
$$75 * 2/100$$
$$= 1.5$$

What is Purchasing Power Parity

If Real exchange rate is equal to 1
it is called Purchasing Power Parity

Example

A Mc Donald's Burger cost Rs 150 in India
Same Burger cost \$2 in USA
(Exchange Rate Rs 75 per \$)

India	USA
Burger Cost Rs 150	Burger Cost \$2 Cost in Rupees = 2 * 75 = 150

Real Exchange Rate =
Normal Exchange Rate * foreign
Price/Domestic Price
 $75 * 2/150 = 150/150 = 1$
This is called Purchasing Power Parity

Example 2 – Purchasing Power Parity

A Mc Donald's Burger cost Rs 100 in India

Same Burger cost \$2 in USA
(Exchange Rate Rs 50 per \$)

India



Burger
Cost Rs 100

USA



Burger Cost \$2
Cost in Rupees
= 2 * 50 = 100

Real Exchange Rate =
Normal Exchange Rate * foreign
Price/Domestic Price
 $50 * 2/100$
 $= 100/100$
 $= 1$

This is called Purchasing Power Parity

Rise in Price of Foreign Exchange is good or bad for economy

For Exports

It is good for economy. Export Increase because it is cheaper for foreigners to purchase our product. This will generate us income from abroad and increase our income

Example - Suppose a foreigner wants to Purchase goods for Rs 70,000

Exchange Rate is Rs70 per \$ So, Foreigner has to spend = $Rs 70,000/70 = \$1000$

Now, suppose Exchange rate of dollar becomes 80 Rupees.

Suppose a foreigner wants to Purchase goods for Rs 70,000. So, Foreigner has to spend = $70,000/80 = \$875$

Hence, it is cheaper for foreigner to purchase our products, hence exports will increase

For Imports

It is bad for economy. As Imported goods become costlier, It increases our expenses and decreases our income.

Example - Suppose we want to import goods worth \$1000

Exchange Rate is Rs 70 per \$

So, we have to pay $70 * 1000 = 70,000$ Rs

Suppose exchange rate increases to Rs 80 per \$

Now we have to pay $80 * 1000 = 80,000$

Since, we have to pay more expenses, it is bad for economy.



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