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

Economic Analysis - II

Course Coordinator
Dr. Sweta Shrivastava
Assistant Professor

Centre for Distance and Online Education

श्रीचन्द्रशेखरेन्द्रसरस्वतीविश्वमहाविद्यालयः

Sri Chandrasekharendra Saraswathi Viswa Mahavidyalaya
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Enathur, Kanchipuram 631561.
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BC205 Economic Analysis – II

Objective

This course aims to familiarize students with the Indian economy—its current structure, future prospects, and the ways it impacts the business environment. It helps learners understand key economic trends and policies shaping business activities within the Indian context.

Unit I

Features of Under Developed Economy-India as Developing Economy-concept of Mixed Economy- Human Development Index-Gini Index-Sectoral Classification of Indian Economy-Agriculture- Industry and Service-Tax and its Classification- Direct and Indirect Tax

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 Programme- Types of un employment- Causes of Unemployment – Demographic Dividend

Unit III

Inflation and Deflation- Types of Inflation-Measuring Inflation- causes of Inflation in India- Concept of National Income- Measurement of National Income

Unit IV

Monetary Policy and Fiscal Policy – Basic Overview of Import and Export (Concept of Balance of Trade and Balance of Payment)

Unit V

Economic reforms- Liberalisation- Privatisation- Disinvestment- Globalisation

Textbooks

1. **"Indian Economy"** – Ramesh Singh, McGraw Hill Education
2. **"Indian Economy: Performance and Policies"** – Uma Kapila, Academic Foundation
3. **"Indian Economy"** – Dutt & Sundaram, S. Chand Publications
4. **"Indian Economy: Problems and Policies"** – A.N. Agrawal, New Age International Publishers
5. **"Business Environment: Text and Cases"** – Francis Cherunilam, Himalaya Publishing House

(Recent editions of the books to be followed)

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UNIT I: Features and Classification of the Indian Economy

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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.

Objectives of Learning

Students will be able to:

- Recognise the key characteristics of underdeveloped economies and how these apply to India.
- Explain the reasons why India is classified as a developing nation.
- Discuss the concept and significance of a mixed economy and its relevance to India's planning and policy.
- Interpret socio-economic indicators like Human Development Index and Gini Index.
- Describe the Indian economy sectoral structure and its transformation over time.
- Understand the distinction and significance of direct and indirect taxation in India’s fiscal system.
- Apply these concepts to real-world discussions on economic development and policy-making.
- Evaluate India’s economic classification and structure using current examples.
  These objectives ensure students are equipped to critically assess India's macroeconomic framework and engage in informed discussions about public policy and economic reforms.

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 scoocialistic 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

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

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

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.

1.5 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

1.6 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:

1.6.1 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 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)**.

1.6.2 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

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

1.6.3 Importance of India’s Tax System

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

1.6.4 Challenges in India’s Tax System

Despite continuous reforms, several challenges persist:

- **Tax Evasion:** Use of loopholes and underreporting reduces revenue.
- **High Compliance Burden:** Especially for small businesses.

- **Complexity in Laws:** Frequent changes cause confusion among taxpayers.
- **Narrow Tax Base:** A small percentage of the population pays direct taxes.

1.6.5 Ongoing Tax Reforms

The government is focusing on:

- Digital tax filing and faceless assessment
- Simplification of GST slabs
- Broadening the tax base
- Strengthening anti-evasion measures
- Encouraging voluntary compliance

Conclusion

This unit has laid the groundwork for understanding the structural features and classifications of the Indian economy. We examined India's economic identity—how it retains characteristics of an underdeveloped nation while progressing as a developing economy. The mixed economic model adopted by India balances the roles of public and private sectors.HDI and Gini Index help measure the quality and equality of economic growth. Sectoral classification provides insights into employment and production patterns, while the tax system shows how the government finances development. Understanding these aspects is crucial for students aiming to analyze economic policies and participate in informed discussions. As India strives for inclusive and sustainable growth, these foundational concepts will help students connect macroeconomic theories with real-world policy implications and challenges

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

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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.

Objectives of Learning

Students will be able to:

1. Understand India's population structure and demographic trends.
2. Explain the concept of population growth and its impact on resources.
3. Describe the stages of the Demographic Transition Theory.
4. Differentiate between absolute and relative poverty.
5. Explain how BPL identification is done in India.
6. Identify the major causes of poverty in India.
7. Describe important poverty alleviation programmes.
8. Understand the types and causes of unemployment in India.
9. Explain the meaning and importance of demographic dividend.
10. Analyze the interrelationship between population growth, poverty, and economic development.

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**
    - More working-age people can contribute to **increased output** in agriculture, industry, and services.
2. **Faster Economic Growth**
    - 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

Entrpreneurship 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.

Conclusion

India’s population dynamics bring both opportunities and challenges. While poverty and unemployment remain serious issues, government schemes and reforms are steps in the right direction. Awareness about demographic changes, poverty causes, and employment generation can recognize learner to know the impact of policies everyday life. As future professionals, students can contribute to making India more inclusive, skilled, and prosperous.

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.
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4. Dhingra, I. C. (2021). ''Indian Economy''. McGraw-Hill Education.
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   McGraw-Hill Education.

Unit III: Inflation, Deflation and National Income

Structure

- Overview
- Learning Objectives
- 3.1 Meaning and Types of Inflation-
- 3.2 Measuring Inflation-
- 3.3 causes of Inflation in India-
- 3.4 Concept of National Income-
- 3.5 Measurement of National Income
- Conclusion
- Question Bank
- Glossary
- Suggested Reading

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.

Learning Objectives

learners will be able to:

- Understand the meaning and impact of inflation and deflation.
- Identify different types and causes of inflation in India.
- Learn how inflation is measured using key indices.
- Understand the concept of national income and how it is calculated.
- Recognize the importance of national income in economic planning.

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

Are:

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:

Inflation Rate=Previous Index (Current Index−Previous Index)×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.

ICOR = Δ Capital / Δ 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.

GDPFC = GDPMP – Indirect Taxes + Subsidies

2. Gross National Product (GNP):

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

GNP = GDP + 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.

GDP Deflator = Nominal GDP / 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 Measure : National income

Main methods to measure national income:

1. **Production Method**: Adds value of total goods as well as services produced.
2. **Income Method**: Adds all income gained by individuals and businesses.
3. **Expenditure Method**: Adds total spending by households, businesses, and the government.
   Data is controlled by the **Central Statistical Office (CSO)**. Accurate national income figures play key role in making comparisons with other countries as well as tracking the growth of nation.

Detailed explanation is given below:

1. Production Method (Output Method)

This method measures national income by calculating the total value of all final goods as well as services produced within the nation during a particular year. In this, economists first estimate the total output produced in different sectors—agriculture, manufacturing, mining, construction, and services. From this total output, they subtract the intermediate goods value such as raw materials, fuel, and components used in the production process to avoid *double counting*. The remaining value is called Value Added, and when all the sectors value is added together, we get the GDP at Market Price (GDP-MP). This method is particularly useful for measuring the performance of the industrial and agricultural sectors. However, it is not much accurate for the service sector because many services are difficult to measure exactly. It is called Output Method and also value is added at each stage of production.

2. Income Method: (Factor Income Method)

This method determines national income by adding up all individuals earned income and businesses for providing factors of production—land, labor, capital, and entrepreneurship. This includes wages and salaries paid to workers, rent earned on land and buildings, interest received on capital invested, and profits earned by companies and the self-employed. It does not include transfer payments like pensions, scholarships, or donations. By summing all factor incomes generated in the economy, economists obtain the National Income at Factor Cost (NIFC). This method is especially useful for understanding income distribution and the contribution of different factors of production to the economy.

Formula:

NI = Compensation to employees + Rent + Interest + Profit + Proprietors' income

3. Expenditure Method:

This measures national income by calculating the expenditure that is, how much is spent on final goods as well as on services within the country. It adds four major components: Consumption expenditure (C) by households, Investment expenditure (I) by businesses on machinery, buildings, and inventories, Government expenditure (G) on public services like education, defense, health, as well as Net Exports (X – M) which is exports subtracts imports.

These together form the formula:
GDP = C + I + G + (X – M)
This method is very useful for understanding demand in the economy and helps government assess which sector is driving growth.

Difficulties in Estimating National Income

1. Conceptual Problems

- Non-monetized sectors (barter, home production)
- Illegal activities
- Difficulty defining economic territory & residency
- Problems in including/excluding transfer payments

2. Statistical Problems

- Lack of accurate data

- Illiteracy among data collectors
- Multiple counting
- Regional diversity
- Problems in price adjustments

Shortcomings of GDP

GDP is not a perfect indicator of well-being because:

- It ignores inequality
- Does not include non-market activities
- Excludes environmental degradation
- Fails to measure happiness, leisure, or quality of life
- Counts negative activities as positive (disasters, diseases)

National Income is more than a number—it reflects the economic strength, productivity, and living standards of a nation. While existing measures like GDP and GNI have limitations, newer indicators aim to capture well-being and sustainability. Accurate national income accounting is essential for effective planning, policymaking, and development.

Role of the Central Statistical Office (CSO)

The Central Statistical Office (CSO), now part of the National Statistical Office (NSO), is responsible for collecting, analyzing, and publishing national income data in India. It gathers information from industries, agriculture, service sectors, banks, government agencies, and surveys. CSO uses standardized international guidelines to ensure accuracy and comparability of data.

Importance of Accurate National Income Measurement

Accurate national income help the government to track the country's economic growth, plan development strategies, and make policy decisions. They also identify whether people's standard of living is improving over time and also allow comparison with other nations. Reliable national income data supports budgeting, investment planning, and assessment of sector-wise performance of the economy.

Conclusion

Inflation and national income are two fundamental concepts that help us understand the overall health of an economy. Inflation means to the persistent increase in the prices of goods as well as services, while deflation represents their decline. Various types of inflation—such as demand-pull, cost-push, and hyperinflation—highlight the varied reasons behind rising prices. To monitor inflation accurately, India relies on key indices like the Consumer Price Index (CPI) and the Wholesale Price Index (WPI). At the same time, national income serves as an important indicator of a country's economic performance and living standards. Three major approaches used: the production method, the income method, and the expenditure method. Together, these concepts help policymakers assess economic progress, identify challenges, and design strategies for sustainable development.

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 Singh14th 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

Structure

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.

Objectives:

Students will be able to:

- Recognize the meaning and significance of monetary and fiscal policies.
- Identify the tools used in these policies to control inflation, unemployment, and economic growth.
- Comprehend the role of import and export in economic development.
- Differentiate between Balance of Trade and Balance of Payments.
- Explain how these concepts affect the Indian economy.

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.

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 supports vulnerable sections of society. Subsidies on essential items like food, fuel, and fertilizers help reduce the Poor people financial burden. 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 reduce 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:

BoT = Value of Exports – 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.

Conclusion

This unit offers a foundational understanding of how monetary and fiscal policies work together to maintain stability and promote economic growth. Monetary policy, implemented by the Reserve Bank of India through instruments such as the repo rate and Cash Reserve Ratio (CRR), helps regulate the supply of money and control inflation. Fiscal policy involves govt. decisions related to taxation and public expenditure, influencing overall demand in the economy. The unit also highlights the basics of international trade, explaining how imports and exports form the core of a country's engagement with the global economy. Concepts such as the Balance of Trade, the Balance of Payments, are essential for understanding a nation's external economic health. Together, these insights help students appreciate how internal policy tools and external trade dynamics shape the broader economic environment.

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.

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Unit V

Economic reforms

Structure

- Overview
- Learning Objectives
- 5.1 Economic reforms in India
- 5.2 Liberalization-
- 5.3 Privatization-
- 5.4 Globalization
- Conclusion
- Question Bank
- Glossary
- Suggested Reading

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.

Learning Objectives:

students will be able to:

- Recognize the **background** for introducing economic reforms in India.
- Define and explain the **concepts of Liberalisation, Privatisation, and Globalisation (LPG)**.
- Identify the **objectives and features** of each reform policy.

- 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 steps 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.

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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.

Conclusion

The adoption of the Liberalisation, Privatisation, and Globalisation (LPG) model transformed India to competitive economy from slow growing economy. These reforms attracted foreign investment, modernized industries, increased exports, and enhanced consumer choices. However, they also brought challenges such as income inequality, rural-urban disparities, and jobless growth. However, reforms provide the framework for long-term development. Hence continuous attempts are needed to address emerging socio-economic inequalities and economic 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

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Economic Analysis II

Case Studies

Unit – I

Case Study: Structural Changes in the Indian Economy

India has witnessed a steady decline in the contribution of agriculture to GDP while the service sector has expanded rapidly. At the same time, MSMEs continue to provide employment opportunities in both rural and urban areas.

Questions:

1. Explain the reasons for the changing sectoral contribution to GDP.

2. Discuss the importance of MSMEs in employment generation.

3. Analyse whether India can be considered a developed economy based on HDI and Gini Index.

Economic Analysis II

Case Studies

Unit – II

Case Study: Population and Employment Challenges

A recent survey revealed that many educated youths are working in temporary platform-based jobs such as food delivery and ride-sharing services. At the same time, population growth continues to increase pressure on employment opportunities.

Questions:

1. Identify the types of unemployment reflected in the case.

2. Explain the opportunities and risks associated with the gig economy.

3. Suggest measures to utilize India's demographic dividend effectively.

Economic Analysis II

Case Studies

Unit – III

Case Study: Inflation and Living Standards

Due to rising fuel prices and supply shortages, the prices of essential commodities increased sharply over a period of six months. Middle-income and low-income families faced difficulties in maintaining their standard of living.

Questions:

1. Identify the type of economic problem discussed in the case.
2. Explain the causes of inflation in the Indian economy.
3. Discuss how inflation affects purchasing power and economic growth.

Economic Analysis II

Case Studies

Unit – IV

Case Study: RBI and Economic Stability

To control rising inflation, the Reserve Bank of India increased the repo rate and tightened monetary policy. At the same time, the government announced higher expenditure on infrastructure through the Union Budget.

Questions:

1. Explain how repo rate influences inflation and credit availability.
2. Distinguish between monetary policy and fiscal policy.
3. Analyze the impact of government expenditure on economic development.

Economic Analysis II

Case Studies

Unit – V

Case Study: Economic Reforms and Self-Reliance

After economic reforms, several multinational companies entered the Indian market. While this increased competition and investment, domestic industries also faced challenges. The government later introduced the Atmanirbhar Bharat initiative to strengthen local manufacturing.

Questions:

1. Discuss the positive and negative effects of globalization on Indian industries.
2. Explain the role of FDI and FII in economic reforms.
3. Evaluate the significance of Atmanirbhar Bharat in promoting self-reliance.

Unit I: Short Stories

Discussion Forum Topic:

“Can short stories create the same emotional impact as novels?”

Guidelines for Discussion:

- Discuss the effectiveness of short stories in conveying themes and emotions.
- Share examples of short stories that created a strong impact on you.
- Compare the compact structure of short stories with longer fiction.
- Explain how authors use limited space effectively.

Unit II: Great Speeches

Discussion Forum Topic:

“Do speeches still influence society in the digital age?”

Guidelines for Discussion:

- Discuss the role of speeches in politics, education, and social movements.
- Share examples of memorable speeches from recent times.
- Explain how media and technology affect public speaking.
- Debate whether social media posts are replacing traditional speeches.

Unit III: One-Act Play

Discussion Forum Topic:

“Is inner beauty more important than physical appearance?”

Guidelines for Discussion:

- Relate the discussion to the themes in *Chitra*.
- Discuss how society judges people based on appearance.

- Share personal opinions on self-identity and confidence.
- Explain the importance of honesty and self-acceptance.

Unit IV: Grammar I

Discussion Forum Topic:

“How does grammar improve effective communication?”

Guidelines for Discussion:

- Discuss the importance of grammar in academic and professional writing.
- Share examples of misunderstandings caused by grammatical errors.
- Explain how punctuation and sentence structure affect clarity.
- Suggest methods for improving grammatical accuracy.

Unit V: Grammar II

Discussion Forum Topic:

“Which language skill is most important: listening, speaking, reading, or writing?”

Guidelines for Discussion:

- Present arguments supporting one language skill over others.
- Discuss how all four skills are interconnected.
- Share personal experiences in learning English.
- Suggest practical ways to improve communication skills.

Economic Analysis II

Multiple Choice Questions with Answers

Unit – I

1. India follows which type of economy?
   a) Capitalist Economy

   b) Socialist Economy

   c) Mixed Economy

   d) Traditional Economy

Answer: c) Mixed Economy

2. HDI stands for:
   a) Human Development Index

   b) Human Division Indicator

   c) Human Development Institution

   d) Human Data Index

Answer: a) Human Development Index

3. Gini Index measures:
   a) Population growth

   b) Inflation

   c) Income inequality

   d) Literacy rate

Answer: c) Income inequality

4. Which sector is also called the primary sector?
    a) Industry
    b) Services
    c) Agriculture
    d) Banking

Answer: c) Agriculture

5. MSME stands for:
    a) Medium Scale Market Enterprise
    b) Micro, Small and Medium Enterprises
    c) Modern Small Manufacturing Enterprise
    d) Medium Service and Manufacturing Enterprise

Answer: b) Micro, Small and Medium Enterprises

6. Which sector contributes the highest share to India's GDP in recent years?
    a) Agriculture
    b) Industry
    c) Services
    d) Mining

Answer: c) Services

Economic Analysis II

Multiple Choice Questions with Answers

Unit – II

1. The theory explaining stages of population growth is called:
    a) Theory of Consumption
    b) Theory of Demographic Transition
    c) Theory of Employment
    d) Theory of Inflation

Answer: b) Theory of Demographic Transition

2. Poverty measured in comparison with others is called:
    a) Absolute Poverty
    b) Relative Poverty
    c) Rural Poverty
    d) Urban Poverty

Answer: b) Relative Poverty

3. Disguised unemployment is commonly found in:
    a) Banking sector
    b) Agricultural sector
    c) IT sector
    d) Transport sector

Answer: b) Agricultural sector

4. Demographic dividend refers to:
    a) Rise in inflation
    b) Increase in exports
    c) Economic benefit from working-age population
    d) Population decline

Answer: c) Economic benefit from working-age population

5. Gig economy mainly depends on:
    a) Permanent jobs
    b) Platform-based work
    c) Agricultural labour
    d) Government employment

Answer: b) Platform-based work

6. Which of the following is a poverty alleviation programme?
    a) MGNREGA
    b) GST
    c) Liberalisation
    d) Disinvestment

Answer: a) MGNREGA

Economic Analysis II

Multiple Choice Questions with Answers

Unit – III

1. Inflation refers to:
    a) Fall in prices
    b) Rise in prices
    c) Stability in prices
    d) Decline in production

Answer: b) Rise in prices

2. Deflation means:
    a) Increase in money supply
    b) General fall in prices
    c) Increase in taxes
    d) Increase in exports

Answer: b) General fall in prices

3. CPI stands for:
    a) Consumer Price Index
    b) Cost Price Indicator
    c) Consumer Production Index
    d) Capital Price Index

Answer: a) Consumer Price Index

4. National income measures:
    a) Government revenue
    b) Total value of goods and services produced
    c) Export earnings only
    d) Agricultural production only

Answer: b) Total value of goods and services produced

5. Per capita income is obtained by:
    a) Dividing national income by population
    b) Multiplying population by income
    c) Dividing exports by imports
    d) Subtracting taxes from GDP

Answer: a) Dividing national income by population

6. Which method is used to measure national income?
    a) Income Method
    b) Product Method
    c) Expenditure Method
    d) All the above

Answer: d) All the above

Economic Analysis II

Multiple Choice Questions with Answers

Unit – IV

1. Repo Rate is the rate at which:
    a) RBI borrows from public
    b) RBI lends to commercial banks
    c) Banks lend to customers
    d) Government borrows from RBI

Answer: b) RBI lends to commercial banks

2. CRR stands for:
    a) Cash Reserve Ratio
    b) Credit Reserve Ratio
    c) Capital Reserve Ratio
    d) Current Reserve Ratio

Answer: a) Cash Reserve Ratio

3. Open Market Operations are conducted by:
    a) Commercial banks
    b) RBI
    c) NABARD
    d) SEBI

Answer: b) RBI

4. Fiscal policy relates to:
    a) Population control
    b) Government revenue and expenditure
    c) Industrial licensing
    d) Foreign trade only

Answer: b) Government revenue and expenditure

5. Fiscal deficit arises when:
    a) Revenue exceeds expenditure
    b) Expenditure exceeds revenue
    c) Imports exceed exports
    d) Inflation rises

Answer: b) Expenditure exceeds revenue

6. The central bank of India is:
    a) SBI
    b) NABARD
    c) RBI
    d) LIC

Answer: c) RBI

Economic Analysis II

Multiple Choice Questions with Answers

Unit – V

1. LPG policy refers to:
    a) Liberalization, Privatization and Globalization
    b) Liberal Policy Growth
    c) Local Production Growth
    d) Labour Productivity Growth

Answer: a) Liberalization, Privatization and Globalization

2. FDI stands for:
    a) Foreign Direct Investment
    b) Foreign Debt Investment
    c) Fiscal Development Index
    d) Financial Development Initiative

Answer: a) Foreign Direct Investment

3. Privatization means:
    a) Expansion of public sector
    b) Transfer of ownership to private sector
    c) Increase in taxation
    d) Reduction in exports

Answer: b) Transfer of ownership to private sector

4. Globalization promotes:
    a) Isolation of economies
    b) International integration
    c) Reduction in trade
    d) Elimination of industries

Answer: b) International integration

5. Atmanirbhar Bharat aims at:
    a) Increasing imports
    b) Economic self-reliance
    c) Reducing industrial growth
    d) Increasing foreign dependence

Answer: b) Economic self-reliance

1. FII refers to:
    a) Foreign Institutional Investment
    b) Foreign Industrial Income
    c) Financial Industrial Institution
    d) Foreign Insurance Investment

Answer: a) Foreign Institutional Investment

Economic Analysis II

Assignment Questions

Unit – I

1. Explain the features of an underdeveloped economy and examine why India is considered a developing economy.
2. Discuss the concept of mixed economy and explain the role of public and private sectors in India.
3. Explain the significance of Human Development Index (HDI) and Gini Index in measuring development and inequality.
4. Analyse the sectoral classification of the Indian economy and discuss recent trends in sectoral contribution to GDP.
5. Evaluate the role of agriculture and MSMEs in the economic development of India.

Economic Analysis II

Assignment Questions

Unit – II

1. Explain the demographic trends in India and discuss the theory of demographic transition.

2. Distinguish between absolute poverty and relative poverty. Explain the methods used for measuring poverty in India.

3. Discuss the major causes of poverty and evaluate the effectiveness of poverty alleviation programmes in India.

4. Explain the different types of unemployment and analyse the causes of unemployment in India.

5. Discuss the concept of demographic dividend and examine the opportunities and challenges of gig economy and platform work.

Economic Analysis II

Assignment Questions

Unit – III

1. Define inflation and deflation. Explain the different types of inflation.

2. Discuss the methods used for measuring inflation and analyse the causes of inflation in India.

3. Explain the concept of national income and discuss the various methods of measuring national income.

4. Examine the trends in inflation in India and their impact on economic growth.

5. Discuss the limitations of national income accounting and explain the significance of per capita income.

Economic Analysis II

Assignment Questions

Unit – IV

1. Explain the meaning and objectives of monetary policy and fiscal policy.
2. Discuss the role of the Reserve Bank of India in controlling credit and maintaining economic stability.
3. Explain the various instruments of monetary policy such as Repo Rate, Reverse Repo Rate, CRR, SLR and Open Market Operations.
4. Analyse the structure of the Union Budget with reference to revenue and capital receipts and expenditure.
5. Distinguish between Revenue Deficit, Fiscal Deficit and Primary Deficit.

Economic Analysis II

Assignment Questions

Unit – V

1. Explain the concepts of liberalisation, privatisation and globalisation.

2. Discuss the impact of economic reforms on the Indian economy.

3. Explain the meaning and role of FDI and FII in economic development.

4. Analyse the challenges of globalisation for the Indian economy.

5. Evaluate the significance of the Atmanirbhar Bharat initiative in promoting self-reliance.