

B.COM  
Year – I  
Semester – II  
Paper - V

## Economic Analysis - II



**Centre for Distance and Online Education**

**श्रीचन्द्रशेखरेन्द्रसरस्वतीविश्वमहाविद्यालयः**

**Sri Chandrasekharendra Saraswathi Viswa Mahavidyalaya**

Deemed to be University u/s 3 of UGC Act 1956 - Accredited with 'A' grade by NAAC

**Enathur, Kanchipuram 631561.**

Sponsored and run by Sri Kanchi Kamakoti Peetam Charitable Trust

---

**Course Writers**

---

Dr. Sweta Srivastava  
Assistant Professor  
Department of Management Studies  
SCSVMV

Dr. C. Kathirvel Babu  
Assistant Professor  
CDOE  
SCSVMV

---

**Programme Coordinator**

---

Mr. S. Swaraj  
Assistant Professor,  
CDOE  
SCSVMV

---

**Chief Editors**

---

Dr. B. Balaji Srinivasan  
Director, CDOE  
SCSVMV

Dr. M. S. Ramaratnam  
Head of the Department,  
Department of Management Studies,  
SCSVMV

# **BC205 Economic Analysis – II**

## **Course Objective**

1. To understand the characteristics of underdeveloped and developing economies, including India's mixed economy.
2. To analyze demographic trends, poverty, unemployment, and their impact on economic development.
3. To study inflation, deflation, national income, and measures of economic growth.
4. To examine monetary and fiscal policy, financial inclusion, and their role in the economy.
5. To understand economic reforms, liberalization, globalization, and initiatives like Atmanirbhar Bharat

## **Unit I**

Features of Underdeveloped Economy – India as a Developing – Concept of Mixed Economy – Human Development Index – Gini Index – Sectoral Classification of Indian Economy: Agriculture, Industry and Services – Trends in Sectoral Contribution to GDP – Role of Agriculture and MSMEs in Economic Development.

## **Unit II**

Growing Population – Demographic Trends in India – Theory of Demographic Transition – Absolute and Relative Poverty – Measurement of Below Poverty Line – Causes of Poverty – Poverty Alleviation Programmes – Types of Unemployment – Causes of Unemployment – Demographic Dividend – Concept and Policy Imperatives – Gig Economy and Platform Work.

## **Unit III**

Inflation and Deflation – Types of Inflation – Measurement of Inflation – Causes of Inflation in India – Concept of National Income – Measurement of National Income – Trends in Inflation in India – Limitations of National Income Accounting – Per Capita Income and Economic Growth.

## **Unit IV**

Monetary Policy and Fiscal Policy – Meaning and objectives -Role of RBI- Instruments: Repo Rate, Reverse Repo Rate, CRR, SLR, Open Market Operations - Monetary Policy Transmission Mechanism - **Fiscal Policy** - Meaning and objectives -Union Budget: Revenue & Capital Receipts and Expenditure - Deficits: Revenue Deficit, Fiscal Deficit, Primary Deficit

## **Unit V**

Economic Reforms – Liberalisation – Privatisation – Disinvestment – Globalisation – Impact of Economic Reforms on Indian Economy – FDI and FII: Meaning and Role – Challenges of Globalisation for India – Atmanirbhar Bharat Initiative.

## **Course Outcomes**

1. Students will be able to explain the features of developing economies and India's sectoral contributions to GDP.
2. Students will be able to analyze population trends, poverty, unemployment, and policy interventions.
3. Students will be able to compute and interpret national income, inflation, and per capita income trends.
4. Students will be able to evaluate monetary and fiscal policies, financial inclusion programs, and RBI instruments.
5. Students will be able to assess economic reforms, globalization effects, FDI/FII, and initiatives for self-reliance.

## **Textbooks**

1. Indian Economy – Ramesh Singh
2. Indian Economy: Performance and Policies – Uma Kapila
3. Indian Economy – Mishra & Puri
4. Development Economics – Debraj Ray
5. The Indian Economy Since Independence – Bimal Jalan

## **Reference Books (5)**

1. Macro Economics and Indian Economy – S.K. Mishra
2. Indian Economy and Economic Reforms – K. R. Gupta
3. Economic Development of India – A.N. Agarwal

4. Public Finance in India – B.P. Tyagi
5. Economic Reforms and India's Growth Story – Arvind Panagariya

#### Web Resources

1. Reserve Bank of India – RBI Publications
2. Ministry of Finance, Government of India
3. World Bank – India Overview
4. UNDP Human Development Reports
5. Investopedia – Economic Concepts

## Economic Analysis - II

	Particulars	Page No.
<b>Unit I:</b>		
1.1	Introduction to Economic System	1
1.2	India is a developing economy	9
1.3	Mixed Economy	10
1.4	Human Development Index	11
1.5	Gini Index	12
1.6	Sectoral Classification	14
1.7	Tax System in India	17
1.8	Trends in Sectoral Contribution to GDP	20
1.9	Role of Agriculture in Economic Development	23
1.10	Role of MSMEs in Economic Development	26
<b>Unit II:</b>		
2.1	Population and Poverty in India	32
2.2	Growing Population & Demographic Trends in India	32
2.3	Theory of Demographic Transition	34
2.4	Absolute and Relative Poverty	35
2.5	Measurement of Below Poverty Line	36
2.6	Causes of Poverty in India	36
2.7	Poverty Alleviation Programme	37
2.8	Unemployment in India	38
2.9	Demographic Dividend in India	40
<b>Unit III:</b>		
3.1	Inflation	55
3.2	Measuring Inflation	56
3.3	Causes of Inflation include	57
3.4	Concept of National Income	58
3.5	Measures of National Income	60
3.6	Trends in Inflation in India	61
3.7	Limitations of National Income Accounting	65
3.8	Per Capita Income and Economic Growth	68
<b>Unit IV:</b>		
4.1	Monetary Policy	74
4.2	Fiscal Policy	75
4.3	Objectives of Fiscal Policy	75
4.4	Balance of Trade	78
4.5	Union Budget	86
4.6	Revenue Deficit, Fiscal Deficit and Primary Deficit	90
<b>Unit V:</b>		
5.1	Economic Reform in India	96
5.2	Liberalization	100
5.3	Globalization	106
5.4	Foreign Direct Investment	108
5.5	Foreign Institutional Investment	112
5.6	Atmanirbhar Bharat Initiative (Self-Reliant India)	120

## **UNIT I: Features and Classification of the Indian Economy**

### **Overview**

The Indian economy is most diverse and dynamic economies in the world, shaped by its colonial past, demographic complexities, and mixed model of development. This unit introduces students to the fundamental characteristics of Indian economy and its classification across sectors. By exploring the characteristics of underdeveloped economies, learners will understand the economic challenges that persist in India despite rapid progress in recent decades. The unit also explores how India functions as a developing economy and follows the mixed economic model with both public and private sector roles. Important economic indices such as the Human Development Index (HDI) and Gini Index are discussed to measure human welfare and inequality. The classification of the economy into primary, secondary, and tertiary sectors helps learners understand the functional distribution of economic activity. Lastly, the unit touches upon India's tax system—its classification into direct and indirect taxes and their respective roles in nation-building. This foundational knowledge enables students to contextualize policies, reforms, and debates surrounding India's economic development.

### **1.1 Introduction to Economic System**

The framework through which a society or government organizes and manages the goods, and services and other resources distribution within a nation.

#### **Economic Systems : Types**

Across the world, different economies operate under varied systems. The major types of economic systems are:

- 1) Traditional Economic System
- 2) Capitalist Economic System
- 3) Socialist Economic System
- 4) Mixed Economic System

#### **1. Traditional Economic System**

A traditional economic system is guided by long-standing customs, practices, and cultural beliefs. In this system, production, distribution, and occupational roles adhere to established patterns passed down through generations. It is generally labor-intensive, with limited specialization or division of labor. Communities under this system often have limited resources due to geographical constraints or lack of access. Because of these limitations, the traditional system usually cannot generate surplus production.

#### **2. Capitalist Economic System**

In capitalist economic system, production factors and distribution is controlled by private or corporate ownership. Economic activities are driven by profit rather than government control.

#### **Features of Capitalism**

- a) Economic freedom
- b) Consumer sovereignty
- c) Limited role of government
- d) Developed financial sector

- e) Profit motive driving efficiency and innovation
- f) Market forces determining prices
- g) Flexible labor markets
- h) Free trade

### **Advantages of Capitalist System**

1. Efficient allocation and use of resources
2. High productivity levels
3. Encourages innovation and dynamic efficiency
4. Strong financial incentives
5. Supports economic and political freedom
6. Can reduce discrimination through competitive markets

### **Disadvantages of Capitalist System**

1. Monopoly and market power
2. Monopsony in labor markets
3. Neglect of social welfare
4. Wealth concentration and inequality
5. Social divisions due to income disparity
6. Cyclical economic fluctuations (boom and bust)

### **3.Socialist Economic System**

The economy in which production is carried out directly for use to meet social needs is socialist economy.

#### **Benefits:**

1. Reduction in income disparities
2. Free or subsidized healthcare
3. Better distribution of income
4. Promotes social cohesion
5. Encourages collective welfare
6. Public ownership benefits society
7. Focus on environmental protection

#### **Limitations:**

1. Limited consumer freedom
2. Less democratic decision-making
3. Absence of automatic market mechanisms
4. Bureaucratic inefficiency
5. Economic rigidity
6. High cost of centralized planning

### **4.Mixed Economy**

It include both socialistic and capitalistic economy. It encourages economic freedom, while the government intervenes to promote social welfare and regulate economic activities.

## **Benefits:**

- a) goods and services equal distribution
- b) Prices reflect supply and demand
- c) Improved production efficiency
- d) Promotes social and economic equity

## **Limitations:**

- a) Focus on profit may affect welfare measures
- b) Frequent corruption
- c) Unequal distribution of wealth
- d) Inefficiency due to excessive government involvement

## **Features: Developed and Developing Economies**

### **(A) Developed Economies**

Out of 182 major countries, only around 34 are considered developed. These nations possess advanced industrial systems, modern infrastructure, and high per capita income.

Examples include: USA, UK, Germany, France, Canada, Australia, Japan, and Italy.

Former UN Secretary General: Kofi Annan

“A developed country is one that allows all its citizens to enjoy a free and healthy life in a safe environment.”

### **(B) Characteristics of Developing Economies**

Developing countries differ in self-respect, freedom of choice, and external dependence from developed countries. Their economies rely on limited export items and traditional farming methods. Population pressure often leads to food shortages. Example: USA, Canada, Australia, and European countries

## **Definitions**

- **Prof. R. Nurkse:** These countries lack adequate capital relative to their labor and natural resources.
- **Michael P. Todaro:** Underdeveloped countries suffer from low living standards, low self-esteem, and limited freedom.

## **Developing Countries: Characteristics**

1. Low per capita income
2. Human capital: low level
3. Widespread poverty and malnutrition
4. High population growth
5. Dominance of agriculture with limited industrialization
6. Low urbanization with rapid rural–urban migration
7. Large informal sector
8. Underdeveloped labor and financial markets

## **Developing Nations: Characteristics**

**(i) Standards of Living : Low**

Majority of people suffers from inadequate food, housing, clothing, and education.

**(ii) Internal and External Debt: High**

Most developing nations depend on foreign loans, making them economically vulnerable.

**(iii) Per Capita Income: Low**

As national income is low and population growth is high so it leads to low per capita income.

**(iv) Agriculture: Excessive Dependence**

Majority of Rural peoples in country depends on outdated agricultural methods.

**(v) Weak Industrial Sector**

Industrial development is sluggish and lacks modern technology.

**(vi) High Unemployment**

Unemployment, underemployment, and disguised unemployment are widespread.

**(vii) Low Productivity**

Due to lack of education, skills, and modern technology, productivity remains low.

**(viii) Balance of Payments: Deficit**

These nations import finished goods and export raw materials.

**(ix) Economy is Dualistic**

Traditional rural sectors coexist with modern urban sectors.

**(x) Capital: Shortage**

Capital scarcity restricts savings and investment.

**(xi) Resources: Poor Utilization**

Resources often remain unutilized due to lack of capital, technology, and skills.

**(xii) Market Imperfections**

Presence of monopolies, poor information flow, and factor immobility makes markets inefficient.

**(xiii) Limited Foreign Trade**

Products do not meet global standards, limiting export potential.

#### (xiv) Poverty

Poverty perpetuates itself through low income, low savings, and investment is also low.

#### (xv) Inflation

Persistent inflation reduces purchasing power and savings.

### Economic Development: Factors

Economy development depends on a combination of **economic** and **non-economic** factors. These factors influence the ability of a nation to produce goods, generate income, and improve the standard of living.

#### A. Economic Factors

##### 1. Population and Manpower Resources

- a) Population provides the **labour force** required for production.
- b) A healthy, skilled, and moderately growing population supports development.
- c) But if population grows too fast or is unskilled, it becomes a **burden** and reduces per-capita income.

##### 2. Natural Resources and Their Utilization

- a) Availability of land, minerals, water, forest, and energy resources help in industrial and agricultural growth.
- b) However, resources must be **scientifically and efficiently used**. Poor technology or mismanagement leads to wastage.

##### 3. Capital Formation

- a) Refers to increasing a country's stock of machinery, buildings, tools, and equipment.
- b) More capital formation = **more productive capacity** and higher economic growth.

##### 4. Capital–Output Ratio

- a) Shows how much capital is needed to produce one unit of output.
- b) A **lower ratio** indicates efficient use of capital (less investment needed for the same output).
- c) A **higher ratio** means production is costly and less efficient.

##### 5. Investment Pattern

- a) When investments are made in **productive sectors** (infrastructure, industries, technology), development accelerates.
- b) Investment in unproductive activities slows down growth.

##### 6. Occupational Structure

- a) If too many people depend on **agriculture**, productivity remains low.
- b) Movement of labour from agriculture to **industry and services** increases national income and development.

## 7. Market Size

- a) A **large market** encourages large-scale production, specialization, and use of advanced technology.
- b) Small markets limit production and reduce incentives for investment.

## 8. Technological Advancement

- a) Adoption of modern technology improves productivity, quality, and competitiveness.
- b) Helps in reducing costs and increasing efficiency in both agriculture and industry.

## 9. Infrastructure

- a) Good transport, communication, power supply, banking, warehousing, etc., are essential for smooth economic operations.
- b) Infrastructure creates the **base** for all economic activities.

## 10. Industrial Relations

- a) Harmonious relations between employers and employees ensure **industrial peace**, higher production, and fewer disruptions.
- b) Frequent conflicts reduce productivity and discourage investment.

## B. Non-Economic Factors

### 1. Desire for Development

- a) People should be willing to **embrace change**, new technology, and modern practices.
- b) Societal attitude towards progress is crucial.

### 2. Education

- a) Educated individuals contribute to innovation, efficiency, and skilled labour.
- b) Education promotes **entrepreneurship**, research, and better decision-making.

### 3. Social and Institutional Reforms

- a) Breaking rigid customs, caste restrictions, corruption, and discrimination improves national productivity.
- b) Social reforms promote equality and utilization of human potential.

### 4. Law and Order

- a) Peace, safety, and political stability encourage domestic and foreign investment.
- b) Crime, unrest, and violence reduce economic confidence.

### 5. Administrative Efficiency

- a) Strong and transparent governance ensures policies are implemented effectively.
- b) Reduces delays, corruption, and inefficiency.

### 6. Cultural Environment

- a) Shared cultural values, unity, and cooperative behaviour promote national integration and stability.
- b) Social harmony leads to smoother economic functioning.

**7. Political and Legal Framework**

- a) A stable political system, clear legal rules, and reforms create a favourable business environment.
- b) Political instability discourages investors and slows development.

**Differences Between Economic Development and Economic Growth**

<b>Basis</b>	<b>Economic Development</b>	<b>Economic Growth</b>
<b>Concept</b>	Broader concept; includes growth + improvement in living standards	Narrow concept; only refers to rise in income levels
<b>Scope</b>	Multidimensional—focuses on income and quality of life	Single dimensional—focuses on income only
<b>Term</b>	Long-term process	Short-term process
<b>Measurement</b>	Quantitative & qualitative indicators like HDI, literacy, infant mortality	Quantitative—measured by increase in GDP
<b>Relevance</b>	Applies mainly to developing nations	Applies mostly to developed nations
<b>Effect</b>	Impacts both economic and social wellbeing	Increases economic indicators only
<b>Nature of Process</b>	Continuous	Time-bound

**Underdeveloped Economy**

An underdeveloped country is a nation that is very low in economic growth, industrial development, and social progress. These countries often face high poverty, low-income levels, weak infrastructure, political instability, and limited access to modern technology. Examples: Somalia, Afghanistan etc.

## **Features of an Underdeveloped Economy**

An **underdeveloped economy** is one that exhibits structural weaknesses and inefficiencies that reduce growth in nation. India, although progressing rapidly in many areas, still demonstrates several characteristics typical of underdevelopment, especially in rural regions and informal sectors. Understanding these features is essential for planning and policy-making.

### **Key Features of Underdeveloped Economies**

#### **1. Per Capita Income: Low**

- Average income per person is very low compared to developed countries.
- Most people cannot afford basic necessities like food, healthcare, and education.

#### **2. Unemployment and Poverty: high**

- People live below the poverty line.
- Unemployment, underemployment, and disguised unemployment are common.

#### **3. Low Capital Formation**

- Savings and investments are insufficient for economic growth.
- Industry, Agriculture remain unmodernized

#### **4. Agriculture-Dependent Economy**

- Majority of people depend on agriculture for their livelihood.
- Most farming is traditional and low in productivity due to outdated techniques.

#### **5. Weak Infrastructure**

- Roads, electricity, water supply, transport, and communication networks are underdeveloped.
- Poor infrastructure hinders industrial growth and trade.

#### **6. Inadequate Social Services**

- Health, education, and sanitation services are limited or poor in quality.
- Rural and backward regions are especially neglected.

#### **7. Low Productivity**

- Productivity in agriculture, industry, and services is low.
- Outdated technology, lack of skills, and limited access to capital are major reasons.

#### **8. Unequal Income Distribution**

- High economic inequality creates social disparities and reduces social mobility.

#### **9. Savings-Investment Gap**

- Low savings rates reduce funds available for productive investments.
- This slows down capital formation and economic expansion.

#### **10. Poor Industrialization**

- Manufacturing and modern industries are underdeveloped.
- Dependence on primary production (agriculture, raw materials) remains high.

#### **11. Vicious Cycle of Poverty**

- Poverty leads to low savings, low investment, and low productivity.
- This perpetuates a continuous cycle of underdevelopment.

#### **12. Underutilization of Resources**

- Inefficient use of resources
- Weak institutions, poor governance hinder proper resource utilization.

#### **13. Weak Institutions and Governance**

- Political and administrative inefficiencies reduce effectiveness of development programs.
- Corruption and bureaucratic delays further limit economic progress.

#### **14. Regional and Sectoral Imbalances**

- Some regions (rural, backward areas) are less developed than urban centers.
- The informal sector dominates, with limited access to markets and formal employment.

An underdeveloped economy suffers from low income, poor infrastructure, heavy reliance on traditional agriculture, weak industrialization, and high inequality. It can be improved by targeted policies, investment in education and health, technological upgrades, infrastructure development, and effective governance.

### **1.2 India as a Developing Economy**

India is also classified as a developing economy because of its socio-economic challenges, and the transitional nature of its growth process. After achieving independence in 1947, India followed a model of planned economic development. The government introduced Five-Year Plans that focused on strengthening agriculture, building basic industries, expanding public sector enterprises, and reducing poverty. Over the decades, India transformed with improvements in industrial capacity, technological adoption, and service-sector expansion.

Despite these achievements, India continues to face significant developmental constraints. Majority of the population still lives below the poverty line, and problems such as unemployment, underemployment, low per-capita income, and inequality are widespread. Rural areas depend heavily on traditional agriculture, while urban regions grow faster, leading to regional imbalances. Furthermore education, health, housing, and sanitation like essential services remains uneven across states.

Economic reforms introduced in 1991—known as Liberalization, Privatization, and Globalization (LPG)—marked a turning point by opening the economy to global markets, encouraging private investment, and strengthening competition. As a result, India has achieved impressive GDP growth, especially in sectors such as IT, telecommunications, and financial services. It is now among the world’s fastest-growing major economies with a rising middle class, increasing consumption, and strong prospects for innovation and entrepreneurship.

However, India’s status as a developing economy cannot be determined by GDP alone. Social indicators such as literacy, gender equality, healthcare access, environmental sustainability, and quality of life continue to influence its development ranking. Moving toward a developed economy will require inclusive growth, reduction of inequality, sustainable use of resources, and widespread improvements in human development.

**1.3 Mixed Economy:** both **government** and **private enterprises** participate actively in economic activities

In this economy, the public sector operates in key and strategic areas such as defense, energy, railways, infrastructure, and essential public services. These industries require large investments, long-term planning, and ensure national security and welfare of society. The private sector functions in sectors like manufacturing, retail, services, information technology, and finance—contributing significantly to employment, production, and economic dynamism.

A central characteristic of a this economy is **government regulation**. The state monitors and controls private-sector activities to prevent exploitation, restrict monopolies, and ensure fair competition. Through policies, laws, and regulatory bodies, the government intervenes to correct market failures and promote equitable distribution of income.

Other important characteristics include:

- a. Price mechanism functioning alongside government planning
- b. State ownership of basic and strategic industries
- c. Private ownership of other industries with regulatory oversight

While this economic model has supported India’s industrialization and modernization, it also faces issues. Public sector undertakings sometimes suffer from inefficiency, political interference, and excessive bureaucracy. Similarly, private enterprises may prioritize profit over social welfare, resulting in inequalities. Yet, for a diverse and populous country like India, the mixed economy provides a balanced approach that leverages market forces while ensuring protection for society.

## **Human Development Index and Gini Index**

The Human Development Index (HDI) and Gini Index are two important tools to assess a country's social and economic performance. HDI, developed by the United Nations, is a composite index that includes life expectancy, education (mean years of schooling and expected years of schooling), and gross national income per capita. It ranks countries by levels of human development rather than just economic growth. India’s HDI has improved over time,

but still falls in the medium category, indicating challenges in health, education, and income. On the other hand, the Gini Index measures income inequality.

India's Gini Index reflects a moderate to high level of inequality, particularly due to uneven access to education, healthcare, and employment. These indices provide a broader picture of development and help policymakers to focus on inclusive growth and equitable distribution of resources. They serve as vital tools for global and national comparisons.

## **1.4 Human Development Index (HDI)**

The Human Development Index (HDI) is a measure used to understand the overall quality of life in different countries. It was developed by the United Nations Development Programme (UNDP) to understand how countries are helping their people grow and live meaningful lives. Unlike earlier measures such as Gross National Product (GNP), which focused only on economic output, the HDI includes broader dimensions like health, education, and income. This gives a more complete picture of human progress.

### **1. Life Expectancy Index**

The life expectancy index reflects expected life of peoples at birth. It helps indicate the health conditions, availability of medical care, and overall well-being of a population. The UNDP measures life expectancy between 20 and 85 years. A country where people live longer will receive a higher score.

### **2. Education Index**

The education index measures the educational achievement of both adults and children. It considers:

- Average years of schooling for adults aged 25 and above
- Expected years of schooling for school-age children

This index shows how developed a country's education system is.

### **3. Gross National Income (GNI) per Capita**

The GNI per capita index measures the average income of citizens based on Purchasing Power Parity (PPP). The UNDP uses income values between \$100 and \$75,000. Since income does not increase equally at all levels, the index uses a logarithmic scale to reflect the changing value of money.

## **Calculating the HDI**

The HDI is calculated by taking the geometric mean of the three indexes:

- Life expectancy index
- Education index
- Income index

Geometric mean means multiplying all three values together and then taking the cube root. Formula given below:

$$\text{HDI} = \sqrt[3]{(I_{\text{Life expectancy}}) \times (I_{\text{Education}}) \times (I_{\text{Income}})}$$

## **Inequality-Adjusted Human Development Index (IHDI)**

The IHDI improves the standard HDI by adjusting for inequalities in health, education, and income. It shows how much human development is lost due to unequal distribution. For example, if a country has a few very rich people but many poor citizens, the income dimension will show inequality, lowering the IHDI compared to the HDI.

Thus, IHDI gives a more realistic picture of how development is experienced by all people, not just the average population.

### **1.5 Gini Index**

The Gini Index, also known as the Gini Coefficient, is one of the most widely used statistical measures for analyzing income and wealth inequality within a nation. Developed by Italian statistician Corrado Gini in 1912, it provides a single numerical value that reflects the extent to which income is distributed uniformly among the population. The Gini Index measures the degree of inequality in the distribution of income or consumption expenditure among individuals or households in an economy. It ranges between 0 and 1 (or 0% to 100%):

- 0 represents perfect equality, where every individual has the same income.
- 1 represents perfect inequality, where a single individual possesses the entire income while all others have none.

Thus, higher Gini values indicate higher inequality, while lower values signify a more equal distribution.

#### **Conceptual Basis: The Lorenz Curve**

The Gini Index is derived from the **Lorenz Curve**, a graphical representation that shows the cumulative share of income held by cumulative percentages of the population.

- The line of perfect equality is a diagonal line where each segment of the population earns an equal share of income.
- The Lorenz Curve plots the actual income distribution.
- The greater the deviation of the Lorenz Curve from the line of perfect equality, the higher the inequality.

The Gini Index essentially measures the area between the line of equality and the Lorenz Curve, expressed as a proportion of the total area under the line of equality.

#### **Formula**

$$\text{Gini Index} = \frac{\text{Area between Line of Equality and Lorenz Curve}}{\text{Total Area under Line of Equality}}$$

While the actual calculation requires statistical data and is typically performed using statistical software, the conceptual understanding remains fundamental for economic analysis.

#### **Interpretation of Values**

- 0.20–0.30: Low inequality (common in advanced welfare economies like Sweden or Norway).
- 0.30–0.45: Moderate inequality (typical of many developing economies).
- 0.45–0.60: High inequality (seen in countries with significant economic disparity, such as South Africa).

- Above 0.60: Very high inequality and potential social instability.

These ranges are indicative and may vary depending on the dataset and reporting agency.

### **Gini Index and Development Indicators**

While the Human Development Index (HDI) measures overall human development—health, education, and income—the Gini Index specifically highlights the fairness of income distribution. A country may have a high HDI but still face high inequality. Hence, many studies use both indicators together to understand the broader development profile of a nation.

### **Importance of the Gini Index**

The **Gini Index** plays a vital role in economic planning and development analysis because it provides meaningful insights into how income is distributed within a country. Its importance can be understood through the following points:

1. **Understanding Income Distribution:**

The Gini Index provides a clear measure of how evenly or unevenly income is distributed within a country. It helps determine whether economic growth is reaching all citizens or only a small section of society.

2. **Support for Policy Design:**

Governments depend on the Gini Index to frame welfare schemes, taxation policies, and social protection programs. A higher Gini value indicates greater inequality and signals the need for stronger redistributive measures.

3. **International Comparisons:**

Because the Gini Index is used worldwide, it allows easy comparison of income inequality between countries. This helps assess whether a nation's development is inclusive when compared with global standards.

4. **Tracking Changes Over Time:**

The Gini Index enables policymakers and researchers to study long-term trends in inequality. By comparing its values over the years, they can determine whether inequality is increasing, decreasing, or remaining stable.

5. **Indicator of Social Well-Being:**

High inequality often leads to social unrest, lower social mobility, and weaker human development outcomes. Therefore, the Gini Index serves as an important indicator of social health, stability, and overall well-being.

## 1.6 Sectoral Classification : Economy of India

This economy is broadly divided into three sectors based on the nature of activities: Primary, Secondary, and Tertiary sectors. Economists divide an economy into three major sectors—**Agriculture, Industry, and Services**. This classification helps in understanding the structure of an economy, the contribution of each sector to national income, and the stages of economic development. The **Primary Sector** involves agriculture, mining, forestry, and fishing—activities that rely on natural resources. It employs a large portion of India's population but contributes a smaller share to GDP. The **Secondary Sector** includes manufacturing and construction. The **Tertiary Sector**, or service sector, includes trade, transport, banking, IT, and healthcare. It has emerged as the dominant contributor to GDP in recent decades, reflecting India's shift toward a service-led growth model. Each sector plays a crucial role in the country's development. Balanced growth across sectors is necessary to ensure overall economic health, rural upliftment, and job creation. The government's policies aim to modernize agriculture, boost manufacturing (e.g., Make in India), and expand digital and financial services to achieve inclusive growth.

The concepts are discussed in detail.

### 1. Primary Sector (Agriculture and Allied

#### Activities) Meaning

This sector involve the **extraction and direct use of natural resources**. **Components**

The primary sector includes:

- a. Agriculture (crop production)
- b. Animal husbandry (dairy, poultry)
- c. Fisheries
- d. Forestry
- e. Mining and quarrying
- f. Plantation crops
- g. Horticulture

#### Features

- a. Highly dependent on natural factors such as rainfall, soil, and climate
- b. Labour-intensive and low use of technology in developing countries
- c. Seasonal employment and disguised unemployment
- d. Low productivity compared to other sectors
- e. Supplies food and raw materials to the industrial sector

## **Role in Economic Development**

1. Ensures food security of the country
2. Industries getting raw material (cotton, sugarcane, jute, timber)
3. Creates employment for a large part of the population
4. Contributes to export earnings
5. Supports rural livelihood and reduces poverty

## **2. Secondary Sector**

### **(Industrial Sector) Meaning**

In this sector, **raw materials are converted into finished or semi-finished goods**. This sector reflects industrialization level in a country.

### **Components**

The industrial sector includes:

- a. Manufacturing industries (textile, steel, cement, food processing)
- b. Construction
- c. Electricity, gas, water supply
- d. Small-scale and medium industries
- e. Heavy industries (machinery, automobiles)

### **Features**

- a) Uses machinery, technology, and skilled labour
- b) Higher productivity than the primary sector
- c) Capital-intensive production processes
- d) Leads to modernization and urbanization
- e) Creates employment in factories and industrial clusters

## **Role in Economic Development**

1. Converts raw materials into value-added products
2. Promotes technological innovation
3. Encourages development of transportation, power, and communication
4. Enhances export competitiveness
5. Increases national income and supports economic diversification

## **3. Tertiary Sector**

## **(Service Sector)**

### **Meaning**

The tertiary sector includes all activities that **provide services rather than producing physical goods.**

It support both agriculture and industry.

### **Components**

It includes:

- a. Commerce and Trade
- b. Transport and logistics
- c. Banking, insurance, financial services
- d. Information technology (IT) and IT-enabled services (ITES)
- e. Education and health services
- f. Real estate and business services
- g. Tourism and hospitality
- h. Public administration and defense
- i. Communication services

### **Features**

- a) No physical output, services are intangible
- b) Highly skilled workforce in many sub-sectors
- c) Fastest-growing sector in modern economies
- d) High contribution to GDP in developed and emerging economies
- e) Supports all other sectors through essential services

### **Role : Economic Development**

1. Generates the highest share of GDP
2. Creates modern jobs in IT, finance, and hospitality
3. Encourages human capital development
4. Facilitates trade, commerce, transportation, and communication
5. Enhances ease of doing business and attracts foreign investment

## **4. Interdependence Between the Three Sectors**

The three sectors operate together and depend on each other:

- **Agriculture → Industry**  
Provides raw materials (cotton, sugarcane, jute, food grains).
- **Industry → Services**  
Needs transport, banking, insurance, warehousing, communication.
- **Services → Agriculture & Industry**  
Offers credit, marketing, logistics, technology, training.

Economic development occurs when all three sectors grow together.

## 5. Sectoral Shift in Economic Development

As countries develop, the contribution of each sector changes:

### Stage 1 – Primary Sector Dominance

Agriculture contributes the largest share of GDP (seen in developing nations).

### Stage 2 – Growth of Industrial Sector

Industrialization increases income and

employment. **Stage 3 – Service Sector**

### Dominance

Service sector becomes the major contributor to GDP (seen in developed nations).

India today is moving toward a service-led growth pattern, with IT, finance, and trade contributing heavily to GDP.

## 6. Importance of Sectoral Classification

- Helps measure structural changes in the economy
- Guides government policy and resource allocation
- Helps compare economies at global level
- Shows which sector needs more investment
- Helps in employment planning and job creation strategies
- Useful in understanding developmental priorities for planners and students

### 1.7 Tax System in India: Direct and Indirect Taxes

India's tax system plays important role in mobilizing resources for development, redistributing income, and funding welfare schemes. The tax system in India forms the backbone of the country's public finance framework. It is through taxation that the government mobilizes revenue for economic development, public services, welfare programs, and infrastructure growth. In India taxes are classified into **Direct Taxes** and **Indirect Taxes**. These are explained below:

### 1.7.1. Direct Taxes

The taxes which **imposed directly on individuals, Hindu Undivided Families (HUFs), firms, and corporate bodies** and these taxes burden **cannot be shifted** to anyone else. They are paid by the same person on whom they are legally imposed.

#### Direct Taxes: features

- **Progressive in Nature:** Higher-income groups pay a larger proportion of their income as tax, ensuring equity.
- **Based on Ability to Pay:** These taxes reduce income inequality by taxing wealthier individuals at higher rates.
- **Non-transferable:** The liability cannot be transferred to another person.

#### Key Types:

1. **Income Tax:**  
Levied on the income of individuals, HUFs, and certain other entities. It forms a major portion of direct tax revenue.
2. **Corporate Tax:**  
Paid by companies on their profits. Different tax rates apply to domestic and foreign companies.
3. **Capital Gains Tax:**  
Imposed on profits from the sale of capital assets like property, stocks, or gold.
4. **Securities Transaction Tax (STT):**  
Charged on transactions carried out on the stock exchange.
5. **Wealth Tax (Abolished in 2015):**  
Earlier levied on the net wealth of individuals, but discontinued to simplify the tax system.

#### Administration

Implementation, and administration of all direct tax laws in India is controlled by the **Central Board of Direct Taxes (CBDT)**.

### 1.7.2. Indirect Taxes

Indirect taxes are imposed on **goods and services**, and unlike direct taxes, the burden can be **shifted** from producers to consumers. The person paying the tax to the government is not necessarily the one bearing its ultimate burden. These taxes affect consumption patterns and prices of goods and services.

#### Major Features of Indirect Taxes

- 1.7.2.1. **Regressive in Nature:** All consumers pay the same tax rate, irrespective of income levels.
- 1.7.2.2. **Shiftable:** Producers or sellers can pass the tax burden to end consumers.

1.7.2.3.**Applied at Multiple Stages:** Charged at the time of purchase, manufacture, or import of goods.

#### **Key Types :**

1. **Goods and Services Tax (GST):**  
Introduced in 2017, GST merged multiple indirect taxes into a one tax structure.
  - Includes **CGST, SGST, IGST**
  - Ensures a **single national market**, removing cascading effects (tax on tax)
2. **Customs Duty:**  
Imposed on goods imported into or exported out of India. Helps protect domestic industries.
3. **Excise Duty (Mostly subsumed under GST):**  
Earlier applied on manufacturing of goods within India. Now limited to items such as petroleum products and tobacco.
4. **Service Tax (Subsumed under GST):**  
Previously levied on services; now merged into GST.

#### **Administration**

The **Central Board of Indirect Taxes and Customs (CBIC)** oversees GST, customs, and remaining indirect tax provisions.

#### **1.7.3.Importance of India's Tax System**

- 1.7.3.1. **Revenue Generation:** Funds public welfare programs, infrastructure, and defense.
- 1.7.3.2. **Economic Stability:** Helps manage inflation, demand, and resource allocation.
- 1.7.3.3. **Redistribution of Income:** Progressive direct taxes reduce inequality.
- 1.7.3.4. **Market Integration:** GST has created a unified national market.
- 1.7.3.5. **Encouragement to Compliance:** Simplified tax laws increase transparency.

#### **1.7.4.Challenges in India's Tax System**

Despite continuous reforms, several challenges persist:

- 1.7.4.1. **Tax Evasion:** Use of loopholes and underreporting reduces revenue.
- 1.7.4.2. **High Compliance Burden:** Especially for small businesses.
- 1.7.4.3. **Complexity in Laws:** Frequent changes cause confusion among taxpayers.
- 1.7.4.4. **Narrow Tax Base:** A small percentage of the population pays direct taxes.

#### **1.7.5.Ongoing Tax Reforms**

The government is focusing on:

1.7.5.1. Digital tax filing and faceless assessment

1.7.5.2. Simplification of GST slabs

1.7.5.3. Broadening the tax base

1.7.5.4. Strengthening anti-evasion measures

1.7.5.5. Encouraging voluntary compliance

## **1.8. Trends in Sectoral Contribution to GDP**

### **1. Sectoral Contribution to GDP**

Gross Domestic Product (GDP) measures the total value of all goods and services produced in a country in a year.

A country's GDP is made up of different **sectors**:

- **Primary Sector** – agriculture, fishing, mining
- **Secondary Sector** – manufacturing, construction, industry
- **Tertiary Sector** – services like transport, finance, education

**Sectoral contribution to GDP** means how much each sector adds to the total GDP.

### **2. Need of Sectoral Trends**

Understanding how sectors contribute to GDP helps us:

- See how the economy is changing over time
- Know where jobs are being created
- Identify which sectors are growing fast
- Form better economic policies and investment decisions

### **3. Typical Pattern of Sectoral Contribution**

#### **a) Early Stage of Development**

Mostly:

- High output in **primary sector**
- Low in industry and services

Reason: Economy depends on farming and natural resources.

#### **b) Middle Stage of Development**

- Secondary sector (manufacturing) grows faster

- Primary sector's share decreases
- Services begin to expand

Reason: Industrialization increases production and jobs.

### c) Developed Stage

- **Tertiary sector contributes the most**
- Secondary sector moderate
- Primary sector becomes smallest

Reason: Services like IT, finance, health become dominant.

## 4. Global Trends (General Pattern)

### Primary Sector

- Its share in GDP is falling worldwide
- Automation and higher productivity means fewer workers but more output
- Example: Countries move away from farming and mining as key GDP contributors over time

### Secondary Sector

- It expands when countries industrialize
- In many developed nations, its growth slows after reaching a peak
- Manufacturing gets more efficient with technology

### Tertiary Sector

- Fastest growing in most countries
- This includes banking, healthcare, education, transport, communication
- Technology and globalization boost services

### Overall Global Shift:

*From Agriculture → Industry → Services*

## 5. Trends in India (Detailed Explanation)

India's trend shows the typical progression of a growing economy:

### Primary Sector

- Contribution to GDP has **declined over decades**
- Still employs a large portion of the population

- Example reasons for decline:
  - People moving to cities for non-farm jobs
  - Mechanization increases productivity but reduces labor needs

### **Secondary Sector**

- Contribution grew steadily post-1990s
- Growth in areas like manufacturing and construction
- Policies like *Make in India* aim to boost this sector

### **Tertiary Sector**

- Largest contributor to GDP now
- Services like IT, telecom, banking, tourism, retail are driving growth
- India is globally known for its IT and business services

### **Summary in India**

- **Agriculture:** Falling share
- **Industry:** Moderate and steady share
- **Services:** Leading share (highest)

This pattern shows that India is moving toward a **service-oriented economy**.

## **6. Causes of These Trends**

### **Reason 1: Structural Transformation**

As incomes rise:

- People buy more services
- Industries grow with infrastructure development

### **Reason 2: Technology**

- Automation boosts industrial efficiency
- Digital services expand rapidly

### **Reason 3: Globalization**

- Countries specialize where they are strong
- Services can be exported easily (example: software)

### **Reason 4: Urbanization**

- People move to cities for better jobs

- Cities have more services and factories

## **7. These Trends Mean for Indians**

### **Employment**

- Less jobs in farming
- More jobs in services and industry

### **Income Patterns**

- Higher incomes in services compared to farming
- Better living standards for service workers

### **Policy Implications**

Government may:

- Improve skill training for industry and services
- Provide support to farmers through technology and credit
- Invest in infrastructure to grow secondary and tertiary sectors

## **1.9. Role of Agriculture in Economic Development**

### **1. Introduction**

Agriculture is one of the oldest and most important economic activities in the world. It includes crop cultivation, animal husbandry, fisheries, forestry, and allied activities. In developing economies, agriculture plays a crucial role not only in providing food but also in supporting overall economic development. Even though its share in GDP may decline over time, agriculture remains the backbone of many economies, especially in countries like India.

### **2. Meaning of Economic Development**

Economic development refers to a long-term process that leads to:

- Increase in national income
- Improvement in living standards
- Reduction in poverty and unemployment
- Structural transformation of the economy

Agriculture contributes directly and indirectly to all these aspects of development.

### **3. Role of Agriculture in Economic Development**

#### **3.1 Contribution to National Income**

In the early stages of development, agriculture contributes a significant share to national

income. A large portion of GDP comes from agricultural output such as food grains, cash crops, livestock, and fisheries.

Even when industrial and service sectors grow, agriculture continues to support GDP by ensuring stable food production and supplying raw materials to other sectors.

### **3.2 Source of Employment**

Agriculture is the largest source of employment in many developing countries.

- It provides livelihood to farmers, agricultural laborers, and workers in allied activities.
- It absorbs surplus labor, especially in rural areas where industrial jobs are limited.
- Seasonal and family-based employment reduces open unemployment.

Thus, agriculture plays a key role in reducing rural poverty and unemployment.

### **3.3 Provider of Food and Food Security**

Economic development cannot take place without adequate food supply.

Agriculture:

- Produces food grains, vegetables, fruits, milk, and other essentials
- Ensures food security for a growing population
- Helps control inflation by stabilizing food prices

A stable agricultural sector prevents food shortages and supports sustained economic growth.

### **3.4 Supply of Raw Materials to Industries**

Many industries depend directly on agriculture for raw materials, such as:

- Cotton for textile industries
- Sugarcane for sugar industries
- Jute for jute industries
- Oilseeds for edible oil industries

Without agricultural growth, agro-based industries cannot function efficiently. Hence, agriculture supports industrial development.

### **3.5 Market for Industrial Goods**

Rural population forms a large market for industrial products.

Agricultural income increases demand for:

- Farm machinery
- Fertilizers and pesticides

- Consumer goods like clothing, appliances, and vehicles

Thus, growth in agriculture increases purchasing power in rural areas and promotes industrial expansion.

### **3.6 Capital Formation**

Agriculture contributes to capital formation in the economy by:

- Generating savings from surplus production
- Providing investible funds through taxation and rural savings
- Supporting investments in infrastructure and industry

In the early stages of development, agricultural surplus is often used to finance industrial growth.

### **3.7 Foreign Exchange Earnings**

Agricultural products contribute to export earnings in many countries.

Examples include:

- Tea, coffee, spices
- Rice, wheat, cotton
- Marine and dairy products

Exports of agricultural goods help:

- Earn foreign exchange
- Reduce trade deficits
- Finance imports of technology and machinery

### **3.8 Reduction of Poverty and Regional Imbalances**

Agricultural development helps:

- Increase rural incomes
- Reduce income inequality
- Promote balanced regional development

Improved irrigation, credit facilities, and technology uplift backward regions and reduce migration to cities.

### **3.9 Support to Sustainable Development**

Agriculture supports sustainable economic development by:

- Promoting eco-friendly practices

- Ensuring long-term food availability
- Supporting rural livelihoods

Modern approaches like organic farming and climate-resilient agriculture enhance sustainability.

#### **4. Role of Agriculture in Indian Economic Development**

In India:

- Agriculture employs a large share of the workforce
- It supports food security for over a billion people
- It contributes to allied sectors like dairy, fisheries, and poultry

Government initiatives such as irrigation projects, minimum support price, and agricultural credit aim to strengthen this sector.

#### **5. Challenges Faced by Agriculture**

Despite its importance, agriculture faces challenges like:

- Low productivity
- Dependence on monsoon
- Small and fragmented land holdings
- Limited access to technology and credit

Addressing these challenges is essential for sustained economic development.

### **1.10. Role of MSMEs in Economic Development**

#### **1. Introduction**

Micro, Small and Medium Enterprises (MSMEs) play a vital role in the process of economic development. These enterprises operate on a small or medium scale and are spread across both rural and urban areas. MSMEs include manufacturing units, service providers, trading activities, and agro-based industries. Due to their flexibility, low capital requirement, and ability to generate employment, MSMEs are considered the backbone of a developing economy.

#### **2. Meaning of MSMEs**

MSMEs are business units classified on the basis of their level of investment and turnover. They are generally characterized by:

- Small size of operation

- Use of local resources
- Labour-intensive production
- Entrepreneurial ownership

MSMEs act as a link between traditional activities and modern industrial growth.

### **3. Importance of MSMEs in Economic Development**

#### **3.1 Contribution to National Income**

MSMEs contribute significantly to the Gross Domestic Product (GDP) of a country.

- They produce a wide range of goods and services.
- Their collective output adds substantially to national income.
- Growth of MSMEs strengthens domestic production capacity.

As these enterprises expand, they increase the overall productive base of the economy.

#### **3.2 Employment Generation**

One of the most important roles of MSMEs is employment creation.

- MSMEs are labour-intensive and create more jobs with less capital.
- They provide employment to skilled, semi-skilled, and unskilled workers.
- They help reduce unemployment and underemployment, especially in rural areas.

Thus, MSMEs play a crucial role in addressing the problem of unemployment.

#### **3.3 Promotion of Entrepreneurship**

MSMEs encourage entrepreneurial development by:

- Providing opportunities for self-employment
- Motivating individuals to start small businesses
- Supporting innovation and creativity

They help develop managerial and technical skills among entrepreneurs, contributing to long-term economic growth.

#### **3.4 Balanced Regional Development**

MSMEs promote balanced economic development by spreading industries across regions.

- They can be set up in backward and rural areas.
- They reduce regional inequalities.

- They prevent excessive migration to cities.

This decentralization of economic activity leads to inclusive growth.

### **3.5 Support to Large Industries**

MSMEs support large industries by:

- Supplying raw materials and intermediate goods
- Providing components, spare parts, and services
- Acting as ancillary and subcontracting units

This interdependence strengthens the industrial structure of the economy.

### **3.6 Export Promotion and Foreign Exchange Earnings**

MSMEs contribute to exports in the form of:

- Handicrafts
- Textiles
- Engineering goods
- Processed food products

Exports by MSMEs help earn foreign exchange, improve the balance of payments, and enhance the country's global competitiveness.

### **3.7 Efficient Use of Local Resources**

MSMEs make effective use of:

- Local raw materials
- Indigenous skills
- Traditional knowledge

This leads to optimal utilization of resources that might otherwise remain unused.

### **3.8 Poverty Reduction and Inclusive Growth**

By generating income and employment, MSMEs help:

- Improve living standards
- Reduce poverty levels
- Promote inclusive economic growth

They provide opportunities to women, minorities, and disadvantaged groups, ensuring social and economic inclusion.

### **3.9 Technological Innovation and Flexibility**

MSMEs are adaptable and flexible in nature.

- They can quickly adopt new technologies.
- They respond faster to changes in consumer demand.
- They promote innovation at the grassroots level.

This flexibility helps the economy remain competitive.

### **4. Role of MSMEs in the Indian Economy**

In India, MSMEs:

- Form a major part of the industrial sector
- Provide large-scale employment after agriculture
- Contribute to manufacturing and service output
- Support rural and semi-urban development

Government support in the form of credit facilities, skill development, and market access has strengthened the MSME sector.

### **5. Challenges Faced by MSMEs**

Despite their importance, MSMEs face several challenges:

- Limited access to finance
- Inadequate infrastructure
- Lack of advanced technology
- Marketing and competition issues

Addressing these challenges is essential for maximizing their contribution to economic development.

### **6. Measures to Strengthen MSMEs**

Economic development can be accelerated by:

- Improving access to institutional finance
- Providing training and skill development
- Encouraging digitalization and innovation
- Enhancing market linkages and exports

## Question Bank

### PART A (2 Marks each)

1. Define an economic system.
2. Name the four major types of economic systems.
3. List two features of an underdeveloped economy.
4. Why is India considered a developing economy?
5. Define a mixed economy and mention one characteristic.
6. What is the Human Development Index (HDI)?
7. Name the three components of HDI.
8. What is the Gini Index used for?
9. List the three major sectors of the Indian economy.
10. Differentiate between direct and indirect taxes with one example each.

### PART B (10 Marks each )

1. Explain the features, advantages, and disadvantages of a capitalist economy.
2. Describe the structural and economic characteristics of developing countries.
3. Discuss why India is classified as a developing economy.
4. Explain the concept and significance of a mixed economy in India.
5. Describe the Human Development Index (HDI) and Inequality-Adjusted HDI.
6. Explain the Gini Index and how it measures income inequality.
7. Describe the primary, secondary, and tertiary sectors of the Indian economy with their roles.
8. Explain the interdependence between the three sectors and sectoral shifts in economic development.
9. Discuss the direct tax in India with examples and features.
10. Explain the challenges in India's tax system and the reforms being implemented.

### PART C (15 Marks each )

1. Explain the concept of a mixed economy and its significance in India.
2. Discuss the Gini Index and how it measures income inequality.
3. Explain the interdependence between primary, secondary, and tertiary sectors in economic development.
4. Describe direct and indirect taxes in India with one example each.
5. What are the challenges in India's tax system?

### Glossary

- **Underdeveloped Economy** – Economy with low income and productivity.
- **Developing Economy** – An economy in transition with improving indicators.
- **Mixed Economy** – Economic system combining public and private sectors.
- **HDI** – Composite index measuring human development.
- **Gini Index** – Measures income distribution or inequality.
- **Primary Sector** – Agriculture and raw material extraction.
- **Secondary Sector** – Manufacturing and industrial activities.
- **Tertiary Sector** – Services like education, banking, and health.
- **Direct Tax** – Tax levied directly on income.
- **Indirect Tax** – Tax levied on goods/services.

## Suggested Reading

1. Datt, R., & Sundharam, K. P. M. (2024). *Indian economy* (73rd ed.). S. Chand & Company Pvt. Ltd.
2. Mishra, S. K., & Puri, V. K. (2024–2025). *Indian economy: Its development experience* (42nd ed.). Himalaya Publishing House Pvt. Ltd.
3. Kapila, U. (Ed.). (2023). *Indian economy: Performance and policies* (24th ed.). Academic Foundation.
4. Government of India, Ministry of Finance. (2025). *Economic survey of India 2024–25*. Government of India

## Unit II – Population and Poverty in India

### Overview

Population and poverty are two critical dimensions that deeply influence India's economic development. India is the world's most populous country, and its demographic structure directly affects resource utilization, and social welfare. A high population growth rate creates pressure on land, food, education, healthcare, housing, and employment opportunities. Poverty is a major challenge, affecting millions of people across rural and urban areas.

This unit explains the relationship between population trends and poverty levels in India. It covers demographic concepts, the Demographic Transition Theory, different types of poverty, measurement of Below Poverty Line (BPL), causes of poverty, major government schemes, unemployment trends, and India's demographic dividend. A clear understanding of these topics helps students and policymakers appreciate the socio-economic issues that shape India's development path.

### 2.1 Population and Poverty in India

India, with over 1.4 billion people, is now the most populous country in the world, and its population is highly diverse across states—while regions like Bihar and Uttar Pradesh continue to show high birth rates, states such as Kerala and Tamil Nadu have recorded much lower population growth. Rapid population increase has a direct link to poverty, as it puts immense pressure on essential resources like food, land, water, education, healthcare, and public services. When the working-age population rises faster than job creation, unemployment and underemployment become widespread, pushing more people into low-income informal work. Even if national income grows, a fast-growing population reduces per capita income, limiting improvements in living standards. Overcrowded schools, strained health services, environmental degradation, deforestation, and pollution further worsen the situation, especially for the poor. Population growth also fuels both urban and rural poverty—cities struggle with slums and job shortages due to migration, while peoples belonging to rural areas suffer from small landholdings, seasonal unemployment, and dependence on agriculture. Overall, a high population results in more dependents, lower savings, reduced investment, slower development, and ultimately deeper poverty, showing how strongly population and poverty are interlinked in India.

### 2.2 Growing Population & Demographic Trends in India

India, with a population exceeding **1.4 billion**, is the most populous country in the world, surpassing even China. Population growth occurs when the number of births exceeds deaths in a given period. A growing population has **both opportunities and challenges**. On one hand, it increases the **labor force** and potential consumers, which can boost economic growth.

Understanding population dynamics and demographic trends is crucial for **effective planning and policymaking**, as they impact sectors like health, education, labor, and social welfare.

## Key Features of India's Population

### 1. Young Population

- Over 60% of India's population is below 35 years.
- This presents a demographic dividend — a large working-age population that can increase growth if properly employed.
- Challenges include providing education, skill development, and employment opportunities to this young population.

### 2. Population Growth Rate

- India's population continues to grow, though at a slower rate than previous decades due to declining fertility rates.

### 3. Sex Ratio

- According to the 2021 census, this **ratio is improving**, but disparities remain in some regions.

### 4. Literacy and Education

- Literacy improved, with higher female literacy leading to a reduction in birth rates.
- Education, especially of women, plays a crucial role in controlling population growth and improving human development indices.

### 5. Urbanization

- Rapid urban migration from rural areas increases city populations.
- Urban areas face housing shortages, traffic congestion, sanitation problems, and pressure on health services.
- States like Maharashtra, Karnataka, and Delhi experience the highest urban population growth.

### 6. Regional Variations

- States like Bihar, Uttar Pradesh, and Madhya Pradesh have higher birth rates.
- States like Kerala and Tamil Nadu show lower birth rates due to better education, healthcare, and family planning programs.

## Demographic Trends in India

Demographic trends refer to changes in the **age, sex, and spatial distribution of the population**, as well as patterns in literacy, employment, and urbanization.

### 1. Age Structure

- India has a **youthful population**, with a growing working-age group.
- Dependency ratio (population dependent on working-age adults) is decreasing, offering potential economic gains.

### 2. Rural-Urban Distribution

- Majority of India's population still resides in rural areas, but urban population is increasing rapidly.
- Urbanization affects **resource allocation, infrastructure development, and employment generation**.

### 3. Fertility and Mortality Rates

- Fertility rates are declining due to family planning and awareness.
- Rate of Mortality have decreased due to **improved healthcare, nutrition, and vaccination programs**.

### 4. Migration Patterns

- Migration is both **internal (rural to urban)** and **international (to Gulf countries, USA, Europe)**.

- Migrants seek better employment and living standards, leading to both **urban stress and rural labor shortages**.
5. **Life Expectancy**
- Life expectancy in India has increased over the past decades.
  - Aging population in some regions will require **pension planning and healthcare expansion** in the future.

## 2.3 Theory of Demographic Transition

The **Theory of Demographic Transition** explains how population growth changes over time as countries develop economically and socially. It consists of **three major stages**:

1. **Stage 1 – High Birth and Death Rates**
  - Both rates are high, resulting in **slow population growth**.
  - Example: Pre-industrial societies.
2. **Stage 2 – Declining Death Rates**
  - Death rates fall due to **improved healthcare, sanitation, and nutrition**, while birth rates remain high.
  - Rapid population growth occurs.
  - Example: India during early 20th century.
3. **Stage 3 – Declining Birth Rates**
  - Birth rates start to decline due to **better education, family planning, and female empowerment**.
  - Population growth slows and eventually stabilizes.
  - Example: Current India in many states like Kerala and Tamil Nadu.

### Significance of the Theory

- Helps **policymakers plan** for future needs in education, health, and employment.
- Explains why population growth slows as a country develops economically.
- Highlights the importance of **family planning, literacy, and healthcare** in controlling population growth.

### Implications of India's Demographic Trends

1. **Opportunities**
  - Large **working-age population** can drive economic growth if adequately trained and employed.
2. **Challenges**
  - Pressure on **resources** like water, food, housing, and energy.
  - Rising **urban unemployment** and informal sector employment.
  - Need for investment in **healthcare, education, and skill development**.
  - Regional disparities in population growth and resource distribution.
3. **Policy Measures**
  - Promotion of **family planning programs**.
  - Expansion of **healthcare facilities and education infrastructure**.
  - Skill development for youth under programs like **Skill India**.
  - Encouragement of **balanced regional development** to reduce migration pressures.

India's growing population and demographic trends present both opportunities and challenges. With a young and expanding workforce, the country has the potential to reap a demographic dividend, boosting growth of economy and social development. However, problems such as urban stress, unemployment, and resource scarcity must be addressed. Understanding population trends and applying the Theory of Demographic Transition are crucial for effective policy planning. India's future growth will depend on investments in education, health, employment generation, and equitable resource distribution.

## 2.4 Absolute and Relative Poverty

India is a country of contrasts: rapid economic growth and technological advancement exist alongside poverty, unemployment, and inequality. Understanding these issues is crucial to planning for a more inclusive and sustainable future. Key areas to study are absolute and relative poverty, unemployment types and causes, and demographic dividend, which together influence India's economic development and social stability. Absolute and Relative Poverty

Absolute poverty refers to a condition where people can't afford basic necessities like food, shelter, and clothing. In India, people living below Rs.150 per day in rural areas and Rs 200 in urban areas are poor.

Relative poverty, however, compares income differences in society. For example, a person earning Rs. 10,000/month may not be poor absolutely, but is relatively poor compared to someone earning Rs 1 lakh/month.

India's poverty line is based on **minimum calorie intake and essential needs**, but critics say it does not reflect modern cost of living accurately.

### Absolute Poverty

Absolute poverty occurs when people **cannot afford the basic necessities of life** such as food, clothing, and shelter. It is measured by minimum income or consumption required to maintain survival.

- In India, people living below Rs. **150 per day in rural areas** and Rs. **200 in urban areas** are often considered absolutely poor.
- Absolute poverty is concerned with **physical survival**, not social comparisons.
- Example: A family unable to provide two meals a day is absolutely poor.

### Relative Poverty

Relative poverty measures **income inequality** and social disadvantage. A person may have sufficient resources to live but may be poor compared to others in the society.

- Example: Someone earning Rs. 10,000 per month may survive comfortably but is relatively poor compared to someone earning Rs.1 lakh per month.
- Relative poverty highlights **social exclusion** and inequality in wealth distribution.

### Poverty Line in India

- India defines poverty using **minimum calorie intake and essential needs**.
- Critics argue that poverty lines do not accurately reflect **modern costs of living**, such as education, healthcare, and transportation.

## 2.5 Measurement of Below Poverty Line (BPL)

BPL is used to identify people who need government assistance. It is calculated using income, and asset ownership. Various committees like **Tendulkar** and **Rangarajan** suggested poverty lines for India.

The government uses **Socio-Economic Caste Census (SECC)** data to identify BPL households. Families who comes under BPL are eligible for benefits like food rations, free healthcare, and subsidized housing. However, corruption and errors in identifying the right beneficiaries remain challenges. BPL identification helps governments target **benefits to the poor**.

### 2.5.1. Methods of Measurement

- **Per Capita Consumption Expenditure:** Measures income spent on basic needs.
- **Income and Asset Ownership:** Considers land, property, and savings.
- **Committees:** Tendulkar (2009) and Rangarajan (2014) committees suggested updated poverty lines for India.

### 2.5.2 Identification of BPL Households

- The **Socio-Economic Caste Census (SECC)** collects data on income, assets, and living conditions to identify BPL households.
- BPL families are eligible for **food rations, free healthcare, and subsidized housing**.

### 2.5.3 Challenges

- **Corruption and errors in beneficiary identification** reduce effectiveness.
- Some deserving families are excluded, while others receive benefits unfairly.

## 2.6 Causes of Poverty in India

Key reasons for poverty include:

- a) **Unemployment:** Lack of jobs means no income.
- b) **Low wages:** Many jobs in agriculture and informal sector pay very little.
- c) **Education and Skill Gap:** Lack of education leads to low employability.
- d) **Population Growth:** More mouths to feed without equal rise in jobs or income.
- e) **Corruption and Policy Failures:** Mismanagement of poverty alleviation programs.
- f) **Discrimination:** Certain castes and communities face exclusion.

Poverty is a complex issue needing multiple solutions like education, employment, and social justice.

## **2.7 Poverty Alleviation Programmes**

Indian Govt. has launched many schemes:

1. **MGNREGA**: Guarantees 100 days of rural employment.
2. **PMAY**: Provides affordable housing.
3. **Public Distribution System (PDS)**: Offers subsidized food grains.
4. **NRHM**: National Rural Health Mission : Ensures health services to poor.

Detailed explanation is given below:

### **1.MGNREGA (Mahatma Gandhi National Rural Employment Guarantee Act)**

MGNREGA is India's largest social security programs, guaranteeing wage employment of hundred days every year to every rural household willing to do unskilled manual work. The scheme aims to reduce rural poverty by providing a steady source of income during lean agricultural seasons. It also works toward strengthening rural infrastructure by creating assets such as ponds, roads, and wells. While MGNREGA has empowered rural workers, especially women, challenges like delayed payments, corruption, and lack of proper planning still affect its effectiveness.

### **2.PMAY (Pradhan Mantri Awas Yojana)**

PMAY seeks to give subsidies and financial help to economically weaker sections, low-income groups, and middle-income households. The scheme promotes the construction of pucca houses with essential amenities like toilets, electricity, and water supply. PMAY objective is to remove housing shortages across India. However, certain problems such as land availability, slow construction, and difficulties in beneficiary identification sometimes delay its progress.

### **3.Public Distribution System (PDS)**

The Public Distribution System is a food security program that provides subsidized essential commodities such as rice, wheat, and sugar to poor households through ration shops. By supplying food grains at affordable prices, PDS plays important role in preventing hunger and malnutrition among vulnerable sections, particularly in rural areas. Although the system has helped millions, it also faces problems like leakage of grains, fake ration cards, which reduce its overall impact

### **4.National Rural Health Mission (NRHM)**

NRHM aims to improve access to quality healthcare in rural areas, especially for the poor, women, and children. It strengthens healthcare infrastructure by upgrading primary health centers, appointing Accredited Social Health Activists (ASHAs), and improving mother and child health services. The mission helps reduce infant and mortality rates of mother and enhances vaccination coverage. Despite significant improvements, NRHM still struggles with shortages of doctors, inadequate facilities, and uneven service delivery across states.

NRHM launched in 2005, aims to provide accessible, affordable, and quality healthcare to rural

populations, particularly focusing on vulnerable groups such as the poor, women, children, and marginalized communities. The mission seeks to strengthen the entire rural healthcare delivery system by upgrading Sub-Centres, Primary Health Centres (PHCs), and Community Health Centres (CHCs) through better infrastructure, increased manpower, and improved availability of essential medicines and equipment.

NRHM also promotes decentralized planning by empowering local bodies, improving accountability, and encouraging participation of community through Village Health and Sanitation Committees (VHSCs). Mobile medical units, telemedicine, and strengthened referral systems have further improved accessibility in remote regions.

However, challenges remain. Many states still face shortages of qualified doctors, nurses, and specialists, inadequate diagnostic facilities, irregular drug supply, and gaps in infrastructure maintenance. Regional disparities persist, with some states showing robust progress while others lag due to poor governance and resource constraints. Despite these limitations, NRHM has played a critical role in transforming rural healthcare delivery and contribute in public health system of India.

## 2.8 Unemployment in India: Types and Causes

Unemployment is a critical socio-economic problem in India. It reduces economic productivity and increases poverty.

### 2.8.1. Types of Unemployment:are

#### 1. Seasonal Unemployment-Major aspects are as follows:

- a) Occurs when work is available only **during certain seasons**.
- b) Common in **agriculture, horticulture, and fishing**, where employment is linked to seasonal cycles.
- c) Example: A farmer may have work during sowing and harvesting but remain unemployed in the off-season.
- d) **Impact:** Leads to underutilization of labor and low income in rural areas.

#### 2. Frictional Unemployment -Major aspects are as follows:

- a) Short-term unemployment when workers are **transitioning between jobs** or entering the workforce for the first time.
- b) It is natural in a growing economy where people **seek better opportunities**.
- c) Example: A college graduate searching for a first job or a worker shifting from one city to another.
- d) **Impact:** Generally temporary and less concerning but can increase if job search mechanisms are inefficient.

#### 3. Structural Unemployment-Major aspects are as follows:

- a) Occurs due to **mismatch between skills and job requirements**.
- b) Arises when industries demand specialized skills, but the workforce lacks them.
- c) Example: IT and engineering sectors requiring digital skills, while graduates have traditional knowledge.
- d) **Impact:** Persistent unemployment if skill development and education policies do not align with industry needs.

#### 4. Cyclical Unemployment-Major aspects are as follows:

- a) Linked to **economic fluctuations or downturns**.
- b) During recessions or slow economic growth, demand for goods and services falls, reducing labor requirements.
- c) Example: Job losses in manufacturing and construction sectors during an economic slowdown.
- d) **Impact:** Temporary but widespread; can affect multiple sectors simultaneously.

#### 5. Disguised Unemployment-Major aspects are as follows:

- a) Common in **agriculture and family-run businesses** in rural India.
- b) Example: A farm with 10 workers may only need 6 to produce the same output; the remaining 4 are effectively unemployed.
- c) **Impact:** Reduces productivity and income per worker; prevalent in rural areas.

### 2.8.2. Causes of Unemployment in India

Unemployment is influenced by **demographic, educational, industrial, and policy-related factors**.

#### 1. Overpopulation

- a) High population growth increases the **labor force faster than job creation**.
- b) Leads to intense competition for limited jobs, especially in urban areas.

#### 2. Lack of Skills-

- a) Education system often fails to equip youth with **industry-relevant skills**.
- b) Technical and vocational training is insufficient, leading to unemployable graduates.
- c) Example: STEM graduates may lack practical exposure, while service sectors demand soft skills.

#### 3. Slow Industrial Growth-

- a) Industrialization in India has been **uneven and slow**, particularly in rural areas.
- b) Limited manufacturing and service sector expansion reduces employment opportunities.

#### 4. Use of Capital-Intensive Technology

- a) Industries adopting **automation and machinery** replace manual labor.
- b) While increasing productivity, it reduces demand for low-skilled workers.
- c) Example: Automated factories, digital banking systems, and mechanized agriculture.

#### 5. Ineffective Employment Policies

- a) Government schemes sometimes fail to **match skills with available jobs**.
- b) Lack of proper monitoring, poor implementation, and regional disparities worsen unemployment.

### 3. Solutions and Recommendations

To address unemployment in India, **strategic interventions** are required:

1. **Promote Labor-Intensive Industries:** Focus on sectors like manufacturing, construction, and services to **absorb more workers**.
2. **Skill Development Programs:** Expand **vocational training, apprenticeships, and digital skills** education.
3. **Encourage Entrepreneurship:** Support **start-ups and micro-enterprises** to generate employment.
4. **Rural Employment Schemes:** Strengthen programs like **MGNREGA** to reduce rural unemployment.
5. **Align Education with Industry Needs:** Introduce **practical curriculum, internships, and industry collaborations**.
6. **Balanced Urbanization:** Develop **secondary towns** to reduce migration pressure on cities.

Unemployment in India is a **complex and multifaceted problem**. Seasonal and disguised unemployment dominate rural areas, while structural and cyclical unemployment affect urban and industrial sectors. Addressing unemployment requires **education reform, skill development, labor-intensive industrial growth, and effective policy implementation**. If handled well, India's **young population** can become a **productive workforce**, turning the challenge of unemployment into a demographic advantage.

## 2.9 Demographic Dividend in India

### 1. Meaning of Demographic Dividend

- a) The **demographic dividend** refers to the **economic growth potential** that arises when the **working-age population (15–59 years)** is larger than the dependent population (children and elderly).
- b) This is not automatic; it depends on **education, skills, health, and employment opportunities**.

### 2. India's Demographic Profile

- a) India has over **1.4 billion people**, with **more than 60% under the age of 35**.
- b) This gives India a **unique advantage** compared to aging populations in countries like Japan and Germany.

### 3. Benefits of Demographic Dividend

Properly leveraged, a demographic dividend can lead to:

1. **Higher Productivity**
  - o More working-age people can contribute to **increased output** in agriculture, industry, and services.
2. **Faster Economic Growth**
  - o A larger labor force can expand **GDP and per capita income**, accelerating economic development.
3. **Innovation and Entrepreneurship**

- Young, skilled individuals can **start businesses**, adopt new technologies, and enhance competitiveness.
- 4. **Social Development**
  - With income generation, **living standards improve**, leading to better education, health, and reduced poverty.

#### 4. Requirements to Harness Demographic Dividend

India must focus on:

1. **Quality Education and Skill Development**
  - Education should be **accessible, inclusive, and aligned with industry needs**.
  - Vocational and technical training can enhance employability.
2. **Health Services for Youth**
  - Healthy workers are **more productive**.
  - Nutrition, preventive healthcare, and mental health programs are essential.
3. **Job Creation**
  - Growth in **manufacturing, services, and labor-intensive industries** is critical.
  - Policies should encourage **start-ups, MSMEs, and rural employment**.
4. **Women Empowerment**
  - Increasing female participation in the workforce **maximizes the demographic advantage**.

#### 5. Challenges in Utilizing Demographic Dividend

If not properly planned, India's demographic dividend can **become a burden**:

##### a) High Unemployment

India's young population can become a demographic dividend only if enough jobs are created to absorb the growing workforce. However, when millions of youth remain unemployed or underemployed, it leads to frustration, loss of productivity, and social unrest. The lack of job opportunities pushes many into low-paid informal work or forces migration in search of employment. If unemployment continues to rise, the demographic advantage can quickly turn into a demographic burden.

##### b) Skill Mismatch

A major challenge is that there is mismatch between the education system and needs of modern industries. Many students graduate without the technical or practical skills required by employers, leading to structural unemployment. Companies struggle to find workers those who are skilled even when there are large numbers of educated youth. This mismatch limits productivity, affects competitiveness, and reduces India's ability to fully utilize its young workforce in high-growth sectors.

##### c) Urban Pressure

As rural youth migrate to cities in search of better jobs and education, urban areas face immense pressure

on housing, transport, sanitation, and public services. Without adequate planning, cities become overcrowded, leading to the growth of slums, traffic congestion, and pollution. Services which are essential like water supply, waste management, and healthcare become strained. This uncontrolled urbanization reduces the life quality and makes cities less productive.

#### **d) Inequality**

If economic policies do not ensure equal access to education, healthcare, and job opportunities, a small section of the population only benefits from economic growth. Rich and the poor Peoples gap widens, leading to greater income inequality. When benefits of the demographic dividend are concentrated among a few, large sections of society remain excluded from progress, weakening overall national development and social stability.

### **6. Policy Measures to Maximize Benefits**

Are:

#### **a) Invest in Education and Skill Development**

To make India's young population productive, the government must strengthen the education and skill development system. This includes expanding technical institutes like ITIs and polytechnics, promoting vocational training, and improving the quality of school and college education. Digital literacy programs play key role to prepare youth for modern, technology-driven jobs. India can create a workforce that is capable, competitive, and ready to meet global job market demands by providing industry-oriented skills to young people.

#### **b) Promote Health and Well-being**

The government must improve access to healthcare by strengthening primary health centers, increasing the number of medical professionals, and promoting preventive healthcare. Extending affordable health insurance schemes helps reduce the financial burden on families and encourages timely treatment. When youth are physically and mentally healthy, their productivity increases, leading to better economic performance.

#### **c) Encourage Employment Generation**

To reduce unemployment and absorb the large workforce, India must create more job opportunities, especially in labor-intensive sectors such as manufacturing, textiles, construction, and food processing. Supporting MSMEs—India's largest job creators—through credit, subsidies, and easy regulations is crucial.

#### **d) Facilitate Entrepreneurship**

Entrepreneurship can generate innovation and create jobs for others. The government can support entrepreneurship by offering financial assistance, simplifying loan procedures, and establishing incubation centers in universities and towns. Skill training in areas like business planning, digital

marketing, and innovation can help young entrepreneurs succeed. When more young people become job creators, it strengthens the overall economy and promotes long-term growth.

### **e) Enhance Women Participation**

Women's participation in the workforce is essential for maximizing demographic dividend benefits. Policies must focus on providing safe working environments, childcare facilities, flexible working hours, and equal opportunities. Programs like skill developments can increase their confidence and employability. When more women join the workforce, household incomes rise, poverty reduces, and the country gains a more diverse and productive labor force.

India's demographic dividend is a once-in-a-generation opportunity. Therefore, strategic planning, investment in human capital, and inclusive policies are crucial to convert India's demographic advantage into long-term prosperity.

## **3.1 Concept and Policy Imperatives**

### **1. Introduction**

Economic development is not an automatic process; it requires clear concepts and well-designed policies. The term *concept and policy imperatives* refers to the basic ideas that guide economic development and the essential policy actions that governments must adopt to achieve growth, stability, and social welfare. Understanding these concepts helps students analyze how economic policies shape development outcomes.

### **2. Concept of Economic Policy**

Economic policy refers to the actions taken by the government to influence economic activities in order to achieve specific objectives such as growth, stability, equity, and employment.

It includes decisions related to:

- Allocation of resources
- Income distribution
- Economic growth and development
- Control of inflation and unemployment

Economic policies are framed based on economic concepts, social needs, and national priorities.

### 3. Objectives of Economic Policy

The main objectives of economic policy are:

1. **Economic Growth** – Increasing national income and production
2. **Price Stability** – Controlling inflation and deflation
3. **Employment Generation** – Providing job opportunities
4. **Equitable Distribution of Income** – Reducing inequality
5. **Balanced Regional Development** – Reducing regional disparities
6. **Economic Stability** – Avoiding economic fluctuations

These objectives form the foundation for policy imperatives.

### 4. Meaning of Policy Imperatives

Policy imperatives are the **essential and unavoidable actions** that governments must take to address economic challenges and achieve development goals.

They arise due to:

- Structural weaknesses in the economy
- Market failures
- Social inequalities
- Resource constraints

Policy imperatives guide governments in prioritizing actions and reforms.

### 5. Conceptual Basis of Policy Imperatives

#### 5.1 Scarcity of Resources

Resources such as land, labour, capital, and technology are limited. Hence, policies must ensure:

- Efficient use of resources
- Reduction of wastage
- Maximum social benefit

This concept demands careful planning and prioritization.

#### 5.2 Market Failure

Markets may fail due to:

- Monopoly power
- Externalities
- Public goods
- Information gaps

Policy imperatives arise to correct these failures through regulation, taxation, and public provision.

### **5.3 Social Welfare and Equity**

Economic growth alone is not sufficient. Policies must ensure:

- Reduction of poverty
- Social justice
- Equal opportunities

This concept leads to policies focused on inclusive development.

### **5.4 Structural Transformation**

Developing economies need to shift:

- From agriculture to industry and services
- From informal to formal sectors

This transformation requires strong policy support.

## **6. Major Policy Imperatives in Economic Development**

### **6.1 Growth-Oriented Policies**

Economic growth is essential for development.

Policy imperatives include:

- Encouraging investment
- Promoting industrialization
- Improving infrastructure
- Supporting innovation and technology

Sustained growth increases national income and employment.

### **6.2 Employment-Focused Policies**

Unemployment and underemployment are major challenges.

Policy imperatives involve:

- Skill development programs
- Support for MSMEs
- Promotion of labour-intensive industries

Employment generation improves living standards and reduces poverty.

### **6.3 Poverty Reduction Policies**

Reducing poverty is a key development goal.

Important policy actions include:

- Income support programs
- Rural development initiatives
- Access to education and healthcare

These policies aim to uplift vulnerable sections of society.

### **6.4 Agricultural Development Policies**

Agriculture remains vital for food security and livelihoods.

Policy imperatives include:

- Investment in irrigation
- Agricultural credit facilities
- Technological support and extension services

Strong agriculture supports overall economic stability.

### **6.5 Industrial and MSME Policies**

Industrial growth accelerates development.

Policy imperatives focus on:

- Supporting small and medium enterprises
- Improving ease of doing business
- Providing infrastructure and finance

These policies strengthen the production base of the economy.

### **6.6 Social Sector Policies**

Human development is essential for long-term growth.

Policy imperatives include:

- Education reforms
- Healthcare expansion
- Nutrition and sanitation programs

Investment in human capital increases productivity and welfare.

### **6.7 Fiscal Policy Imperatives**

Fiscal policy involves government spending and taxation.

Key imperatives are:

- Productive public expenditure
- Progressive taxation
- Fiscal discipline

Efficient fiscal policy promotes stability and growth.

### **6.8 Monetary Policy Imperatives**

Monetary policy controls money supply and credit.

Policy imperatives include:

- Controlling inflation
- Ensuring adequate credit to productive sectors
- Maintaining financial stability

Stable prices support sustainable growth.

### **6.9 Sustainable Development Policies**

Economic growth should not harm the environment.

Policy imperatives involve:

- Promoting renewable energy
- Encouraging sustainable resource use
- Addressing climate change

Sustainability ensures development for future generations.

## **7. Role of Government in Policy Implementation**

The government plays a central role by:

- Designing appropriate policies
- Implementing reforms effectively
- Monitoring outcomes
- Making adjustments based on results

Good governance enhances policy effectiveness.

## **8. Relevance of Concept and Policy Imperatives in India**

In India, policy imperatives are shaped by:

- Large population
- Income inequality
- Regional imbalances
- Need for inclusive growth

Economic reforms, development programs, and welfare schemes reflect these imperatives.

### **4.1 Gig Economy and Platform Workers**

#### **1. Introduction**

In recent years, the nature of work has undergone significant changes due to technological advancement and digitalization. One of the most important outcomes of this change is the emergence of the **gig economy** and **platform-based work**. Unlike traditional employment, gig work is characterized by short-term contracts, flexible working hours, and task-based payments. This new form of work has created both opportunities and challenges for economic development.

#### **2. Meaning of Gig Economy**

The gig economy refers to a labor market where individuals earn income by performing **short-term, temporary, or task-based jobs**, often facilitated through digital platforms.

Key features of the gig economy include:

- Short-duration work assignments
- Flexible working arrangements
- Payment based on tasks or projects
- Absence of long-term employer–employee relationship

Examples include ride-hailing, food delivery, freelance services, and online content creation.

### **3. Meaning of Platform Workers**

Platform workers are individuals who obtain work through **digital platforms or mobile applications** that connect workers with customers.

These platforms:

- Act as intermediaries between workers and users
- Use technology to allocate work
- Determine pricing, ratings, and work conditions

Platform workers are usually considered independent workers rather than regular employees.

### **4. Growth of Gig Economy**

The gig economy has expanded rapidly due to several factors:

- Growth of internet and smartphone usage
- Increased demand for flexible services
- Preference for flexible working hours
- Rising unemployment and underemployment
- Expansion of digital platforms

This growth has transformed the structure of labor markets in many countries.

### **5. Role of Gig Economy in Economic Development**

#### **5.1 Employment Generation**

The gig economy creates large-scale employment opportunities.

- It absorbs surplus labor from both rural and urban areas
- It provides income opportunities to students, women, and part-time workers
- It reduces open unemployment by offering alternative work options

Thus, gig work acts as a supplementary source of employment.

#### **5.2 Flexibility and Work Choice**

One of the major advantages of the gig economy is flexibility.

- Workers can choose working hours
- They can decide the type and amount of work
- It allows work-life balance

This flexibility increases labor force participation.

### **5.3 Contribution to Income and Consumption**

Gig work increases household income.

- Additional income improves purchasing power
- Increased consumption stimulates economic growth
- It supports demand in the service sector

Hence, gig income contributes indirectly to national income.

### **5.4 Promotion of Digital Economy**

The gig economy strengthens the digital economy by:

- Encouraging digital payments
- Expanding e-commerce and online services
- Increasing technology adoption

It supports innovation and modernization of the economy.

### **5.5 Support to Urban Services**

Gig and platform workers play a major role in urban economies.

They provide services such as:

- Transport
- Food delivery
- Home services
- Logistics

These services improve efficiency and convenience in cities.

## **6. Types of Gig and Platform Work**

### **6.1 Location-Based Gig Work**

Work is performed at a physical location.

Examples:

- Ride-hailing drivers
- Delivery partners
- Home service providers

## **6.2 Online-Based Gig Work**

Work is performed through the internet.

Examples:

- Freelance writing
- Graphic design
- Data entry
- Online tutoring

## **7. Challenges Faced by Gig and Platform Workers**

### **7.1 Lack of Job Security**

- Work is uncertain and irregular
- Income is unstable
- Workers can be removed from platforms easily

### **7.2 Absence of Social Security**

Most gig workers do not receive:

- Health insurance
- Paid leave
- Pension benefits

This makes them economically vulnerable.

### **7.3 Income Inequality**

- Earnings depend on demand and platform algorithms
- Workers often face high competition
- No minimum wage guarantee

### **7.4 Limited Bargaining Power**

- Workers have little control over pricing
- Platforms decide terms and conditions
- Collective bargaining is weak

## **8. Policy Concerns and Imperatives**

To protect gig and platform workers, policy measures are essential.

Important policy imperatives include:

- Legal recognition of gig workers
- Provision of social security benefits
- Skill development and training
- Fair wage and transparent payment systems

Government intervention is necessary to ensure decent working conditions.

### **9. Gig Economy in the Indian Context**

In India, the gig economy has grown rapidly due to:

- Large working-age population
- Expansion of digital platforms
- Urbanization and service demand

Gig work provides livelihood to millions, but it also highlights the need for stronger labor protection and inclusive growth policies.

### **10. Impact on Traditional Employment**

The gig economy is changing traditional employment patterns.

Positive impacts:

- Greater flexibility
- New income opportunities

Negative impacts:

- Rise of informal employment
- Decline in job security

Thus, it creates a mixed impact on the labor market.

### **Question Bank**

#### **PART A 2-Marks Questions**

1. What is the current population of India?
2. What is meant by demographic trends?
3. State the stage of Demographic Transition India is currently in.
4. Define absolute poverty.

5. Define relative poverty.
6. How does the government identify BPL households?
7. Mention one type of unemployment common in India.
8. Give one major cause of unemployment in India.
9. What age group is considered for demographic dividend?
10. Name one sector where job creation is essential to utilize demographic dividend.

### **PART B 10-Marks Questions**

1. Explain the concept of growing population and its influence on country resources.
2. Compare and contrast absolute and relative poverty with suitable examples.
3. Explain how Below Poverty Line (BPL) is measured in India.
4. Discuss the main causes of poverty in India.
5. Explain any two major government poverty alleviation programs and their objectives.
6. Describe the different types of unemployment prevalent in India with examples.
7. Explain the major causes of unemployment in India.
8. Explain the concept of demographic dividend and its economic importance.
9. Describe the challenges India faces in converting the demographic boom into a demographic dividend.

### **PART C 15-Marks Questions**

1. Discuss India's population growth trend and critically examine its long-term implications for national development.
2. Explain the Demographic Transition Theory in detail and evaluate India's current demographic position.
3. Critically examine the concepts of absolute and relative poverty with real-life Indian examples.
4. Evaluate the methods used in India to identify Below Poverty Line (BPL) households and challenges in targeting the poor.
5. Analyze the major structural, social, and economic causes of poverty in India.

### **Glossary**

**Absolute Poverty:** A condition where people lack basic necessities of life like food, clothing, and shelter.

BPL (Below Poverty Line): An economic benchmark used by the government to identify economically disadvantaged individuals or households.

Disguised Unemployment: More people working on a task than actually needed.

Demographic Dividend: Economic growth potential due to a large working-age population.

### **Suggested Reading**

1. Ramesh Singh. (2023). "Indian Economy" (15th ed.). McGraw-Hill Education.
2. Dutt, R., & Sundharam, K. P. M. (2022). "Indian Economy" (72nd ed.). S. Chand Publishing.
3. Kapila, U. (n.d.). "Indian Economy since Independence". Academic Foundation.
4. Dhingra, I. C. (2021). "Indian Economy". McGraw-Hill Education.
5. Agarwal, A. N., & Singh, S. P. (2020). "Indian Economy: Problems of Development and Planning" McGraw-Hill Education.

## Unit III: Inflation, Deflation and National Income

### Overview

Inflation means a general increase in goods and services prices in the country. When inflation occurs, money value falls. This affects everyone—consumers, businesses, and the government. A little inflation is considered healthy for a growing economy. It shows there is demand, and producers are making profits. But if inflation is too high, it becomes a problem. It makes everyday items like food, fuel, clothes, and travel expensive, especially hurting people with fixed incomes.

Deflation is the reverse of inflation. It means a general decrease in prices. At first, this may seem good—things are cheaper. But deflation is usually a sign that demand is low and businesses are struggling to sell their products. When companies earn less due to falling prices, they may reduce workers' salaries or lay off staff. This reduces people's income and further lowers demand. Inflation affects the prices we pay daily, while national income reflects how much wealth a country generates in a year.

### 3.1 MEANING AND TYPES OF INFLATION

**Inflation** is the rise in goods and services prices over time. It means that with the same amount of money, you can buy fewer things than before. For example, if milk costs ₹40 today and becomes ₹50 next month, that's inflation.

**Deflation** is the reverse of inflation—when prices fall. Although this may sound good, deflation often signals weak demand in the economy, which results in unemployment and business closures. Both inflation and deflation affect people's savings, business profits, and government decisions.

#### Types of Inflation

##### 1. Demand-Pull Inflation

Demand-pull inflation occurs when goods and services demands becomes higher than the available supply. When same product many peoples want to buy but production cannot keep up, prices naturally rise. Example, during festival seasons, the demand for sweets, clothes, and gifts increases.

##### 2. Cost-Push Inflation

Cost-push inflation happens when the cost of producing goods increases. When expenses like wages, fuel, raw materials, or electricity become more expensive, companies pass these costs on to consumers by raising prices. For instance, if petrol prices rise, transportation becomes costly, which leads to higher prices for vegetables, groceries, and other goods. This type of inflation affects both businesses (higher production cost) and consumers (higher purchase prices).

##### 3. Imported Inflation

Imported inflation arises when the prices of imported goods increase in the global market. Since India depends heavily on imports like crude oil, a rise in international oil prices forces India to pay more. This leads to higher fuel prices and increases the cost of transportation and manufacturing. As a result, overall prices in the economy rise. Thus, inflation enters the country through imports, even if domestic conditions remain unchanged.

## 4. Creeping Inflation

Creeping inflation refers to a slow, mild, and predictable rise in prices—usually less than 3% per year. This type of inflation is common in stable economies and is not considered harmful. It reflects steady economic growth, where prices increase gradually over time. Governments usually accept creeping inflation because it encourages spending and investment.

## 5. Walking Inflation

Walking inflation is a moderate level of inflation, usually between 3% and 10% per year. At this level, prices rise at a noticeable pace, due to which purchasing power of consumers decreased. If walking inflation continues for a long period, it can to reduced real income.

## 6. Running Inflation

Prices increase rapidly, making it difficult for people to manage their daily expenses. It creates instability in the economy, reduces savings, and affects investment decisions. Governments need to act quickly using monetary and fiscal policies to bring inflation under control.

## 7. Hyperinflation

Hyperinflation is the most extreme form of inflation, where prices rise uncontrollably—sometimes by 50% or more in just one month. This situation destroys the value of money, as prices double in a few days or weeks. Examples include Zimbabwe and Venezuela, where people lost trust in their national currency, and the economy nearly collapsed.

### 3.2 Measuring Inflation

The two most commonly used indexes in India are:

#### 1. Consumer Price Index (CPI)

The CPI measures changes in prices from the viewpoint of consumers. Example: If vegetables, milk, and fuel become expensive for people, CPI goes up. CPI playing important role in deciding salaries, pensions, and allowances.

#### 2. Wholesale Price Index (WPI)

WPI measures changes in price at the wholesale or business level. It tracks the prices of goods sold in bulk between companies, not at the consumer level. Example: If steel or cement prices rise in bulk markets, WPI reflects that WPI gives an early signal about inflation before it reaches the consumer.

**Inflation Rate is Calculated as follows;** To find how much prices have changed over time, the inflation rate is calculated using this formula:

$$\text{Inflation Rate} = \frac{\text{Current Index} - \text{Previous Index}}{\text{Previous Index}} \times 100$$

This tells us the **percentage increase in prices** over a given time period (usually monthly or yearly).

#### **Why is Measuring Inflation Important?**

- Helps the **RBI in deciding interest rates.**
- Guides the government in setting **monetary and fiscal policies.**
- Affects common people's **daily expenses** and **purchasing power.**
- Helps businesses in planning their Product pricing, and salaries.

So, accurate measurement of inflation is essential for good economic planning and to protect citizens from rising costs.

### **3.3 Causes of inflation include:**

- a. Higher demand than supply (demand-pull inflation)
- b. Rising costs of raw materials (cost-push inflation)
- c. Excess money supply in the market Causes of deflation include:
- d. Fall in consumer demand
- e. Excess production
- f. Reduction in government spending

Detail Explanation of causes of Inflation is given below:

#### **1. Higher demand than supply (Demand-Pull Inflation)**

When people want to purchase more goods and services than what is available in the market, prices rise. Example: If demand for onions suddenly increases but supply is limited, onion prices go up. This happens due to rising incomes, festivals, population growth, or increased government spending.

#### **2. Rising costs of raw materials (Cost-Push Inflation)**

When the cost of producing goods increases—such as higher prices of raw materials, fuel, wages, or electricity—companies raise prices to maintain profits. Example: If petrol or diesel prices rise, transportation costs increase, making goods more expensive.

#### **3. Excess supply of money in the market**

When more money is printed by the central bank or when loans become cheap, people have more money to spend. If supply of money grows faster than the supply of goods, prices increase. Example: If banks give loans easily at low interest rates, people buy more houses, cars, etc., causing prices to rise.

#### **4. Fall in consumer demand**

When people start spending less—because of unemployment, low incomes, or fear of recession—businesses reduce prices to attract buyers, leading to deflation. Example: During economic slowdown, people cut unnecessary expenses.

#### **5. Excess production**

To clear stock, firms reduce prices, causing overall price fall (deflation). Example: Oversupply of cars or real estate can reduce prices.

#### **6. Reduction in government spending**

If the government cuts its spending on public projects, salaries, infrastructure, etc., the economy slows down. Less money circulates, demand decreases, and prices drop. Example: Reduced investment in construction or rural schemes leads to decline in demand for materials and labors.

Both inflation and deflation affect savings, investments, jobs, and the cost of living. Hence, governments and central banks (like the RBI) try to control them using monetary policies. Understanding inflation and deflation helps us understand why prices rise or fall and how it affects our daily life and the country's economy.

### 3.4 Concept of National Income

National Income is the total monetary value of all final goods and services which are produced by the country's residents in a financial year. It reflects the nation's economic performance and forms the framework for economic planning and policy formulation.

#### Importance of National Income:

- Measures economic growth
- Guides government in policy and planning
- Useful for understanding inflation and employment levels

#### National Income (NI)

National Income (NI) refers to the total value of all final goods and services produced within a nation during a particular period, generally one financial year. It reflects the overall economic performance and productive capacity of a nation.

#### National Income Accounting

This method is used by the Govt. to measure the economic growth of nation. It records production, income, and expenditure of country within a given time frame, helping policymakers assess growth and development.

#### Basic Concepts :

##### 1. Circular Flow of Income concept:

This concept shows how **money, goods, and services move** among households, firms, government, and foreign sectors.

- Households supply factors of production and receive income.
- Firms produce goods/services and receive payments from households.  
Income and expenditure continuously circulate, forming a closed loop.

##### 2. Domestic / Economic Territory

Economic territory includes the area under the control of the Government of India where people, goods, and capital can move freely.

#### Important points:

- **Foreign embassies in India** → *Not* part of India's economic territory.
- **Indian embassies abroad** → *Are* considered part of India's economic territory.

##### 3. Market Price (MP)

The price a consumer pays to buy a product in the market.

- **Includes** indirect taxes (GST, excise).
- **Excludes** subsidies.

#### 4. Factor Cost (FC)

The cost incurred by producers for using factors of production—land, labour, capital, entrepreneurship.

- **Excludes** indirect taxes.
- **Includes** subsidies.

#### 5. Nominal (Current) Price

Price of goods/services **at the existing market price** of the current year. Includes inflation.

#### 6. Real (Constant/Base Year) Price

Price of goods/services at **base year prices**, used for comparing performance of economy across years.

#### 7. Depreciation

Loss in value of fixed assets due to **wear and tear, usage, or obsolescence**. Known as Consumption of Fixed Capital.

#### 8. (NFIA): Net Factor Income from Abroad

Difference between the income residents earn abroad and non-residents earn within the country.

**NFIA = Factor income received from abroad – Factor income paid abroad**

#### 9. Transfer Payments

Payments made without any exchange of goods/services. Examples: Scholarships, pensions, donations, gifts.

They are **not included** in NI.

#### 10. Capital Output Ratio (COR)

Amount of capital required to produce one unit of output.

**COR = Capital / Output**

Lower COR = higher efficiency.

#### 11. Incremental Capital Output Ratio (ICOR)

Extra investment required to produce an additional unit of output.

$$\text{ICOR} = \Delta \text{ Capital} / \Delta \text{ Output}$$

### 3.5 Measures of National Income

#### 1. Gross Domestic Product (GDP)

GDP measures the final goods and services total value produced within India's economic territory during one year.

##### **GDP at Market Price: (GDPMP)**

Includes indirect taxes and excludes subsidies.

##### **GDP at Factor Cost (GDPFC)**

Income generated by factors of production.

$$\text{GDPFC} = \text{GDPMP} - \text{Indirect Taxes} + \text{Subsidies}$$

#### 2. Gross National Product (GNP):

GNP measures the value of final goods and services **produced by residents of a country**, regardless of location.

$$\text{GNP} = \text{GDP} + \text{NFIA}$$

##### **Difference between GDP and GNP**

- **GDP** → Production within domestic territory.
- **GNP** → Production by citizens of the country.

#### 3. Real GDP vs Nominal GDP

- **Nominal GDP** → Value of output at current year prices (includes inflation).
- **Real GDP** → Value of output at constant/base year prices (inflation removed).

#### 4. GDP Deflator

Indicator of inflation within the economy.

$$\text{GDP Deflator} = \text{Nominal GDP} / \text{Real GDP}$$

#### 5. Gross Value Added (GVA)

Contribution of labour and capital to

production. **GVA = GDP – Indirect**

## Taxes + Subsidies GDP vs GVA

GVA	GDP
Output minus intermediate consumption	Value of final goods/services
Input-side measure	Output-side measure
Sector-wise	Economy-wide

### 6. Net National Income (NNI)

Income available after subtracting depreciation.

**Net Domestic**

**Product :(NDP)**

**NDP = GDP –**

**Depreciation Net**

**National Product:**

**(NNP) NNP = GNP**

**– Depreciation**

### 3.6 Trends in Inflation in India

#### 3.6.1. Introduction

Inflation is one of the most important macro-economic issues in India. It directly affects the cost of living, purchasing power of money, savings, investment, and overall economic stability. Studying the trends in inflation helps us understand how prices have changed over time and how the Indian economy has responded to internal and external challenges.

#### 3.6.2. Meaning of Inflation

Inflation refers to a **sustained and continuous rise in the general price level of goods and services over a period of time**. As inflation increases, the value of money declines, meaning people can buy fewer goods and services with the same amount of income.

Inflation is not a one-time increase in prices but a long-term upward movement in overall prices.

#### 3.6.3. Measures of Inflation in India

Inflation in India is measured using different price indices:

### **3.6.3.1 Consumer Price Index (CPI)**

- Measures changes in prices paid by consumers
- Reflects cost of living
- Widely used for inflation targeting

### **3.6.3.2 Wholesale Price Index (WPI)**

- Measures price changes at the wholesale level
- Includes goods traded in bulk
- Earlier used as the main inflation indicator

At present, CPI is considered the primary measure of inflation in India.

## **3.6.4. Historical Trends in Inflation in India**

### **3.6.4.1 Inflation in the Pre-Reform Period**

In the early decades after independence:

- Inflation was moderate but persistent
- Major causes were food shortages, wars, and supply constraints
- Agriculture played a major role in price movements

Price rises were mainly driven by food inflation due to dependence on monsoon.

### **3.6.4.2 Inflation During Economic Reforms**

After economic reforms:

- Market-oriented policies increased competition
- Industrial production expanded
- Inflation showed fluctuations

Although growth increased, inflation was influenced by global oil prices, demand expansion, and fiscal deficits.

### **3.6.4.3 Inflation in Recent Decades**

In recent years:

- Inflation has shown **periodic rise and fall**
- Food and fuel prices have been major contributors
- Services inflation has also increased due to rising demand

Government and monetary authorities have focused on controlling inflation while supporting

growth.

### **3.6.5. Major Trends in Inflation in India**

#### **3.6.5.1 Declining Trend with Periodic Spikes**

- Long-term trend shows better control compared to earlier decades
- Short-term spikes occur due to food shortages, fuel price increases, or global shocks

Thus, inflation is no longer permanently high but remains sensitive to supply conditions.

#### **3.6.5.2 Food Inflation as a Key Driver**

Food items have a significant weight in India's consumption basket.

- Prices of cereals, vegetables, pulses, and edible oils fluctuate frequently
- Monsoon failure, supply chain disruptions, and storage issues affect prices

Food inflation strongly influences overall inflation trends.

#### **3.6.5.3 Fuel and Energy Price Impact**

Fuel prices affect inflation through:

- Transportation costs
- Production expenses
- Electricity and household fuel prices

Global crude oil price changes have a direct impact on Indian inflation.

#### **3.6.5.4 Rising Services Inflation**

With economic growth:

- Demand for education, healthcare, transport, and housing has increased
- Services inflation has become more prominent

This reflects structural changes in the Indian economy.

#### **3.6.5.5 Inflation Moderation Through Policy Measures**

In recent times:

- Inflation targeting framework has been adopted
- Monetary policy focuses on price stability
- Fiscal discipline has improved

These measures have helped reduce extreme inflation.

### **3.6.6. Causes of Inflation in India**

### **3.6.6.1 Demand-Pull Factors**

- Increase in population
- Rising incomes and consumption
- Expansion of government spending

High demand pushes prices upward.

### **3.6.6.2 Cost-Push Factors**

- Increase in wages
- Higher input costs
- Rise in fuel and raw material prices

These factors increase production costs, leading to higher prices.

### **3.6.6.3 Supply-Side Constraints**

- Dependence on agriculture
- Poor storage and transport
- Weather-related disruptions

Supply shortages often result in price rise.

## **3.6.7. Effects of Inflation in India**

### **3.6.7.1 Impact on Consumers**

- Reduces purchasing power
- Increases cost of living
- Affects fixed-income groups the most

### **3.6.7.2 Impact on Savings and Investment**

- High inflation discourages savings
- Creates uncertainty for investors
- Distorts resource allocation

### **3.6.7.3 Impact on Economic Growth**

Moderate inflation:

- Encourages production and investment

High inflation:

- Creates instability

- Slows economic growth

Thus, maintaining optimal inflation is important.

### **3.6.8. Role of Government and RBI in Controlling Inflation**

#### **3.6.8.1 Monetary Policy Measures**

- Regulation of interest rates
- Control of money supply
- Inflation targeting framework

#### **3.6.8.2 Fiscal Policy Measures**

- Reducing fiscal deficit
- Controlling government expenditure
- Rationalizing taxes and subsidies

#### **3.6.8.3 Supply-Side Measures**

- Improving agricultural productivity
- Strengthening storage and distribution
- Reducing import duties on essential goods

### **3.6.9. Inflation Trends and Indian Economy**

India has moved from:

- High and persistent inflation to more **managed and policy-guided inflation**

However, challenges remain due to:

- Global uncertainties
- Climate change impact on agriculture
- Volatile fuel prices

## **3.7 Limitations of National Income Accounting**

### **1. Introduction**

National income accounting is an important tool used to measure the economic performance of a country. It helps in estimating the total value of goods and services produced during a specific period. Indicators such as national income, GDP, GNP, and per capita income are widely used to assess economic growth and development. However, despite its usefulness, national income accounting has several limitations that restrict its ability to present a complete and accurate picture of economic welfare.

## **2. Meaning of National Income Accounting**

National income accounting refers to a systematic method of measuring the total income generated in an economy over a period of time. It includes income earned by individuals, businesses, and the government through productive activities. Although it provides valuable quantitative data, it does not capture many qualitative aspects of economic life.

## **3. Major Limitations of National Income Accounting**

### **3.1 Exclusion of Non-Market Activities**

One of the major limitations is that national income accounting includes only those goods and services that are exchanged through the market.

- Household services such as cooking, cleaning, and child care performed by family members are excluded.
- Volunteer services and social work are not counted.

As a result, the actual productive contribution to the economy is underestimated.

### **3.2 Difficulty in Measuring the Informal Sector**

In developing economies, a large portion of economic activity takes place in the informal or unorganized sector.

- Small traders, street vendors, and casual laborers often do not maintain proper records.
- Income from such activities is difficult to estimate accurately.

This leads to underestimation of national income.

### **3.3 Problem of Double Counting**

Double counting occurs when the value of intermediate goods is included along with final goods.

- For example, counting both the value of raw materials and the finished product.
- This leads to overestimation of national income.

Although methods are used to avoid this, complete elimination of double counting is difficult.

### **3.4 Inaccurate Data and Statistical Errors**

National income estimates depend on large-scale data collection.

- Inaccurate reporting
- Incomplete surveys
- Estimation errors

These issues affect the reliability of national income figures, especially in countries with limited statistical infrastructure.

### **3.5 Ignoring Income Distribution**

National income accounting shows total income but does not reveal how income is distributed among people.

- A rise in national income may benefit only a small section of society.
- Income inequality and poverty may still exist despite economic growth.

Thus, national income is not a true measure of social welfare.

### **3.6 Neglect of Quality of Life and Welfare**

National income measures economic output, not human well-being.

It ignores:

- Health and education quality
- Leisure time
- Social security
- Environmental quality

Therefore, higher national income does not always mean better living standards.

### **3.7 Environmental Degradation Not Considered**

Production activities may harm the environment.

- Pollution
- Depletion of natural resources
- Climate change effects

National income accounting counts such production as positive contribution, even if it causes long-term damage.

### **3.8 Changes in Price Level**

National income figures can be misleading due to inflation.

- An increase in national income may be due to rising prices rather than real growth.
- Nominal income does not reflect actual increase in production.

Although real income measures adjust for inflation, accurate price indices are difficult to construct.

### **3.9 Valuation Problems**

Some goods and services do not have a clear market value.

- Government services
- Public administration
- Defense services

These are often valued at cost, which may not reflect their true economic value.

### **3.10 International Comparability Issues**

Comparing national income across countries is difficult due to:

- Differences in price levels
- Exchange rate fluctuations
- Differences in consumption patterns

Thus, international comparisons may be misleading.

## **4. Limitations in Measuring Economic Development**

National income accounting mainly measures economic growth, not development.

It fails to capture:

- Poverty reduction
- Human development
- Social progress

Hence, national income alone cannot be used as a comprehensive indicator of development.

## **5. Importance of Complementary Indicators**

Due to these limitations, economists use additional indicators such as:

- Human Development Index (HDI)
- Poverty and inequality measures
- Environmental indicators

These provide a broader understanding of development.

## **3.8 Per Capita Income and Economic Growth**

### **1. Introduction**

Per capita income is one of the most widely used indicators for understanding the economic condition of a country. It shows the average income of people and is often used to compare the standard of living across regions and over time. Economic growth, on the other hand, refers to an increase in the real output of goods and services in an economy. Studying the

relationship between per capita income and economic growth helps in assessing whether growth leads to better living standards.

## **2. Meaning of Per Capita Income**

Per capita income refers to the **average income earned per person in a country during a particular year.**

It is calculated as:

$$\text{Per Capita Income} = \text{National Income} \div \text{Total Population}$$

This measure helps to estimate the average level of income and economic well-being of the population.

## **3. Meaning of Economic Growth**

Economic growth means a **sustained increase in the real national income or real GDP of a country over time.**

Features of economic growth include:

- Increase in production capacity
- Expansion of goods and services
- Rise in real income

Economic growth focuses on the quantitative increase in output.

## **4. Relationship Between Per Capita Income and Economic Growth**

Per capita income and economic growth are closely related.

- Economic growth increases national income.
- If population growth is slower than income growth, per capita income rises.
- Rising per capita income indicates improvement in average living standards.

However, economic growth alone does not guarantee equitable distribution of income.

## **5. Importance of Per Capita Income in Economic Analysis**

### **5.1 Indicator of Standard of Living**

Per capita income reflects:

- Ability to consume goods and services
- Access to better healthcare and education
- Improved living conditions

Higher per capita income usually indicates a better standard of living.

## **5.2 Comparison Across Countries and Regions**

Per capita income is used to:

- Compare economic performance of different countries
- Classify countries as low, middle, or high income
- Measure progress over time

It provides a simple method for comparison.

## **5.3 Policy Planning and Decision Making**

Governments use per capita income data to:

- Formulate development policies
- Allocate resources
- Identify economically backward regions

It serves as a basic tool for economic planning.

## **6. Factors Affecting Per Capita Income**

### **6.1 Growth of National Income**

An increase in production and productivity raises national income and per capita income.

### **6.2 Population Growth**

Rapid population growth reduces per capita income.

- Even if total income rises, high population growth dilutes income gains.
- Population control is important for improving per capita income.

### **6.3 Productivity of Labour**

Higher productivity increases output per worker, raising national income and per capita income.

### **6.4 Capital Formation**

Investment in physical and human capital improves production capacity and income levels.

### **6.5 Technological Progress**

Technological advancement leads to efficient production and higher economic growth.

## **7. Per Capita Income and Economic Growth in Developing Countries**

In developing economies:

- Economic growth may occur without significant rise in per capita income.

- High population growth offsets income gains.
- Unequal income distribution limits welfare improvement.

Thus, growth must be inclusive to raise per capita income meaningfully.

## **8. Limitations of Per Capita Income as a Measure of Growth**

### **8.1 Ignores Income Distribution**

Per capita income is an average figure.

- It does not show inequality.
- A small rich population can raise the average.

### **8.2 Excludes Non-Monetary Factors**

It does not consider:

- Health and education quality
- Social security
- Environmental conditions

Hence, it is not a complete measure of welfare.

### **8.3 Informal Sector Not Fully Captured**

In many countries, informal income is underreported, leading to inaccurate per capita income estimates.

## **9. Role of Per Capita Income in Economic Development**

Per capita income growth is essential for development because it:

- Improves consumption capacity
- Reduces poverty
- Enhances savings and investment

Sustained growth in per capita income reflects long-term economic progress.

## **10. Per Capita Income and Indian Economy**

In India:

- Per capita income has increased over time
- Economic growth has been accompanied by structural changes
- Population growth and inequality remain challenges

Policies focus on inclusive growth to ensure that economic growth leads to higher per capita

income for all.

## **QUESTION BANK**

### **PART A – 2 Marks Questions**

1. Define inflation.
2. Define deflation.
3. What is demand-pull inflation?
4. What does CPI measure?
5. What does WPI measure?
6. State any one cause of inflation in India.
7. Define GDP.
8. Define GNP.
9. What is depreciation?
10. Define NNP.
11. What is National Income at Factor Cost?
12. What is Disposable Personal Income?
13. Mention any one importance of national income.
14. What is cost-push inflation?
15. Write the formula of GDP by expenditure method.

### **PART B – 10 Marks Questions**

1. Explain the concepts of inflation and deflation with suitable examples.
2. Describe the various types of inflation—demand-pull, cost-push, imported, creeping, walking, running, and hyperinflation.
3. Explain how inflation is measured using CPI and WPI.
4. Discuss the major causes of inflation in India.
5. Explain the concept of GDP as well as three methods to measure it.
6. Differentiate between GDP as well as GNP with examples.
7. Explain the concept and importance of NNP.
8. Describe Personal Income and Disposable Personal Income and how they are calculated.

### **PART C – 15 Marks Questions**

1. What is inflation? Discuss in detail its types, causes, and impact on the Indian economy.
2. Explain in detail how inflation and deflation affect consumers, businesses, and government policy.
3. Discuss the measurement of inflation using CPI and WPI. Explain why accurate inflation data is important for policymakers.
4. Explain GDP, GNP, and NNP. Evaluate how each indicator helps in understanding a country's economic performance.
5. National Income and Inflation are key macroeconomic indicators. Discuss their interrelationship and importance for economic development.

### **Glossary**

Inflation: General rise in prices.

Deflation: General fall in prices.

CPI: Consumer Price Index.

WPI: Wholesale Price Index.

GNP: Gross National Product.

CSO: Central Statistical Office.

### **Suggested Reading**

1. Indian Economy by Ramesh Singh 14th Edition, 2024, published by McGraw Hill Education.
2. Principles of Economics by M. L. Seth Revised Edition, 2023, published by Laxmi Publications.
3. Macro Economics by H. L. Ahuja 21st Edition, 2023, published by S. Chand Publishing.
4. Basic Statistics by G. C. Beri 5th Edition, 2021, published by Tata McGraw Hill.
5. Managerial Economics by D. N. Dwivedi 8th Edition, 2022, published by Vikas Publishing House.

## Unit IV: Monetary Policy, Fiscal Policy, and International Trade

### Overview

In this unit students will learn about the key economic policies used by governments to manage a country's economy—**Monetary Policy** and **Fiscal Policy**. It also covers the basics of international trade, particularly **imports and exports**, and introduces the concepts of **Balance of Trade (BoT)** and **Balance of Payments (BoP)**. These tools and indicators are important for making sound financial and trade-related decisions.

### 4.1 Monetary Policy: Meaning and Tools

#### Monetary Policy: Meaning and Objectives

It is the process by which a country's central bank—such as the Reserve Bank of India (RBI)—controls the supply of money, credit availability, and interest rates in an economy. Its core objectives include maintaining price stability (controlling inflation), promoting economic growth, managing employment levels, and stabilizing the financial system. A well-designed monetary policy ensures that inflation can be controlled while providing enough liquidity for businesses and consumers to support economic activities.

In India, the RBI is responsible for framing and executing monetary policy. Through various tools and techniques, the RBI attempts to balance inflation and growth by either expanding or contracting the money supply.

#### Types of Monetary Policy:

1. **Expansionary Monetary Policy** – This is used during periods of low economic activity. The RBI reduces interest rates to increase the supply of money, aiming to boost consumption and investment.
2. **Contractionary Monetary Policy** – This is used when inflation is high. The RBI increase the rate of interest so that loans become more expensive, thereby reducing spending and controlling inflation.

Both policies are dynamic and depend on current macroeconomic conditions. Policymakers need to strike a balance to avoid either stalling growth or triggering runaway inflation.

#### Tools of Monetary Policy:

1. **Repo Rate:** – This is the rate of interest at which the RBI lends short-term funds to commercial banks. Borrowing becomes expensive, if repo rate is higher reducing money supply and lower rate boosts liquidity and encourages lending.
2. **Reverse Repo Rate :-** Rate at which the RBI borrows money from banks. It helps absorb excess liquidity. When the RBI increases the reverse repo rate, banks are encouraged to deposit funds with the RBI, reducing money in circulation.
3. **Cash Reserve Ratio (CRR) :-** This is the percentage(%) of a bank's total deposits that must be kept with the RBI in the form of cash. An increase in CRR reduces the bank's lending capacity, while a reduction increases it.
4. **Statutory Liquidity Ratio (SLR) :-** This is the portion of deposits that banks must invest in specified government securities before offering credit. Like CRR, changes in SLR impact the liquidity available in the country.

5. **Open Market Operations (OMO):** – This refers to the RBI buying as well as selling Govt. bonds in the open market. If the RBI sells securities, it sucks liquidity out of the system. Buying them injects money into the system. OMOs are frequently used to manage short-term liquidity.
6. **Bank Rate:** – Though not used frequently today, this is the long-term rate of interest at which the RBI lends to commercial banks. Changes in the bank rate influence general interest rates in the country.

## Recent Developments in India's Monetary Policy

India has adopted a more structured and transparent monetary policy in recent years.

**Monetary Policy Committee : (MPC) formed** in 2016 marked a major shift. The MPC, headed by the RBI Governor and comprising both RBI and government-appointed members, meets every two months to decide on policy rates based on inflation forecasts and economic data.

The RBI used expansionary monetary policy by reducing the repo rate and injecting liquidity to support growth during the pandemic of COVID-19. In contrast, in response to global inflationary pressures in 2022–2023, the RBI started tightening policy by increasing repo rates to contain inflation.

### Monetary Policy: Impact on the Economy

Monetary policy directly impacts interest rates, inflation, exchange rates, and the overall investment climate. For instance, low-interest rates encourage industries to borrow and invest in production, leading to job creation and growth and when inflation rises, higher interest rates discourage excess borrowing and spending, bringing prices down.

For households, changes in interest rates affect EMIs (Equated Monthly Installments), savings rates, and investment returns. For businesses, it affects the investments and decisions about expansion. Thus, monetary policy has widespread implications across all sectors.

## 4.2 Fiscal Policy: Meaning and Instruments

Fiscal policy refers to the government's strategy for managing its income (revenue) and expenses (expenditure) to influence the overall economic activity of a country. It helps in stabilizing the economy, controlling inflation, boosting economic growth, reducing unemployment, and ensuring social welfare.

Indian Govt. implements fiscal policy mainly through the **Finance Ministry**, using tools such as **taxation, public spending, subsidies, and borrowing**. Unlike monetary policy, which is controlled by the Reserve Bank of India :(RBI), fiscal policy is entirely in the hands of the elected government.

### 4.3. Objectives of Fiscal Policy

#### 1. Stimulate economic growth in times of slowdown

Fiscal policy aims to boost the economy when growth is low or during a recession. The government increases spending on projects, reduces taxes, and gives incentives to businesses. These steps increase demand, production, and investment, helping the economy recover.

## **2. Control inflation by reducing government spending**

When prices rise beyond a comfortable level, the government uses fiscal policy tools to bring inflation under control. It may reduce its own expenditure, cut certain subsidies, or increase taxes. These steps reduce the overall money supply in the economy, lower excessive demand, and help stabilize prices.

## **3. Promote employment through public works and development programs**

Fiscal policy also aims to tackle unemployment by investing in public works such as roads, bridges, dams, and housing projects. These activities create many direct jobs and support additional employment in related industries. Government-funded development programs and skill training initiatives further help increase job opportunities and reduce unemployment.

## **4. Progressive taxation and welfare schemes: Reduce income inequality**

Another important objective of fiscal policy is to narrow the gap in income between various sections of society. Under progressive taxation, individuals with higher incomes pay proportionately higher taxes. This revenue is used by the Govt. to finance welfare schemes like healthcare, education, pensions, and subsidies for economically weaker groups, helping promote greater equality.

## **5. Support infrastructure development**

Fiscal policy plays a key role in building and strengthening the nation's infrastructure. Government spending on services which are essential such as roads, schools, hospitals, power supply, and transport networks improves the living standards for citizens. Strong infrastructure also encourages investment, increases productivity, and supports long-term economic growth.

### **Key Instruments of Fiscal Policy**

#### **1. Public Expenditure:**

Public expenditure refers to all the spending done by the government on various areas like defence, infrastructure, education, healthcare, and welfare of society. This expenditure contribute in boosting economic activity by creating jobs, developing infrastructure, and improving public services. When the government spends more, it increases overall demand in the economy, which encourages businesses to produce more and hire additional workers. Thus, public expenditure acts as a major tool for promoting growth, reducing unemployment, and improving living standards.

#### **2. Taxation**

Taxation is the main source of revenue for the government and a critical instrument of fiscal policy. It includes both direct taxes—such as Income Tax and Corporate Tax, directly collected from individuals and businesses—and indirect taxes, such as the Goods and Services Tax: (GST), which are levied on goods and services. With the help of taxation, the government can redistribute income by charging higher tax rates on higher-income groups. Taxes can be utilized to influence behavior; for example, offering tax rebates on electric vehicles encourages adoption of eco-friendly alternatives. Therefore, taxation helps generate revenue, promote fairness, and guide economic activities.

#### **3. Fiscal Deficit and Fiscal Surplus**

Fiscal deficit occurs when the government's total expenditure is greater than its total revenue, excluding borrowings. In developing economies, a moderate fiscal deficit can be beneficial because it allows the government to invest in infrastructure and development projects. However, high fiscal deficits may increase inflation, lead to excessive borrowing, and create debt burdens for future generations. On the contrary, a fiscal surplus exists when government revenue is higher than expenditures, though this is rare in developing nations. Managing fiscal deficit and surplus helps maintain economic stability and ensure responsible financial management.

#### 4. Subsidies and Transfers

Subsidies and transfer payments are major tools used by the government to support vulnerable sections of society. Subsidies on essential items like food, fuel, and fertilizers help reduce the financial burden on poor people. In addition, welfare schemes such as MNREGA, PM-KISAN, old-age pensions, and scholarships provide direct financial assistance to improve living conditions. These transfers not only support low-income households but also enhance social welfare, reduce poverty, and promote inclusive growth. Through such measures, fiscal policy ensures that economic benefits reach the weaker sections of society.

#### Types of Fiscal Policy

- **Expansionary Fiscal Policy:**
  - Used during economic slowdown or recession.
  - Government increases spending and reduces taxes to increase demand and employment.
- **Contractionary Fiscal Policy:**
  - Used during periods of high inflation.
  - Government increases taxes or reduces spending to control excessive demand in the country.

#### Fiscal Policy: in India

India, being a developing country, needs large-scale investments in infrastructure, education, and health. Fiscal policy helps mobilize resources and directs them towards development. During crises like COVID-19, the government used expansionary fiscal measures to support people through free food distribution, income support, and healthcare investment. On the other hand, rising deficits can be dangerous. That is why the FRBM: Fiscal Responsibility and Budget Management Act was introduced to keep fiscal deficit under control.

#### Imports and Exports: Concepts

**Imports** are goods as well as services bought from other countries, while **exports** are goods as well as services sold to other countries.

- **Exports** earn foreign exchange and promote economic growth.
- **Imports** allow advanced technology as well as raw material not available domestically.

India exports software, garments, jewelry, etc., and imports oil, electronics, machinery, etc.

#### 4.4 Balance of Trade (BoT)

It is a major component of the Balance of Payments (BoP), which includes both goods and services. BoT helps measure a country's economic strength in global trade.

Formula:

$$\text{BoT} = \text{Value of Exports} - \text{Value of Imports}$$

- If the exports value is greater than imports, it is called a Trade Surplus.
- If the imports value is greater than exports, it is called a Trade Deficit.

#### Why BoT Matters:

- A **Trade Surplus** is a sign of a strong economy. It helps in improving national income by bringing more foreign currency into the country.
- A **Trade Deficit**, if large and persistent, may lead to borrowing from other countries and increase the foreign debt burden.
- However, importing essential goods like oil, technology, or capital machinery—even if it creates a deficit—can help in long-term development.

#### 4.5 Balance of Payments :(BoP)

It is a complete and record of **all economic transactions** between a nation and the **rest of the world** during a specific period, usually a year. These transactions include the trade of goods and services, movement of capital, and financial transfers.

BoP helps us understand how a country interacts economically with other countries and whether it is earning more from the world or spending more abroad.

#### Major Components of BoP

##### 1. Current Account

This account deals with:

- Exports as well as imports of goods (also called visible trade)
- Services like tourism, transport, IT, etc.
- Transfer payments like remittances, foreign aid, and gifts.

If exports as well as remittances are more than imports and payments, the current account of BoP shows a surplus; otherwise, it shows a deficit.

##### 2. Capital Account

This includes:

- **Foreign investments** made by Indians abroad and foreigners in India.
- **Loans** taken or given to other countries.
- **Sale and purchase of assets** like land or factories in foreign countries.

A surplus here means India is receiving more investments than it is making abroad.

### 3. Financial Account

This part records:

- **Foreign exchange reserves**
- **Currency inflows/outflows**
- **Transactions involving central banks**

#### BoP Surplus and Deficit

- **BoP Surplus:** Inflow is greater than outflow. In simple words the economy is receiving more money from abroad than it is paying out (inflow > outflow).
- **BoP Deficit** means outflow of economy is greater than inflow. Spending more in abroad than it's earning (outflow > inflow).

#### Importance of BoP

- Helps in framing trade, monetary, and fiscal policies.
- Indicates the nation's strength in the global market.
- Affects exchange rates and foreign investment.

#### BoT vs. BoP:

While BoT includes only visible goods, BoP (Balance of Payments) also includes services, capital flows, and financial transfers. Hence, BoT is just one part of BoP.

### Monetary Policy Transmission Mechanisms

#### 1. Introduction

Monetary policy is an important tool used by the central bank to regulate money supply and credit conditions in an economy. However, policy decisions taken by the central bank do not affect the economy immediately. The process through which changes in monetary policy influence output, inflation, investment, and employment is known as the **monetary policy transmission mechanism**. Understanding this mechanism helps in analyzing how monetary policy actions impact the real economy.

#### 2. Meaning of Monetary Policy Transmission

Monetary policy transmission refers to the **chain of effects through which changes in policy instruments such as interest rates, reserve requirements, or liquidity measures influence economic activity and prices**.

It explains:

- How central bank decisions reach households and firms
- How financial markets respond to policy changes
- How inflation and growth are ultimately affected

### 3. Importance of Monetary Policy Transmission

The effectiveness of monetary policy depends on:

- Speed of transmission
- Strength of transmission
- Stability of transmission channels

If transmission is weak or delayed, policy objectives such as price stability and growth cannot be achieved efficiently.

### 4. Main Channels of Monetary Policy Transmission

Monetary policy works through several channels. These channels may operate simultaneously.

#### 5. Interest Rate Channel

The interest rate channel is the **most traditional and widely used transmission mechanism**. **Working:**

- Central bank increases or decreases policy rates
- Commercial banks adjust lending and deposit rates
- Changes in interest rates influence borrowing and spending

**Impact:**

- Lower interest rates encourage investment and consumption
- Higher interest rates discourage borrowing and spending

Thus, interest rate changes affect aggregate demand, output, and inflation.

#### 6. Credit Channel

The credit channel focuses on the **availability of bank credit** rather than interest rates alone.

**Two Components:**

##### a) Bank Lending Channel

- Monetary tightening reduces bank reserves
- Banks reduce lending
- Investment and consumption decline

##### b) Balance Sheet Channel

- Interest rate changes affect asset values
- Lower asset values weaken borrower balance sheets
- Reduced borrowing capacity slows economic activity

The credit channel is especially important in bank-dominated economies.

### **7. Asset Price Channel**

Monetary policy influences prices of financial assets such as:

- Shares
- Bonds
- Real estate

#### **Working:**

- Lower interest rates increase asset prices
- Higher asset prices increase household wealth
- Increased wealth leads to higher consumption

This channel links monetary policy with consumer spending and investment decisions.

### **8. Exchange Rate Channel**

In an open economy, monetary policy affects the exchange rate.

#### **Working:**

- Lower interest rates reduce capital inflows
- Domestic currency depreciates
- Exports become cheaper and imports costlier

#### **Impact:**

- Export demand increases
- Domestic production rises
- Inflation may increase due to costlier imports

This channel connects monetary policy with external trade and prices.

### **9. Expectations Channel**

Expectations play a crucial role in monetary transmission.

#### **Working:**

- Policy announcements influence expectations of inflation and growth
- Credible policies anchor inflation expectations
- Businesses and consumers adjust decisions accordingly

If people trust the central bank, policy actions become more effective.

## 10. Liquidity Channel

The liquidity channel works through **changes in cash and liquid assets**. **Working:**

- Expansionary policy increases liquidity
- Households and firms feel financially comfortable
- Spending increases

Liquidity affects short-term economic decisions, especially during financial stress.

## 11. Role of Monetary Policy Transmission in India

In India:

- The interest rate channel is gaining importance
- The banking system plays a major role in credit transmission
- Exchange rate and expectations channels are also significant

The Reserve Bank of India focuses on improving transmission efficiency through policy reforms.

## 12. Factors Affecting Transmission Mechanism

Several factors influence the strength of transmission:

- Health of banking system
- Level of financial inclusion
- Market competition
- Fiscal dominance
- Global economic conditions

Weak financial institutions can slow transmission.

## 13. Challenges in Monetary Policy Transmission

- Delays in interest rate pass-through
- Large informal sector
- Rigidities in lending rates
- External shocks

These challenges reduce the effectiveness of policy actions.

## 14. Improving Monetary Policy Transmission

Measures include:

- Strengthening banking sector

- Improving financial markets
- Enhancing transparency and communication
- Reducing non-performing assets

Effective transmission ensures policy goals are achieved.

## **Fiscal Policy**

### **1. Introduction**

Fiscal policy is one of the most important tools of economic management used by the government to influence the level of economic activity in a country. Through fiscal policy, the government controls public revenue and public expenditure to achieve economic stability, growth, and social welfare. In developing economies, fiscal policy plays a crucial role in accelerating economic development and reducing inequality.

### **2. Meaning of Fiscal Policy**

Fiscal policy refers to the **use of government revenue and expenditure policies to influence economic conditions**. It involves decisions relating to:

- Government spending
- Taxation
- Public borrowing

By adjusting these components, the government aims to regulate aggregate demand and promote economic development.

### **3. Definition of Fiscal Policy**

Fiscal policy can be defined as:

*The policy of the government relating to public expenditure, taxation, and public debt for achieving economic objectives such as growth, stability, and equitable distribution of income.*

This definition highlights the role of the government in managing the economy through budgetary measures.

### **4. Nature of Fiscal Policy**

The nature of fiscal policy can be understood through the following characteristics:

#### **4.1 Government-Oriented Policy**

Fiscal policy is formulated and implemented by the government through the annual budget and related financial decisions.

#### **4.2 Planned and Deliberate**

Fiscal policy actions are planned in advance and based on economic goals and priorities.

### **4.3 Flexible in Nature**

Fiscal policy can be adjusted according to economic conditions:

- Expansionary during recession
- Contractionary during inflation

### **4.4 Development-Oriented**

In developing countries, fiscal policy focuses on:

- Infrastructure development
- Poverty reduction
- Human capital formation

### **4.5 Long-Term Impact**

Unlike monetary policy, fiscal policy often has a long-term impact on economic growth and development.

## **5. Objectives of Fiscal Policy**

### **5.1 Economic Growth**

Fiscal policy aims to promote economic growth by:

- Increasing public investment
- Encouraging private investment
- Developing infrastructure

### **5.2 Price Stability**

Fiscal measures help control inflation by:

- Reducing unnecessary government expenditure
- Increasing taxes to curb excess demand

### **5.3 Full Employment**

Government spending on public works and development projects creates employment opportunities.

### **5.4 Equitable Distribution of Income**

Fiscal policy reduces income inequality through:

- Progressive taxation
- Welfare and subsidy programs

### **5.5 Economic Stability**

Fiscal policy helps maintain stability by reducing economic fluctuations such as booms and recessions.

## **5.6 Balanced Regional Development**

Government expenditure is directed toward backward regions to reduce regional disparities.

## **6. Instruments of Fiscal Policy**

Fiscal policy operates through:

- **Taxation**
- **Public Expenditure**
- **Public Borrowing**

Each instrument plays a specific role in economic management.

## **7. Uses of Fiscal Policy in Economic Development**

### **7.1 Mobilization of Resources**

Fiscal policy helps mobilize resources by:

- Increasing tax revenue
- Encouraging savings
- Using public borrowing

These resources are used for development projects.

### **7.2 Capital Formation**

Government investment in infrastructure, education, and healthcare promotes capital formation and long-term growth.

### **7.3 Promotion of Industrial Development**

Fiscal incentives such as tax concessions and subsidies encourage industrial growth and entrepreneurship.

### **7.4 Development of Agriculture**

Fiscal policy supports agriculture through:

- Subsidies for inputs
- Investment in irrigation
- Rural development programs

### **7.5 Reduction of Poverty and Inequality**

Government spending on social welfare programs improves the standard of living of weaker sections.

### **7.6 Stabilization of the Economy**

Fiscal policy stabilizes the economy by managing demand during inflation and recession.

### **7.7 Encouragement of Private Sector**

Through tax incentives and public-private partnerships, fiscal policy encourages private investment.

### **8. Fiscal Policy in Developing Economies**

In developing countries:

- Fiscal policy plays a developmental role
- Government investment compensates for lack of private capital
- Focus is on inclusive growth and social justice It is an

essential tool for structural transformation.

### **9. Limitations of Fiscal Policy**

Despite its importance:

- Implementation delays may reduce effectiveness
- High fiscal deficit can create inflationary pressure
- Political considerations may affect policy decisions Thus,

careful planning and discipline are necessary.

## **Union Budget**

### **1. Introduction**

The Union Budget is one of the most important financial documents of a country. It reflects the economic policies, priorities, and development goals of the government for a particular financial year. Through the Union Budget, the government estimates its income and plans its expenditure to achieve economic growth, stability, and social welfare.

### **2. Meaning of Union Budget**

The Union Budget is an **annual financial statement** presented by the Central Government before the Parliament. It contains:

- Estimated receipts (income) of the government
- Proposed expenditures for the coming financial year

The Union Budget is prepared for a period of **one financial year**, from **1st April to 31st March**.

### **3. Definition of Union Budget**

The Union Budget may be defined as:

*A comprehensive statement of the government's estimated receipts and expenditures for a given financial year, presented for legislative approval.*

This definition emphasizes the planning and approval aspects of the budget.

#### **4. Characteristics of Union Budget**

##### **4.1 Annual Financial Statement**

The Union Budget is prepared every year and shows the government's financial plan for one year.

##### **4.2 Legal Authorization**

No tax can be collected and no expenditure can be incurred without the approval of Parliament.

##### **4.3 Comprehensive in Nature**

It includes all expected receipts and expenditures of the Central Government.

##### **4.4 Policy-Oriented Document**

The budget reflects the economic and social policies of the government such as poverty reduction, employment generation, and infrastructure development.

##### **4.5 Development-Focused**

In a developing country, the Union Budget emphasizes growth, welfare schemes, and public investment.

##### **4.6 Transparency and Accountability**

The Union Budget ensures accountability by clearly stating how public money will be raised and spent.

#### **5. Receipts of the Union Government**

Government receipts refer to the **income received by the government during a financial year**. These are classified into:

- Revenue Receipts
- Capital Receipts

#### **6. Revenue Receipts**

##### **6.1 Meaning of Revenue Receipts**

Revenue receipts are **regular income of the government that do not create any liability and do not reduce government assets**.

##### **6.2 Components of Revenue Receipts**

Revenue receipts are divided into:

- **Tax Revenue**
- **Non-Tax Revenue**

##### **6.3 Tax Revenue**

Tax revenue is the income received from taxes such as:

- Income tax
- Corporate tax
- Goods and Services Tax (GST)
- Customs and excise duties

Taxes are compulsory payments made by citizens to the government without direct benefit.

#### **6.4 Non-Tax Revenue**

Non-tax revenue includes income from:

- Fees and fines
- Interest on loans given by the government
- Dividends from public sector enterprises
- Profits from government services

#### **6.5 Importance of Revenue Receipts**

Revenue receipts help in:

- Financing day-to-day administration
- Funding welfare schemes
- Maintaining public services

### **7. Capital Receipts**

#### **7.1 Meaning of Capital Receipts**

Capital receipts are **non-recurring receipts** that either:

- Create a liability, or
- Reduce government assets

#### **7.2 Components of Capital Receipts**

Capital receipts include:

- Public borrowing
- Loans received from foreign governments or institutions
- Recovery of loans given by the government
- Disinvestment of public sector enterprises

#### **7.3 Nature of Capital Receipts**

- They are generally used for long-term development

- They affect the financial position of the government

## **8. Expenditure of the Union Government**

Government expenditure refers to **spending incurred by the government to perform its functions**. It is classified into:

- Revenue Expenditure
- Capital Expenditure

## **9. Revenue Expenditure**

### **9.1 Meaning of Revenue Expenditure**

Revenue expenditure refers to **expenditure incurred for day-to-day functioning** of the government which:

- Does not create assets
- Does not reduce liabilities

### **9.2 Examples of Revenue Expenditure**

- Salaries of government employees
- Interest payments on public debt
- Subsidies on food, fuel, and fertilizers
- Pension payments
- Maintenance of public services

### **9.3 Features of Revenue Expenditure**

- Short-term in nature
- Recurring expenditure
- Necessary for administration and welfare

### **9.4 Impact of Revenue Expenditure**

Revenue expenditure ensures:

- Smooth functioning of government machinery
- Social security and welfare of citizens

## **10. Capital Expenditure**

### **10.1 Meaning of Capital Expenditure**

Capital expenditure refers to **expenditure that leads to the creation of assets or reduction of liabilities**.

### **10.2 Examples of Capital Expenditure**

- Construction of roads, bridges, and railways
- Investment in power projects
- Purchase of machinery and equipment
- Loans given to states and public enterprises
- Repayment of public debt

### 10.3 Features of Capital Expenditure

- Long-term benefits
- Non-recurring in nature
- Promotes economic growth

### 10.4 Importance of Capital Expenditure

Capital expenditure:

- Enhances productive capacity
- Creates employment
- Supports infrastructure development

### 11. Difference between Revenue and Capital Items

Basis	Revenue Items	Capital Items
Nature	Regular	Non-regular
Asset creation	No	Yes
Liability	No	Yes/No
Time period	Short-term	Long-term

### 12. Role of Union Budget in Economic Development

- Allocates resources for development
- Reduces income inequalities
- Promotes economic stability
- Encourages investment and growth

### 4.6. Revenue Deficit, Fiscal Deficit and Primary Deficit

#### 1. Introduction

In modern economies, governments often spend more than their income to promote development, welfare, and economic stability. This gap between government expenditure and receipts is known as a **deficit**. Deficits play a crucial role in public finance and macroeconomic management, especially in developing countries like India.

Understanding different types of deficits helps in evaluating the financial health of the government and the sustainability of public spending.

## 2. Meaning of Deficit

A **deficit** occurs when the **government's total expenditure exceeds its total receipts** during a financial year.

In simple terms:

**Deficit = Government Expenditure – Government Receipts**

Deficits indicate the extent to which the government depends on borrowing to meet its expenses.

## 3. Need for Studying Government Deficits

Government deficits are important because they:

- Reflect the fiscal discipline of the government
- Influence inflation and interest rates
- Affect public debt and future tax burden
- Impact economic growth and development

## 4. Types of Government Deficits

Government deficits are mainly classified into:

1. Revenue Deficit
2. Fiscal Deficit
3. Primary Deficit

Each deficit highlights a different aspect of government finance.

## 5. Revenue Deficit

### 5.1 Meaning of Revenue Deficit

Revenue deficit arises when the **revenue expenditure exceeds revenue receipts**. **Revenue**

**Deficit = Revenue Expenditure – Revenue Receipts**

It shows that the government's regular income is insufficient to meet its regular expenses.

### 5.2 Components Involved

- **Revenue Receipts:** Tax and non-tax revenue

- **Revenue Expenditure:** Salaries, subsidies, interest payments, pensions, and administrative expenses

### 5.3 Causes of Revenue Deficit

- High expenditure on subsidies and welfare schemes
- Rising salary and pension obligations
- Low tax collection
- Inefficient tax administration

### 5.4 Implications of Revenue Deficit

- Government borrows even for consumption purposes
- Reduces funds available for capital formation
- Increases public debt
- Weakens long-term economic growth

### 5.5 Evaluation of Revenue Deficit

A high revenue deficit is considered **undesirable**, as it indicates poor financial management and lack of savings by the government.

## 6. Fiscal Deficit

### 6.1 Meaning of Fiscal Deficit

Fiscal deficit represents the **total borrowing requirement of the government**.

**Fiscal Deficit = Total Expenditure – (Revenue Receipts + Non-debt Capital Receipts)**

It shows how much the government needs to borrow to finance its overall deficit.

### 6.2 Components of Fiscal Deficit

- **Total Expenditure:** Revenue and capital expenditure
- **Non-debt Capital Receipts:** Recovery of loans, disinvestment receipts

### 6.3 Causes of Fiscal Deficit

- Large public expenditure on infrastructure and welfare
- Tax concessions and exemptions
- Economic slowdown reducing revenue
- Increased defense and interest payments

### 6.4 Impact of Fiscal Deficit

**Positive effects (when moderate):**

- Boosts economic growth
- Supports infrastructure development
- Generates employment

**Negative effects (when excessive):**

- Leads to inflationary pressure
- Increases public debt
- Raises interest rates
- Burdens future generations

**6.5 Fiscal Deficit and Economic Development**

In developing countries, a certain level of fiscal deficit is acceptable if borrowed funds are used for productive purposes.

**7. Primary Deficit**

**7.1 Meaning of Primary Deficit**

Primary deficit is the **fiscal deficit excluding interest payments. Primary**

**Deficit = Fiscal Deficit – Interest Payments**

It shows the current year’s fiscal performance without considering past debt obligations.

**7.2 Significance of Primary Deficit**

- Indicates whether current expenditure is financed by current revenue
- Reflects government’s fiscal responsibility
- Helps assess debt sustainability

**7.3 Interpretation of Primary Deficit**

- **Zero Primary Deficit:** Government borrows only to pay interest
- **Positive Primary Deficit:** Current expenditure exceeds current revenue
- **Negative Primary Deficit (Primary Surplus):** Government has surplus after meeting interest obligations

**8. Comparison of Different Deficits**

Basis	Revenue Deficit	Fiscal Deficit	Primary Deficit
<b>Concept</b>	Gap in revenue account	Overall borrowing need	Fiscal deficit minus interest
<b>Focus</b>	Day-to-day finances	Total fiscal imbalance	Current fiscal effort

<b>Indicates</b>	Dissaving	Debt requirement	Fiscal discipline
<b>Nature</b>	Undesirable	Acceptable if productive	Key policy indicator

### 9. Relationship among Deficits

- Revenue deficit is a part of fiscal deficit
- Fiscal deficit includes both revenue and capital components
- Primary deficit isolates the impact of past borrowings

### 10. Measures to Control Government Deficits

- Improving tax collection
- Rationalizing subsidies
- Controlling non-productive expenditure
- Encouraging disinvestment
- Promoting economic growth

## QUESTION BANK

### PART A – 2 Marks Questions

1. Define Monetary Policy.
2. State any two objectives of Monetary Policy.
3. What is Repo Rate?
4. What is Reverse Repo Rate?
5. Define Fiscal Policy.
6. Mention any two instruments of Fiscal Policy.
7. What is meant by Public Expenditure?
8. Define Imports and Exports.
9. What is Balance of Trade (BoT)?
10. State the formula for BoT.
11. Define Trade Deficit.
12. What is Expansionary Fiscal Policy?
13. Define Trade Surplus?

### PART B – 10 Marks Questions

1. Explain the meaning, objectives, and types of Monetary Policy.
2. Describe the major tools of Monetary Policy utilized by the RBI.
3. Explain Instruments of Fiscal Policy .
4. Discuss the Fiscal Policy objectives in India.
5. Explain the concept of Imports as well as Exports and their role in economic development.

6. Describe the (BoT) Balance of Trade and explain its importance.
7. Explain briefly the importance of Balance of Payments components. (BoP).
8. Discuss Expansionary and Contractionary Fiscal Policies with examples.
9. Explain why BoP is important for a country like India.

### **PART C – 15 Marks Questions**

1. Discuss in detail the Monetary Policy of India, including objectives, tools, MPC, and recent developments.
2. Explain Fiscal Policy in detail. Evaluate its role in economic growth, employment generation, income distribution, and inflation control.
3. Describe India's import–export structure. How do international trade flows impact India's economic development?
4. “Monetary Policy and Fiscal Policy are the two pillars of macroeconomic management.” Discuss with examples and Indian context.

### **Glossary**

- **Repo Rate:** RBI lending rate to banks.
- **Fiscal Deficit:** Excess of expenditure over revenue.
- **Imports:** Goods bought from other nations
- **Exports:** Goods sold to other nations
- **Balance of Trade:** Difference between exports as well as imports of goods.
- **Balance of Payments:** Complete record of international transactions.

### **Suggested Reading**

1. Singh, R. (2024). *Indian economy* (15th ed.). McGraw Hill Education.
2. Ahuja, H. L. (2023). *Macroeconomics* (22nd ed.). S. Chand Publishing.
3. Tyagi, B. P. (2022). *Public finance*. Jai Prakash Nath & Co.
4. Reserve Bank of India. (2024). *RBI annual report 2023–24*. Reserve Bank of India.
5. Government of India, Ministry of Finance. (2025). *Economic survey of India 2024–25*. Government of India.
6. Datt, R., & Sundharam, K. P. M. (2024). *Indian economy* (73rd ed.). S. Chand & Company Pvt. Ltd.
7. Mishra, S. K., & Puri, V. K. (2024–2025). *Indian economy: Its development experience* (42nd ed.). Himalaya Publishing House Pvt. Ltd.
8. Kapila, U. (Ed.). (2023). *Indian economy: Performance and policies* (24th ed.). Academic Foundation.

## Unit V

### Economic reforms

#### Overview

The 1991 Economic Reforms in India marked a significant shift from a state-controlled economy to a liberalised and market-driven system. These reforms were introduced to overcome a severe economic crisis marked by high inflation and fiscal deficits. The Govt. of India initiated structural reforms with the help of global institutions such as the IMF: International Monetary Fund and World Bank. The reforms included Liberalisation (removing controls and restrictions), Privatisation (reducing government ownership in public enterprises), and Globalisation (increasing integration with the world economy). This unit explores the origin, objectives, features, and impact of these reforms, and also examines the challenges India faced during the implementation of LPG (Liberalisation, Privatisation, Globalisation) policies. Understanding these reforms is essential for analyzing India's growth trajectory, policy changes, and the modern economic landscape.

- Evaluate the **impacts** of economic reforms on different sectors of the Indian economy.
- Analyze the **challenges** associated with LPG reforms.

#### 5.1 Economic Reform in India

India entered the 1990s with major economic challenges like Balance of Payment crisis. Foreign exchange reserves could cover only two weeks of imports. At the same time, fiscal deficits were rising, public sector enterprises were inefficient, and economic growth was stagnating. To avoid bankruptcy, India approached the IMF(International Monetary fund) for financial assistance. In return, the IMF recommended structural reforms. This led to the launch of LPG – Liberalisation, Privatisation and Globalisation – in 1991. The objectives of these reforms is to shift India from a controlled economy to a more open, market-driven system.

#### Major Reforms Carried Out in 1991

The 1991 reforms brought a paradigm shift in how India's economy functioned. Key actions included ending the license raj, encouraging participation of private sector, reducing trade restrictions, promoting investment in foreign countries, and overhauling financial and taxation systems. The objective was to make the country more efficient, competitive, globally integrated, and investment-friendly.

#### 1. Fiscal Stabilization

Fiscal stabilization focused on improving the government's financial health.

- a. **Reducing fiscal deficit:** Government cut unnecessary expenditure, controlled subsidies, and aimed to reduce wasteful spending.
- b. **Improving revenue:** Tax reforms were introduced to increase government income and reduce leakages.
- c. **Control of inflation:** High inflation was tackled by tightening monetary policy and cutting fiscal imbalances.

## 2. Industrial Policy: (NIP),

This Policy of 1991 marked a major turning point in India's economic history because it transformed how industries operated in the country. Before 1991, India followed a system of heavy government control, where businesses needed many licenses and permissions to start or expand industries. The economy was largely closed to foreign companies, and public sector enterprises dominated most industries. With the New Industrial Policy, the government removed many of these restrictions by abolishing industrial licensing for most sectors, reducing the role of the public sector, and allowing private companies to grow freely. It also encouraged foreign investment, introduced modern technology, and opened Indian markets to global competition. As a result, industries became more efficient, competitive, and innovative. In short, NIP 1991 shifted India from a controlled economy to a more open, market-driven economy, leading to faster industrial growth and greater global integration.

### Focus on:

- a. **Abolition of license raj:** Industrial licensing was removed for most industries, making it easier to start and expand businesses.
- b. **Reduced government control:** Public sector dominance was reduced; many sectors were opened to private participation.
- c. **Encouraged competition:** Removal of entry barriers increased competition and improved productivity.
- d. **Foreign collaboration permitted:** Technology transfer and joint ventures became easier.
- e. **Reduced public sector reservation:** Sectors earlier restricted for PSUs were opened to private firms.

## 3. Foreign Investment:

It means flow of capital, technology, and expertise from other countries into India. Under the policy, the government introduced the *automatic route*, which allowed foreign companies to invest in many sectors without needing prior government approval, making the process faster and business-friendly. Foreign equity limits were increased, allowing international firms to own larger shares in Indian companies and encouraging major global brands to enter the Indian market. This also led to a significant inflow of modern technology, new machinery, advanced management practices, and global best practices, which improved the efficiency and productivity of Indian industries. Overall, foreign investment became a key driver of economic growth, job creation, and modernization in post-1991 India.

### Focus on:

- a. **Automatic route approvals:** FDI in many sectors did not require government permission.
- b. **Higher foreign equity limits:** Foreign ownership limits were raised across industries.
- c. **Increased technology inflow:** Global firms brought advanced technology and management practices.
- d. **Integration with global value chains:** Enabled India to become part of worldwide production networks.

## 4. Trade and Exchange Rate Policy

Trade reforms aimed to integrate India with the global market. The major step was the reduction of import tariffs, which made foreign goods cheaper and exposed Indian producers to healthy competition, encouraging them to improve quality and efficiency. The government also removed import licensing on

many products, which simplified the import process and reduced delays and bureaucratic hurdles. To boost exports, several promotion measures such as tax incentives, duty drawbacks, and improved export finance were introduced, helping Indian exporters access global markets more easily. Another important reform was the shift to exchange rate system which is market-determined: the Indian currency was first devalued to make exports more competitive and later allowed to adjust freely according to market demand and supply..

**Focus on:**

- a. **Reduction in import tariffs:** Tariffs were lowered to make imports cheaper and encourage competition.
- b. **Removal of import licensing:** Many items no longer required licenses, simplifying the import process.
- c. **Export promotion measures:** Incentives and support systems were enhanced for exporters.
- d. **Shift to market-determined exchange rate:** Rupee was devalued and later allowed to move according to market forces.
- e. **Improved foreign reserves:** Resulted in stronger external stability.

## 5. Tax Reforms

The objectives of tax reforms are to make the taxation system simpler, transparent, and efficient. Tax reforms after 1991 were introduced to make India's taxation system simpler, transparent, and more efficient. Major steps were increase in the tax base so that more individuals, companies, and economic activities were brought under the tax net, increasing government revenue. Voluntary compliance encouraged and tax evasion reduced. The introduction of Value Added Tax: (VAT) replaced multiple state-level taxes, making the tax structure more uniform and reducing cascading effects. These reforms collectively improved compliance, minimized loopholes, reduced corruption, and helped the government collect taxes more efficiently.

**Focus on:**

- a. **Broadening the tax base:** More people and businesses were brought into the tax net.
- b. **Lower tax rates:** Personal and corporate tax rates : decreased to encourage compliance.
- c. **Introduction of VAT:** Replaced multiple state-level taxes, making taxation uniform.
- d. **Introduction of GST: (later):** A major reform integrating all the indirect taxes into a single system.
- e. **Better compliance and reduced evasion:** Simplified structure led to improved tax collection.

## 6. Public Sector Reforms:

These reforms aimed to make government-owned enterprises more efficient and reduce the financial burden they placed on the government. A key step was **disinvestment**, where the government sold minority or majority stakes in Public Sector Undertakings (PSUs) to raise funds and bring in private sector efficiency. Efforts were also made to improve the performance of PSUs by giving their boards more autonomy, promoting professional management, and reducing political interference. Several sectors such as telecom, civil aviation, and power were opened to private players to encourage competition and innovation. The reforms also focused on reducing losses of sick or inefficient PSUs, thereby lowering the fiscal pressure on the government. Overall, these changes helped modernize the public sector, enhance service delivery, and make the economy more competitive.

### Focus on

- a. **Disinvestment:** Government began selling minority or majority stakes in PSUs.
- b. **Improving performance:** PSU boards were given more autonomy; professional management was encouraged.
- c. **Opening sectors to private players:** Telecom, civil aviation, power, and others saw private entry.
- d. **Reducing losses:** Aim was to reduce financial burden on government due to loss-making units. efficient and reduce fiscal burden.

### 7. Financial Sector Reforms:

This reforms strengthened the banking and capital market systems. The financial sector reforms were introduced to make India's banking and capital markets more efficient, competitive, and globally integrated. A major step was the **deregulation of interest rates**, which gave banks the freedom to decide interest rates instead of following rigid government controls. The reforms also focused on **strengthening prudential norms**, such as enforcing capital adequacy ratios and strict guidelines for Non-Performing Assets (NPAs), ensuring that banks remained financially healthy. Another major change was the **reduction of SLR and CRR**, which increased the lending capacity of banks.

- **SLR (Statutory Liquidity Ratio)** refers to the percentage of a bank's net demand and time liabilities that must be maintained in the form of liquid assets such as cash, government securities, or gold.
- **CRR (Cash Reserve Ratio)** is the percentage of a bank's deposits that must be kept with the RBI in cash form and cannot be used for lending.

By reducing SLR and CRR, banks had more money available to lend to businesses and consumers, boosting economic activity. The reforms also encouraged the entry of **private and foreign banks**, increasing competition and improving the quality of banking services. Additionally, the **capital market** saw significant strengthening, with SEBI empowered as an independent regulator to ensure transparency, fairness, and investor protection. Overall, these reforms modernized India's financial system and enhanced its stability and efficiency.

### Focus on:

- a. **Deregulation of interest rates:** Banks were given freedom to set interest rates.
- b. **Strengthened prudential norms:** Measures like capital adequacy ratios and NPAs norms were introduced.
- c. **Reduced SLR and CRR:** Freed more money for banks to lend.
- d. **Entry of private and foreign banks:** Increased competition and improved service quality.
- e. **Capital market reforms:** SEBI became a powerful regulator; norms for transparency and investor protection were strengthened.

### Impact of Economic Reforms of 1991

#### a) On Various Macroeconomic Parameters (Short-Term)

Reforms led to an immediate improvement in foreign reserves, reduced inflation, and stabilised GDP growth. The economy gained credibility globally, and confidence among investors

increased.

### **b) On Poverty Reduction (Long-Term)**

In the long run, reforms contributed to higher growth rates and job creation, especially in services. This helped in reducing poverty levels, though the benefits were uneven across regions and communities.

### **c) On Disparity Between Rich and Poor (Long-Term)**

While economic reforms boosted overall prosperity, they also widened income inequality. Urban areas and skilled populations benefited more, while rural and unskilled segments lagged behind, highlighting the need for inclusive growth policies.

The 1991 economic reforms were a turning point for India, shifting it from a closed economy to one integrated with global markets. While the reforms spurred growth and modernization, challenges like inequality and sectoral imbalance persist, requiring ongoing policy innovation and inclusive strategies.

## **Factors that Necessitated Economic Reforms**

India faced a severe economic crisis in 1991. Imports were rising faster than exports, creating a balance of payments problem. High external debt made it difficult to pay interest to foreign lenders. Rising inflation and a large fiscal deficit added further pressure on the economy.

NEP was introduced in response. The NEP included stabilization measures to control inflation and structural reforms for long-term efficiency.

### **Stabilization Measures of NEP:**

Stabilization measures were short-term steps to restore economic balance. They focused on correcting the BoP crisis and controlling inflation. The government aimed to rebuild foreign exchange reserves. Price levels were managed to protect citizens' purchasing power. These measures laid the foundation for long-term reforms.

### **Structural Reform Policies**

Structural reforms were long-term measures to improve economic efficiency and global competitiveness. They removed outdated regulations and rigid controls. The reforms were categorized into **Liberalization, Privatization, and Globalization (LPG)**. The goal was to create a market-driven, open economy. These policies promoted private investment, innovation, and international trade.

### **5.2 Liberalization:**

Liberalization reduced government restrictions. Prices in most industries were determined by market forces. Small-scale industries gained freedom from reservation rules. The reforms encouraged private participation and investment.

## **1. Industrial Sector: Deregulation**

Industrial licensing was removed for most industries, except alcohol, cigarettes, explosives, aerospace, electronics, and pharmaceuticals. Only atomic energy and some railway operations remained public sector reserved. Small-scale industries were freed from restrictions. Market competition determined prices in most sectors. This deregulation encouraged efficiency and innovation.

## **2. Financial Sector Reforms:**

RBI's role shifted from strict regulator to facilitator of the financial sector. Banks were allowed more autonomy in opening branches and managing operations. Foreign investment in banks was increased to 74%. Foreign Institutional Investors (FIIs) could invest in Indian markets. These reforms strengthened financial institutions and promoted investment.

## **3. Tax Reforms:**

Direct taxes were reduced gradually to discourage evasion, including lower corporate tax rates. Indirect taxes were unified under GST in 2017, replacing multiple taxes like excise, VAT, and service tax. Tax procedures were simplified to improve compliance. Lower rates encouraged formal sector participation. The reforms aimed to increase revenue efficiency and reduce evasion.

## **4. Foreign Exchange Reforms:**

The Indian currency (rupee) was devalued in 1991 to increase exports and foreign exchange inflows. The exchange rate system became more market-driven. This helped improve India's international competitiveness. It encouraged foreign investment and trade. Market-based currency determination reduced government intervention.

## **5. Trade and Investment: Policy Reforms**

Export duties were eliminated to boost competitiveness abroad. The policies encouraged foreign investment and trade integration. India's economy became more open and globally connected.

### **5.3 Privatization**

Privatization transferred ownership or management of PSEs to private hands. The government withdrew fully or partially from enterprises. Disinvestment involved selling part of government equity to private investors. Objectives included improving efficiency, modernizing operations, and attracting FDI. Privatization reduced financial burdens and increased competitiveness.

### **Maharatnas, Navratnas, and Miniratnas**

Certain PSEs were categorized for greater autonomy and efficiency. Maharatnas included Indian Oil and Steel Authority of India. Navratnas included HAL and MTNL, while Miniratnas included BSNL, AAI,

and IRCTC. These companies gained operational freedom to improve performance. The system aimed to foster professional management and profitability.

## **5.4 Globalization**

Globalization integrated India's economy with the global market. It encouraged free flow of goods, services, capital, and technology. Countries became economically interdependent and more competitive. Globalization reduced trade barriers and created a borderless economy. It promoted growth, efficiency, and international collaboration.

### **Outsourcing**

Outsourcing involves hiring services from external providers, often abroad. India became a hub for IT, call centers, accounting, and other services. Advanced communication technologies enabled real-time service delivery. Outsourcing provided cost-effective solutions to global companies. It created jobs and expanded India's service sector.

### **World Trade Organization (WTO)**

The WTO was established in 1995 to regulate international trade. It replaced GATT and created a rule-based trading system. WTO aims to reduce barriers and promote fair trade among nations. India committed to lowering tariffs and removing quantitative restrictions. Membership improved India's access to global markets.

### **Positive Impacts of Globalization**

Globalization boosted economic growth by expanding trade and investment. Living standards improved due to job creation and better services. Access to technology helped improve education, healthcare, and infrastructure. Cultural understanding increased through global interaction. It connected India to global markets and resources.

### **Negative Impacts of Globalization**

Income inequality widened as jobs shifted to low-cost regions. Environmental degradation increased due to higher production and consumption. Local industries faced competition from imports, causing job losses. Global competition raised tensions among nations. Some sections of society experienced economic vulnerability.

## **Indian Economy During Reforms: An**

### **Assessment Positive Impacts**

#### **1. Growth in GDP**

GDP growth rose from 5.6% (1980–91) to 8.2% (2007–12). Agriculture grew slowly while industrial growth fluctuated. The service sector became the main driver of growth. From 2012–22, agriculture recovered, industry stabilized, and services grew at 9.2% in 2021–22. Reforms shifted focus to a service-led economy.

#### **2. Rapid growth in FDI and foreign exchange reserves:**

FDI and FII rose from \$100 million (1990–91) to \$30 billion (2017–18). Forex reserves increased from \$6 billion to \$413 billion. These inflows strengthened economic stability and confidence. Foreign investment also promoted modernization and technology transfer.

### **3. Growth in exports**

India became a key exporter of auto parts, pharmaceuticals, engineering goods, software, and textiles. Export growth increased competitiveness internationally. Trade expansion helped raise foreign exchange reserves. Industries gained global exposure. Exports contributed significantly to GDP growth.

### **4. Better control over inflation**

Inflation was largely managed through supply-side and monetary measures. Price rise of essential goods remained moderate. Stable inflation helped protect consumers' purchasing power. Economic reforms strengthened market efficiency. This created a stable environment for investment and growth.

## **Negative Impacts**

### **1. Growth and Employment**

Despite high GDP growth, employment did not increase proportionately. This resulted in "jobless growth." Many sectors could not absorb the growing workforce. Service sector growth created fewer jobs compared to industry. Youth unemployment remained a concern.

### **2. Reforms in Agriculture**

Agricultural growth slowed, and public investment in irrigation and power declined. Reduced fertilizer subsidies raised production costs for small farmers. Global competition exposed farmers to price volatility. Shift to cash crops reduced food production. Food prices increased, affecting affordability.

### **3. Reforms in Industry**

Industrial growth slowed due to reduced domestic demand. Cheaper imports replaced local goods. Increased competition affected small-scale industries. Employment opportunities in manufacturing declined. Some domestic firms struggled to remain profitable.

### **4. Disinvestment**

Some PSEs were sold below market value, causing government losses. Revenue from disinvestment was used to cover deficits, not development. Public sector modernization was delayed. Infrastructure investment suffered. Privatization sometimes prioritized short-term revenue over long-term growth.

### **5. Reforms and Fiscal Policies:**

Tax reductions did not significantly boost revenue. Lower tariffs reduced customs income. This limited government spending on welfare and development. Developmental programs faced

funding challenges despite reforms.

## **Liberalization, Privatization and Globalization (LPG) and the Impact of Economic Reforms on the Indian Economy**

### **1. Introduction**

Economic reforms refer to the changes introduced by the government to improve the efficiency, competitiveness, and growth of the economy. In India, major economic reforms were initiated in **1991** to overcome economic stagnation, balance of payments crisis, and inefficiencies in the existing economic system. These reforms were based on three main pillars: **Liberalization, Privatization, and Globalization**, commonly known as the **LPG model**.

### **2. Background of Economic Reforms in India**

Before 1991, the Indian economy was characterized by:

- Excessive government control
- Industrial licensing system
- Limited foreign trade
- Low productivity and growth

The economic crisis of 1991 forced India to adopt structural reforms to integrate its economy with the global market and improve overall performance.

### **3. Liberalization**

#### **3.1 Meaning of Liberalization**

Liberalization refers to the **reduction or removal of government restrictions and controls** on economic activities. It aims to provide greater freedom to businesses and encourage competition.

#### **3.2 Objectives of Liberalization**

- To increase efficiency in production
- To promote competition
- To attract domestic and foreign investment
- To modernize industries

#### **3.3 Measures of Liberalization in India**

- Abolition of industrial licensing for most industries
- Reduction in import tariffs and quotas
- Simplification of tax structure

- Liberal foreign exchange regulations
- Freedom to expand and diversify businesses

### **3.4 Impact of Liberalization on Indian Economy**

#### **Positive Impact:**

- Improved industrial efficiency
- Increase in productivity
- Growth of private sector
- Better quality of goods and services

#### **Negative Impact:**

- Increased competition for small-scale industries
- Regional imbalances
- Market dominance by large firms

## **4. Privatization**

### **4.1 Meaning of Privatization**

Privatization refers to the **transfer of ownership or management of public sector enterprises to the private sector**. It also includes reducing government participation in economic activities.

### **4.2 Objectives of Privatization**

- To improve efficiency and profitability
- To reduce financial burden on the government
- To encourage private investment
- To promote market-driven growth

### **4.3 Forms of Privatization**

- Disinvestment of government shares
- Outsourcing of services
- Public-private partnerships
- Contracting out management

### **4.4 Impact of Privatization on Indian Economy**

#### **Positive Impact:**

- Improved performance of enterprises
- Reduction in government expenditure
- Better management practices
- Increased competitiveness

**Negative Impact:**

- Fear of job losses
- Social inequality
- Reduced focus on social objectives

**5.3. Globalization**

**5.3.1. Meaning of Globalization**

Globalization refers to the **integration of the domestic economy with the global economy** through free flow of goods, services, capital, technology, and information.

**5.3.2. Objectives of Globalization**

- 5.3.3. To expand international trade
- 5.3.4. To attract foreign direct investment (FDI)
- 5.3.5. To access modern technology
- 5.3.6. To improve global competitiveness

**5.3.4. Measures of Globalization in India**

- 5.3.5. Reduction in trade barriers
- 5.3.6. Encouragement of foreign investment
- 5.3.7. Participation in international trade agreements
- 5.3.8. Expansion of export-oriented industries

**5.3.5. Impact of Globalization on Indian**

**Economy Positive Impact:**

- 5.3.6. Growth of export sector
- 5.3.7. Inflow of foreign capital
- 5.3.8. Technological advancement
- 5.3.9. Expansion of service sector

**Negative Impact:**

5.3.10. Exposure to global economic shocks

5.3.11. Pressure on domestic industries

5.3.12. Cultural and social concerns

## **6. Combined Impact of LPG Reforms on Indian Economy**

### **6.3. Impact on Economic Growth**

6.3.5. Increase in GDP growth rate

6.3.6. Expansion of industrial and service sectors

6.3.7. Improved infrastructure development

### **6.4. Impact on Industrial Sector**

6.4.5. Modernization of industries

6.4.6. Increase in private sector participation

6.4.7. Growth of small and medium enterprises

### **6.5. Impact on Agriculture**

6.5.5. Improved access to global markets

6.5.6. Growth in agro-based industries

6.5.7. Challenges due to price fluctuations

### **6.6. Impact on Employment**

6.6.5. Creation of jobs in services and IT sector

6.6.6. Shift from traditional employment to skilled jobs

6.6.7. Growth of informal and contract employment

### **6.7. Impact on Foreign Trade**

6.7.5. Increase in exports and imports

6.7.6. Diversification of export products

6.7.7. Improvement in foreign exchange reserves

### **6.8. Impact on Social Sector**

6.8.5. Expansion of education and health services

6.8.6. Reduction in poverty levels

6.8.7. Rise in income inequality

## **7. Criticism of LPG Reforms**

- Neglect of agriculture and rural development
- Growing income disparities
- Increased dependence on foreign capital
- Environmental degradation

## 8. Role of Government after Reforms

Even after LPG reforms, the government continues to:

- Regulate markets
- Protect vulnerable sections
- Promote inclusive growth
- Ensure social welfare

## 9. Need for Balanced Economic Reforms

Economic reforms must ensure:

- Growth with equity
- Sustainable development
- Social justice
- Economic stability

### 5.4. Foreign Direct Investment (FDI)

#### 1. Introduction

In the modern globalized world, capital flows across national boundaries play a crucial role in economic development. One of the most important forms of international capital flow is **Foreign Direct Investment (FDI)**. For developing economies like India, FDI has become an essential source of capital, technology, managerial skills, and employment generation. It helps integrate the domestic economy with the global economic system.

#### 2. Meaning of Foreign Direct Investment (FDI)

Foreign Direct Investment refers to an investment made by a foreign individual, company, or entity in the productive activities of another country with the intention of **long-term participation and control**.

In simple terms:

**FDI is an investment in which a foreign investor acquires ownership and managerial control in a business enterprise of another country.**

Unlike portfolio investment, FDI involves direct involvement in production, management, and

decision-making.

### **3. Definition of FDI**

Foreign Direct Investment can be defined as:

*An investment by a resident entity of one country into an enterprise located in another country, with the objective of establishing a lasting interest and effective control.*

This definition highlights the long-term and control-oriented nature of FDI.

### **4. Characteristics of Foreign Direct Investment**

#### **4.1 Long-Term Investment**

FDI is generally made with a long-term perspective and not for short-term profit.

#### **4.2 Ownership and Control**

FDI provides the investor with partial or full ownership and managerial control over the enterprise.

#### **4.3 Productive Use of Capital**

FDI is invested in real sectors such as manufacturing, services, infrastructure, and technology.

#### **4.4 Transfer of Technology**

Foreign investors bring advanced technology, modern production methods, and innovation.

#### **4.5 Flow of Managerial Skills**

FDI introduces professional management practices, marketing skills, and organizational efficiency.

#### **4.6 Risk Sharing**

Investment risks are shared between domestic and foreign partners.

### **5. Need for Foreign Direct Investment**

#### **5.1 Capital Requirement**

Developing countries often face shortage of domestic capital. FDI helps bridge the investment gap.

#### **5.2 Technological Advancement**

FDI enables access to modern technology that may not be available domestically.

#### **5.3 Infrastructure Development**

FDI supports the development of infrastructure such as power, transport, and communication.

#### **5.4 Employment Generation**

Foreign enterprises create direct and indirect employment opportunities.

### **5.5 Balance of Payments Support**

FDI brings foreign exchange, reducing pressure on the balance of payments.

## **6. Objectives of Foreign Direct Investment**

### **6.1 Objectives of Host Country**

- To accelerate economic growth
- To promote industrial development
- To generate employment
- To enhance exports
- To improve competitiveness

### **6.2 Objectives of Investing Country**

- To expand global market presence
- To earn higher profits
- To access natural resources
- To reduce production costs
- To diversify investment risks

## **7. Forms of Foreign Direct Investment**

- **Greenfield Investment:** Establishing new enterprises
- **Brownfield Investment:** Mergers and acquisitions
- **Joint Ventures:** Shared ownership with domestic firms
- **Wholly Owned Subsidiaries:** Full foreign ownership

## **8. Role of FDI in Economic Development**

### **8.1 Role of FDI in Economic Growth**

FDI increases capital formation, productivity, and overall economic output, contributing to higher GDP growth.

### **8.2 Role in Industrial Development**

FDI promotes:

- Expansion of manufacturing sector
- Modernization of industries

- Development of export-oriented units

### **8.3 Role in Employment Creation**

FDI generates:

- Direct employment in foreign enterprises
- Indirect employment in supporting industries

### **8.4 Role in Technology Transfer**

FDI facilitates:

- Adoption of advanced technology
- Skill development among workers
- Innovation and research activities

### **8.5 Role in Foreign Trade**

FDI enhances:

- Export capacity
- Integration into global value chains
- Improvement in trade balance

### **8.6 Role in Service Sector Growth**

FDI has played a significant role in the growth of:

- Information technology
- Banking and insurance
- Telecommunications
- Retail and logistics

## **9. Impact of FDI on Indian Economy**

### **Positive Impact**

- Increase in foreign exchange reserves
- Growth of service and manufacturing sectors
- Improvement in infrastructure
- Better quality products and services

### **Negative Impact**

- Risk to domestic small-scale industries

- Profit repatriation
- Market dominance by multinational companies

## 10. Challenges Related to FDI

- Regulatory barriers
- Inadequate infrastructure
- Policy uncertainty
- Regional concentration of investment

## 11. Measures to Attract FDI

- Simplification of approval procedures
- Stable and transparent policies
- Improvement in infrastructure
- Ease of doing business reforms

## 5.5. Foreign Institutional Investment (FII)

### 1. Introduction

With the growth of global financial markets, international capital flows have become an important factor in the economic development of nations. One such flow is **Foreign Institutional Investment (FII)**, which involves investment by foreign financial institutions in a country's capital markets. In India, FIIs have played a significant role in strengthening financial markets, increasing liquidity, and supporting economic growth.

### 2. Meaning of Foreign Institutional Investment (FII)

Foreign Institutional Investment refers to investments made by **foreign financial institutions** such as mutual funds, pension funds, hedge funds, insurance companies, and investment banks in the **financial assets** of another country.

In simple words:

**FII is the investment made by foreign institutions in a country's stock market, bond market, and other financial instruments without gaining managerial control.**

Unlike Foreign Direct Investment, FII does not involve ownership or control over business operations.

### 3. Definition of FII

Foreign Institutional Investment can be defined as:

*Investment by foreign institutions in the securities and financial markets of a host country with the objective of earning returns through capital appreciation and income.*

This definition highlights the financial and market-oriented nature of FII.

#### **4. Characteristics of Foreign Institutional Investment**

##### **4.1 Short-Term and Medium-Term Nature**

FII investments are generally short-term or medium-term and can be withdrawn quickly based on market conditions.

##### **4.2 No Managerial Control**

FIIs do not participate in the management or decision-making of companies.

##### **4.3 Investment in Financial Assets**

FIIs invest mainly in:

- Equity shares
- Bonds and debentures
- Government securities
- Mutual fund units

##### **4.4 Highly Mobile Capital**

FII capital is volatile and can move in and out of the country rapidly.

##### **4.5 Market-Driven Returns**

Returns depend on market performance, interest rates, and investor sentiment.

##### **4.6 Regulated Investment**

FII investments are regulated by financial market authorities to ensure transparency and stability.

#### **5. Need for Foreign Institutional Investment**

##### **5.1 Development of Capital Markets**

FIIs contribute to the growth and modernization of stock markets.

##### **5.2 Increase in Liquidity**

FII inflows enhance market liquidity, making trading more efficient.

##### **5.3 Mobilization of Foreign Capital**

FIIs provide access to foreign savings for domestic investment.

##### **5.4 Improvement in Market Efficiency**

Participation of foreign institutions improves pricing efficiency and corporate governance.

## **5.5 Support to Government Borrowing**

FII invest in government securities, helping to finance fiscal deficits.

## **6. Objectives of Foreign Institutional Investment**

### **6.1 Objectives of Foreign Investors**

- To earn higher returns
- To diversify investment portfolios
- To benefit from emerging market growth
- To reduce risk through global diversification

### **6.2 Objectives of the Host Country**

- To strengthen financial markets
- To attract foreign capital
- To improve market transparency
- To enhance investor confidence

## **7. Forms of FII Investments**

FII invest in:

- Equity shares of listed companies
- Corporate bonds and debentures
- Government securities
- Derivative instruments

## **8. Role of FII in Economic Development**

### **8.1 Role in Capital Market Development**

FII:

- Increase trading volume
- Improve depth and width of markets
- Encourage introduction of new financial instruments

### **8.2 Role in Economic Growth**

By mobilizing foreign capital, FII support investment and economic expansion indirectly.

### **8.3 Role in Improving Corporate Governance**

Foreign institutional investors demand transparency, accountability, and better management

practices.

#### **8.4 Role in Foreign Exchange Availability**

FII inflows bring foreign currency, strengthening foreign exchange reserves.

#### **8.5 Role in Price Discovery**

FIIs contribute to accurate pricing of securities through informed trading.

### **9. Impact of FII on Indian Economy**

#### **Positive Impact**

- Strengthening of Indian stock markets
- Increase in market capitalization
- Enhanced global integration
- Improved financial discipline

#### **Negative Impact**

- Market volatility
- Sudden capital outflows
- Exchange rate instability
- Speculative trading behavior

### **10. Comparison between FDI and FII**

<b>Basis</b>	<b>FDI</b>	<b>FII</b>
<b>Nature</b>	Long-term	Short-term
<b>Control</b>	Yes	No
<b>Investment area</b>	Productive sectors	Financial markets
<b>Stability</b>	Stable	Volatile

### **11. Challenges Related to FII**

- High volatility of capital flows
- Dependence on global financial conditions
- Risk of financial instability
- Exchange rate fluctuations

## **12. Measures to Manage FII Flows**

- Regulatory controls
- Monitoring capital movements
- Strengthening domestic financial markets
- Maintaining macroeconomic stability

## **Challenges of Globalisation for India**

### **1. Introduction**

Globalisation refers to the growing integration of national economies with the world economy through trade, investment, technology, and movement of capital. India adopted globalisation as part of its economic reforms in 1991 with the objective of achieving higher growth and modernization. While globalisation has brought several benefits to India, it has also created many challenges across economic, social, and cultural dimensions.

Understanding these challenges is important to assess the long-term sustainability of India's integration with the global economy.

### **2. Nature of Globalisation in the Indian Context**

Globalisation in India involves:

- Expansion of foreign trade
- Inflow of foreign capital
- Entry of multinational companies
- Exposure to global competition

However, India's diverse economic structure makes it more vulnerable to the adverse effects of global integration.

### **3. Major Challenges of Globalisation for India**

#### **4. Challenge to Domestic Industries**

##### **Explanation**

Globalisation exposes Indian industries to intense competition from foreign companies with advanced technology and large financial resources.

##### **Impact**

- Small and medium enterprises struggle to survive
- Closure of traditional industries

- Unequal competition between domestic and multinational firms

## **5. Employment Challenges**

### **Explanation**

Globalisation encourages capital-intensive production rather than labour-intensive methods.

### **Impact**

- Jobless growth
- Rise in contract and informal employment
- Decline in job security and workers' rights

## **6. Income Inequality**

### **Explanation**

Benefits of globalisation are not evenly distributed among all sections of society.

### **Impact**

- Rich and skilled workers gain more
- Poor and unskilled workers face stagnation
- Regional economic disparities increase

## **7. Challenges to Agriculture**

### **Explanation**

Indian agriculture faces global price fluctuations and competition from subsidized agricultural products of developed countries.

### **Impact**

- Farmers face income instability
- Dependence on global markets
- Increase in rural distress

## **8. Cultural and Social Challenges**

### **Explanation**

Globalisation promotes western lifestyles, consumerism, and cultural homogenization.

### **Impact**

- Erosion of traditional values
- Loss of indigenous practices

- Influence on youth culture and social norms

## **9. Financial Market Volatility**

### **Explanation**

Globalisation allows free flow of foreign capital, which can be unstable and speculative.

### **Impact**

- Stock market fluctuations
- Sudden capital outflows
- Exchange rate instability

## **10. Dependence on Foreign Capital and Technology**

### **Explanation**

Excessive reliance on foreign investment and technology may reduce self-reliance.

### **Impact**

- Outflow of profits
- Limited domestic innovation
- Vulnerability to global economic shocks

## **11. Environmental Challenges**

### **Explanation**

Globalisation promotes rapid industrialization and urbanization.

### **Impact**

- Environmental degradation
- Pollution and resource depletion
- Weak enforcement of environmental laws

## **12. Trade Deficit**

### **Explanation**

Increased imports due to globalisation may exceed export growth.

### **Impact**

- Persistent trade deficits
- Pressure on foreign exchange reserves
- Dependence on external borrowing

### **13. Loss of Economic Sovereignty**

#### **Explanation**

Global economic institutions and multinational corporations influence domestic policies.

#### **Impact**

- Reduced policy flexibility
- Pressure to adopt global standards
- Constraints on welfare-oriented policies

### **14. Unequal Regional Development**

#### **Explanation**

Globalisation benefits regions with better infrastructure and connectivity.

#### **Impact**

- Growth concentrated in urban and coastal areas
- Backward regions remain underdeveloped
- Migration and urban congestion

### **15. Impact on Small Traders and Retailers**

#### **Explanation**

Entry of global retail chains affects traditional retail businesses.

#### **Impact**

- Decline of small shops
- Loss of livelihood
- Market concentration

### **16. Skill Gap and Education Challenges**

#### **Explanation**

Globalisation demands skilled manpower.

#### **Impact**

- Skill mismatch
- Exclusion of unskilled workers
- Pressure on education and training systems

### **17. Need for Policy Support to Manage Challenges**

To address challenges of globalisation, India needs:

- Strong domestic industries
- Skill development programs
- Inclusive growth strategies
- Balanced trade policies
- Environmental protection

## **18. Role of Government**

The government plays a key role by:

- Regulating foreign capital flows
- Supporting small and medium enterprises
- Protecting vulnerable sectors
- Promoting self-reliance along with openness

### **5.6. Atmanirbhar Bharat Initiative (Self-Reliant India)**

#### **1. Introduction**

The **Atmanirbhar Bharat Initiative** is a major economic vision introduced by the Government of India to strengthen domestic capabilities and reduce excessive dependence on foreign countries. The initiative aims to make India a **self-reliant and resilient economy** while remaining actively integrated with the global economic system.

Atmanirbhar Bharat does not imply isolation from the world; rather, it focuses on building internal strength so that India can compete confidently at the global level.

#### **2. Meaning of Atmanirbhar Bharat**

The term **Atmanirbhar Bharat** literally means **Self-Reliant India**.

In economic terms, it refers to:

*A development strategy that emphasizes domestic production, innovation, self-sufficiency, and efficient utilization of national resources to achieve sustainable economic growth.*

The initiative encourages local production, local supply chains, and domestic entrepreneurship.

#### **3. Background of Atmanirbhar Bharat Initiative**

The Atmanirbhar Bharat Initiative gained prominence during the period of:

- Global economic disruptions
- Supply chain breakdowns

- Economic slowdown and health crisis

These challenges highlighted India's dependence on imports in critical sectors such as medical equipment, electronics, and raw materials. The initiative was introduced to strengthen domestic manufacturing and economic resilience.

#### **4. Objectives of Atmanirbhar Bharat Initiative**

The major objectives of Atmanirbhar Bharat include:

- Promoting domestic production and manufacturing
- Reducing dependence on imports
- Strengthening small and medium enterprises
- Encouraging innovation and entrepreneurship
- Creating employment opportunities
- Achieving sustainable and inclusive growth

#### **5. Core Philosophy of Atmanirbhar Bharat**

Atmanirbhar Bharat is based on the principle of:

##### **“Local to Global”**

This philosophy encourages:

- Producing locally
- Consuming responsibly
- Competing globally

The initiative supports openness to trade while ensuring national economic strength.

#### **6. Five Pillars of Atmanirbhar Bharat**

The Atmanirbhar Bharat Initiative rests on five key pillars:

##### **6.1 Economy**

- Shift from incremental growth to quantum growth
- Strengthening domestic demand and investment

##### **6.2 Infrastructure**

- Development of modern physical and digital infrastructure
- Improved logistics and connectivity

##### **6.3 System**

- Reforms in governance and policy framework
- Simplification of procedures and regulations

#### **6.4 Vibrant Demography**

- Leveraging India's young population
- Skill development and human capital formation

#### **6.5 Demand**

- Strengthening purchasing power
- Encouraging consumption of domestic goods

### **7. Key Areas Covered under Atmanirbhar Bharat**

#### **7.1 Manufacturing Sector**

- Promotion of domestic manufacturing
- Encouragement of production-linked incentives
- Development of industrial clusters

#### **7.2 Micro, Small and Medium Enterprises (MSMEs)**

- Financial support to MSMEs
- Easier access to credit
- Protection from unfair competition

#### **7.3 Agriculture and Rural Economy**

- Strengthening farm infrastructure
- Promoting agro-processing
- Enhancing farmers' income

#### **7.4 Technology and Innovation**

- Promotion of digital platforms
- Support for research and development
- Encouraging start-ups

#### **7.5 Defense and Strategic Sectors**

- Indigenous production of defense equipment
- Reduced import dependence
- Development of domestic capabilities

## **8. Economic Significance of Atmanirbhar Bharat**

### **8.1 Impact on Economic Growth**

- Increase in domestic investment
- Expansion of manufacturing output
- Strengthening of supply chains

### **8.2 Employment Generation**

- Creation of jobs in manufacturing and services
- Growth of entrepreneurship
- Support for informal and formal sectors

### **8.3 Import Substitution**

- Reduction in import bills
- Promotion of domestic alternatives
- Strengthening balance of payments

### **8.4 Development of MSMEs**

- Enhanced competitiveness of small firms
- Integration into value chains
- Improved access to markets

### **8.5 Strengthening Economic Resilience**

- Reduced vulnerability to global shocks
- Stable domestic production system
- Improved crisis preparedness

## **9. Role of Atmanirbhar Bharat in Global Integration**

Atmanirbhar Bharat supports:

- Strategic globalization
- Export competitiveness
- Participation in global value chains

It promotes **self-reliance with openness**, not protectionism.

## **10. Challenges in Achieving Atmanirbhar Bharat**

Despite its potential, the initiative faces several challenges:

- Inadequate infrastructure in some regions
- Skill mismatch in labor force
- Dependence on imported technology
- Need for higher investment in research
- Regional imbalances

### **11. Measures Required for Successful Implementation**

To strengthen Atmanirbhar Bharat, India must:

- Improve ease of doing business
- Invest in education and skill development
- Promote innovation and R&D
- Strengthen financial institutions
- Ensure inclusive growth

### **12. Role of Government**

The government plays a crucial role by:

- Creating supportive policies
- Providing financial incentives
- Regulating markets
- Supporting vulnerable sectors
- Encouraging domestic production

### **13. Atmanirbhar Bharat and Sustainable Development**

The initiative supports:

- Long-term economic stability
- Environment-friendly production
- Inclusive development
- Balanced regional growth

## **QUESTION BANK**

### **PART A – 2 Marks Questions**

1. What were the main reasons behind the 1991 economic reforms?

2. Define Liberalisation.
3. Mention any two features of Liberalisation.
4. Define Privatisation.
5. State two objectives of Privatisation.
6. Define Globalisation.
7. What is meant by Disinvestment?
8. What do you mean by Balance of Payments crisis?
9. Name any two stabilization measures taken in 1991.
10. What is Foreign Direct Investment (FDI)?
11. What was the role of IMF in India's 1991 reforms?
12. What is meant by Industrial Licensing? 13. What was the major change introduced by the New Industrial Policy 1991?
14. Define Outsourcing.
15. State one positive and one negative impact of globalization.

#### **PART B – 10 Marks Questions**

1. Explain the background and causes of economic reforms in India.
2. Describe the characteristics of Liberalisation introduced under the NEP 1991.
3. Explain the main objectives and forms of Privatisation in India.
4. Explain the financial sector reforms introduced after 1991.
5. Discuss the effects of the LPG reforms on poverty and inequality in India.
6. Explain the trade and exchange rate policy reforms introduced in 1991.
7. Describe India's disinvestment policy and its major outcomes.
8. Evaluate the positive and negative impacts of the 1991 reforms on agriculture and industry.

#### **PART C – 15 Marks Questions**

1. Discuss in detail the Liberalisation, Privatisation, and Globalisation (LPG) reforms of 1991.
2. Examine the factors that necessitated the 1991 economic reforms. Discuss the crisis (BoP, inflation, fiscal deficit), IMF involvement, stabilization measures, and structural reforms.
3. Explain the major sectors affected by the 1991 reforms—Industrial sector, financial sector, public sector, Trade sector. Evaluate how these changes transformed the structure and performance of the Indian economy.

4. Evaluate the positive and negative impacts of the 1991 economic reforms. Cover GDP, employment, FDI, exports, poverty, inequality, agriculture, industry, and fiscal health.
5. Critically analyze India's economic performance since the 1991 reforms. Discuss achievements, challenges like jobless growth, inequalities, global competition, and suggest future measures.

### **Glossary**

- Liberalisation: Reducing government restrictions in the economy to allow free-market functioning.
- Privatisation: Transfer of ownership or control from the public to private sector.
- Globalisation: Integration of domestic economy with the global economy.
- Disinvestment: Selling government stakes in public sector enterprises.
- Foreign Direct Investment (FDI): Investment by foreign entities in Indian businesses or industries.

### **Suggested Reading / References**

1. Singh, R. (2025). Indian Economy (Latest ed.). McGraw Hill Education.
2. Misra, S. K., & Puri, V. K. (2025). Economic Development and Policy in India (Latest ed.). Himalaya Publishing House.
3. Rao, V. V. B. (2024). Economic Reforms in India. Academic Foundation.
4. Reserve Bank of India. (2024). RBI Annual Report 2023–24. Reserve Bank of India.
5. Government of India, Ministry of Finance. (2025). Economic Survey of India 2024–25. Government of India.