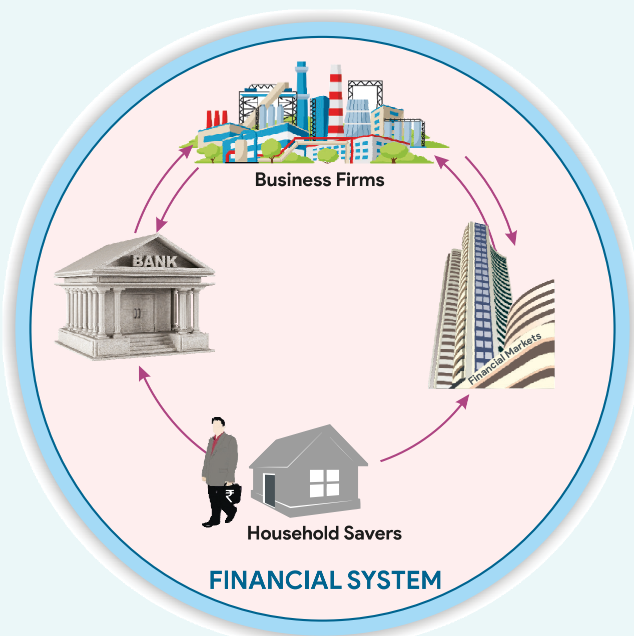
INDIAN ECONOMY

FIRST STEP

NCERT Based Course for **CSE**
after **class 11**



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INDIAN ECONOMY

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Contents

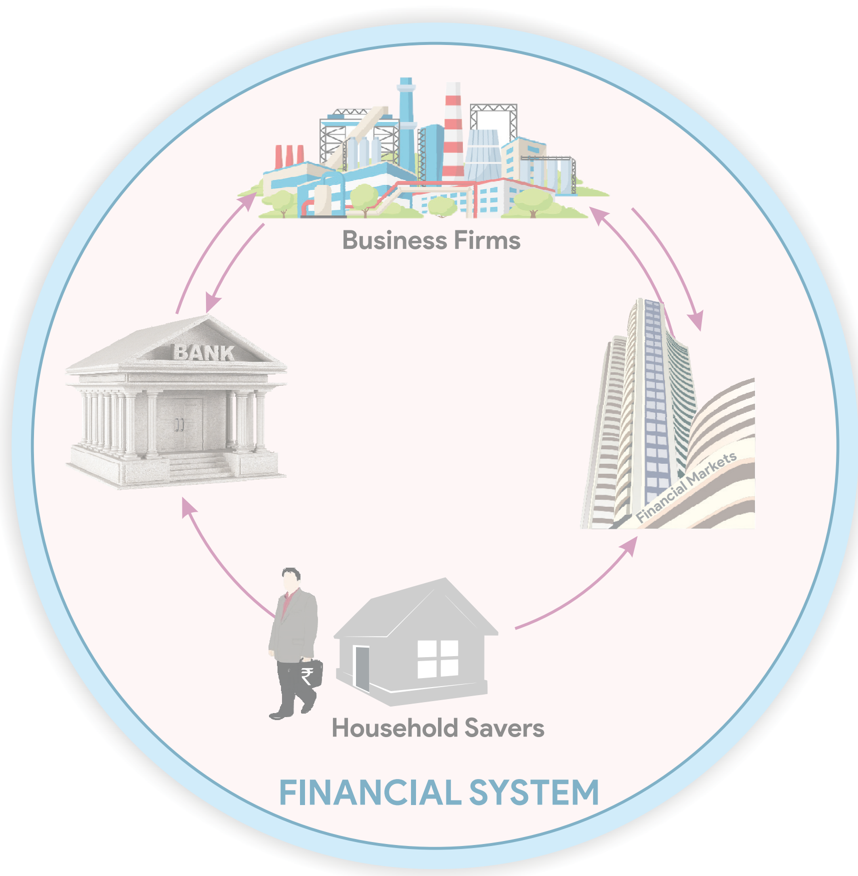
INDIAN ECONOMY

CHAPTER~12

Agriculture in India 109

CHAPTER~13

Industrial Sector in India 122


Business Firms
BANK
Financial Markets
Household Savers
FINANCIAL SYSTEM

Indian Economy

CHAPTER 1

Economy: An Introduction

1.1 Introduction

Economics is the science of analyzing the production, distribution and consumption of goods and services. In other words, what choices people make; how and why they make them when making purchases.

Adam Smith, regarded as the Father of Economics, author of 'The Wealth of Nations' defines economics as "The science of wealth." Smith offered another definition, "The Science relating to the laws of production, distribution and exchange."

Indian Economy refers to production, distribution, trade and consumption of goods and services within Indian Territory.

An economy is the result of a set of processes that involves its culture, education, technological evolution, history, social organization as well as its geography, natural resource endowment and ecology.

The study of economics can be categorized into Microeconomics and Macroeconomics.

- **Microeconomics** is the study of economics at the individual or business level; how individual people or businesses behave given scarcity and government intervention. Microeconomics includes concepts such as supply and demand, price elasticity, quantity demanded and quantity supplied.
- **Macroeconomics** is the study of the performance and structure of the whole economy rather than individual markets. Macroeconomics includes concepts such as inflation, international trade, unemployment, and national consumption and production.

1.2 Types of Economic System

There are four primary types of economic systems in the world: traditional, command, market and mixed.

Traditional Economic System

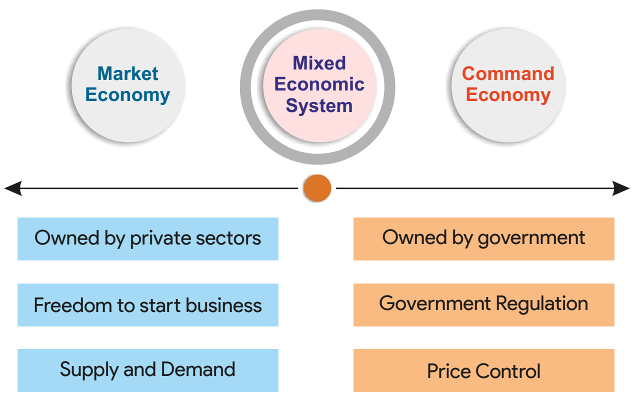
- A traditional economic system is based on customs, history and time-honoured beliefs. A traditional economy is an economic system in which traditions, customs, and beliefs help shape the goods and services the economy produces, as well as the rule and manner of their distribution.
- Countries that use this type of economic system are often rural and farm-based. Also known as a subsistence economy, a traditional economy is defined by bartering and trading.
- A little surplus is produced and if any excess goods are made, they are typically given to a ruling authority or landowner.
- Traditional economies would never, ever, in a million years see the type of profit or surplus that results from a market or mixed economy. In general, surplus is a rare thing.

Command Economic System

- A command economy is a system where the Government, rather than the free market, determines what goods should be produced, how much should be produced and the price at which the goods are offered for sale. It also determines investments and incomes.
- The command economy is a key feature of any communist society.

Market Economic System

- A market economy is very similar to a free market. The government does not control vital resources, valuable goods or any other major segment of the economy.
- Organizations run by the people determine how the economy runs, how supply is generated, what demands are necessary, etc.



Mixed Economic System

- A mixed economic system (also known as a Dual Economy) is just like it sounds (a combination of economic systems), but it primarily refers to a mixture of a market and command economy.
- In the most common types of mixed economies, the market is more or less free of government ownership except for a few key areas.

Model Adopted by India

The leaders of Independent India had to decide the type of economic system most suitable for our nation, which would promote the welfare of all rather than a few.

Among the different types of economic systems, socialism appealed to Jawaharlal Nehru the most. However, he was not in favour of the kind of socialism established in the former Soviet Union where all the means of production, i.e. all the factories and farms in the country, were owned by the government and there was no private property.

It was not possible in a democracy like India for the government to change the ownership pattern of land and other properties of its citizens in the way that it was done in the former Soviet Union.

After Independence, India opted for the Mixed Economy. In the process of organizing the economy, some basic and important infrastructural economic responsibilities were taken up by the State Governments (centre and state) and rest of the economic activities were left to private enterprise i.e. the market.

But once the country started the process of economic reforms in early 1990s, the prevailing state-market mix was redefined and a new form of mixed economy began to be practised.

The redefined mixed economy for India had a declared favour for the market economy.

Many economic roles, which were under complete government monopolies, were now opened for participation by the private sector.

- Examples are many - telecommunication, power, roads, oil and natural gas, etc. At the same time, social sectors such as education, healthcare, drinking water, etc. were given extra emphasis by the state.

1.3 Classification of Sectors of Economy

The contribution made by the different sectors of the economy, namely the agricultural sector, the industrial sector and the service sector in the GDP of the country makes up the structural composition of the economy.

In some countries, growth in agriculture contributes more to the GDP growth, while in some countries the growth in the service sector contributes more to GDP growth.

Sectors of Indian Economy are divided in following manner:

1. On the Basis of Nature of Job

Primary Sector:

- The primary sector involves the extraction of raw materials from the earth. Therefore, this is sometimes known as the Extraction Sector.
- Goods in this sector are produced by exploiting natural resources.
- People engaged in primary activities are called *red-collar workers*.

Secondary Sector:

- The secondary sector involves the transformation of raw materials into finished or manufactured goods.
- In this sector natural products change into other forms through ways of manufacturing associated with industrial activity.
- For example: cotton fibre to yarn and then clothes, sugarcane is used for making sugar, and iron ore is used for making iron and steel.
- People engaged in secondary activities are called *blue collar workers*.

Tertiary Sector:

- The service sector is concerned with the intangible aspect of offering services to consumers and business. But tertiary sector also involves retail of the manufactured goods. It also provides services, such as insurance and banking.
- Service sector also includes some essential services that may not directly help in the production of goods for example, teachers, doctors, and those who provide personal services such as washer men, barbers, cobblers, lawyers etc. This sector jobs are called *white collar jobs*.

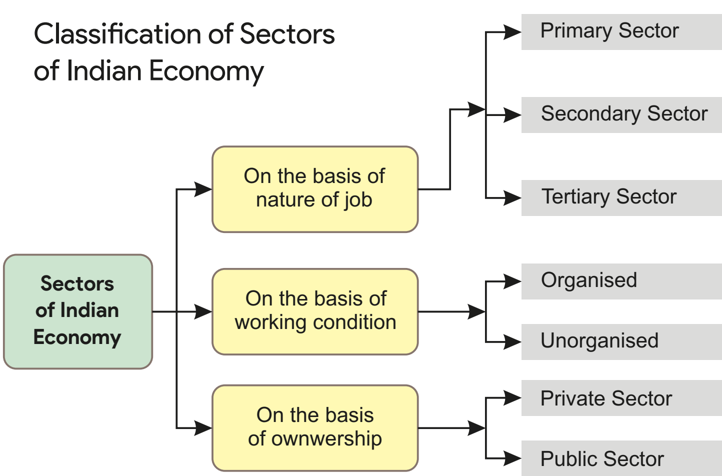
Quaternary Sector:

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

Quinary Sector:

- Quinary sector includes the highest levels of decision making in a society or economy.
- This sector includes top executives or officials in such fields as government, science, universities, nonprofit, healthcare, culture and the media.

Classification of Sectors of Indian Economy



2. On the Basis of Working Condition

Organised Sector:

- In this sector, employment terms are fixed and regular, and the employees get assured work and social security.
- It can also be defined as a sector, which is registered with the government and a number of acts apply to the enterprises. Schools and hospitals are covered under the organised sector.

- Workers in the organised sector enjoy security of employment. They are expected to work only a fixed number of hours. If they work more, they have to be paid overtime by the employer.

Unorganised Sector:

- An unorganised worker is a home-based worker or a self-employed worker or a wage worker in the unorganized sector.
- It includes a worker in the organized sector who is not covered by any of the Acts pertaining to welfare Schemes as mentioned in Schedule-II of Unorganized Workers Social Security Act, 2008.
- In this sector wage-paid labour is largely non-unionised due to casual and seasonal nature of employment and scattered location of enterprises.
- The sector is marked by low incomes, unstable and irregular employment, and lack of protection either from legislation or trade unions.

3. On the Basis of Ownership

The Public Sector:

- In the Public Sector, the government owns most of the assets and it is the part of the economy concerned with providing various governmental services. The purpose of the public sector is not just to earn profits. Governments raise money through taxes and other ways to meet expenses on the services rendered by it.
- Classification of Central Public Sector Enterprises (CPSEs): CPSEs are classified into 3 categories- Maharatna, Navratna and Miniratna. Presently, there are 7 Maharatna, 16 Navratna and 71 Miniratna CPSEs.

The Private Sector:

- In the private sector, ownership of assets and delivery of services is in the hands of private individuals or companies.
- It is sometimes referred to as the citizen sector, which is run by private individuals or groups, usually as a means of enterprise for profit, and is not controlled but regulated by the State.
- Activities in the private sector are guided by the motive to earn profits. To get such services we have to pay money to these individuals and companies.

1.4 Factors of Production

Factors of production is an economic term to describe the inputs that are used in the production of goods or services in the attempt to make an economic profit.

The factors of production include land, labour, capital and entrepreneurship.

The factors of production

1. Land : Natural resources
2. Labour : Human skill and effort
3. Capital : Equipment and materials
4. Enterprise : Organisation and undertaking production

Together produce goods and services

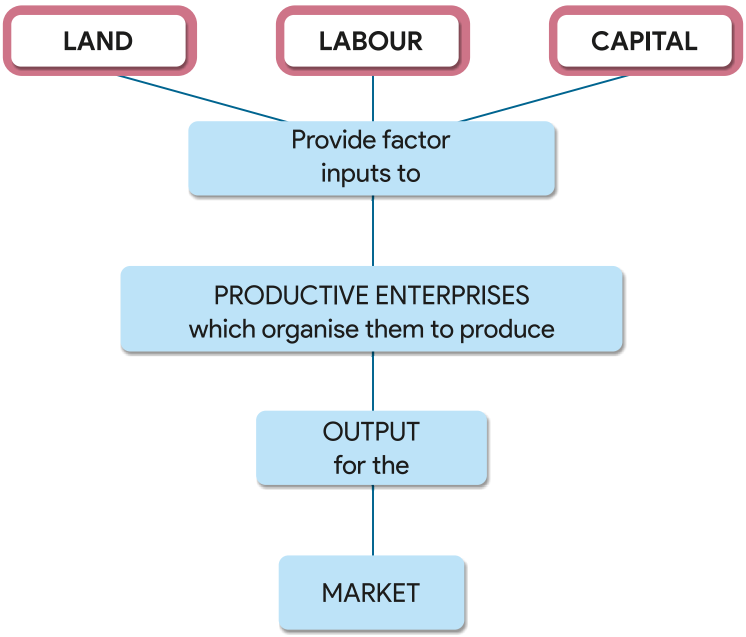
Land

- Land is an economic resource encompassing natural resources found within a nation's economy. This resource includes timber, land, fisheries, farms and other similar natural resources.
- Land is usually a limited resource for many economies. Example: India has 15% of the global population but only 2.4% of the global land.

Labour

- Labour represents the human capital available to transform raw material or national resources into consumer goods.
- Human capital includes all able-bodied individuals capable of working in the nation's economy and providing various services to other individuals or businesses.

- This factor of production is a flexible resource as workers can be allocated to different areas of the economy for producing consumer goods or services.
- Human capital can also be improved through training or educating workers.



The organisation of Production

Capital

- Capital has two economic definitions as a factor of production.
- Capital can represent the monetary resources companies use to purchase natural resources, land and other capital goods.
- Capital also represents the major physical assets individuals and companies use when producing goods or services. These assets include buildings, production facilities, equipment, vehicles and other similar items.

Entrepreneurship

- Organisation, as a factor of production, refers to the task of bringing land, labour and capital together.
- It involves the establishment of coordination and co-operation among these factors. The person in charge of an organisation is known as an organiser or an entrepreneur.
- The entrepreneur is the person who takes the charge of supervising the organisation of production and of framing the necessary policy regarding business.

1.5 Types of Goods

In economics, any object that is 'useful' is good. Useful here means utility, not good or bad in a moral sense.

A good is different from service because while the former is a tangible object, later is an action that benefits someone. A service is the non-material equivalent of a good.

Since Physical objects can be touched, they are called tangible goods. Intangible goods cannot be touched but only experienced.

- So, services come under the category of intangible goods. We note here that both goods and services can be collectively called "products".

Final Goods	Intermediate Goods
Used for final consumption	Not used for final consumption
Made by using intermediate goods.	Used as raw material for production of final goods.
They are finished goods.	They are unfinished goods.
Value is calculated for GDP.	Not calculated, as the value of final goods included the value of intermediate goods.
Ex. Biscuits are final goods.	Ex. Flour, milk and sugar are intermediate goods used in making biscuits.

Final (Finished) Goods

- The commodity produced by an enterprise is being sold out to the consumers. In the process the commodity goes under various transformations through productive processes into other goods before being sold to the consumers for Final Use. Such an item that is meant for final use and will not pass through any more stages of production or transformation is called a Final Good.
- *For example:* A car sold to a Consumer is a final good; the components such as tyres sold to the car manufacturer are not; they are intermediate goods used to make the final goods. The same tyres, if sold to a consumer, would be final goods.

Final goods are divided into 2 parts:

1. **Consumption Goods:**
   - Tangible goods that are produced and subsequently purchased for direct consumption to satisfy the current human needs or wants.
   - *Example:* Food, Clothing, Cigarettes, Pen, TV Set, and Radio etc.
   - Similarly, services rendered to consumers by hotels, retailers, barbers etc. are Consumer Services as they satisfy the immediate needs of the consumers.

Consumer Goods are divided into two categories:
Durable Goods: This can be used in consumption again and again over a considerable period of time. e.g., chair, car, fridge, shoes, TV set etc.
Non-Durable Goods: are like single-use goods which are used up by consumers in a single act of consumption, e.g., milk, fruits, matches, cigarettes, coal, etc.

2. **Capital Goods**
   - Capital goods are fixed assets of producers which are repeatedly used in production of other goods and services. Alternatively durable goods which are bought for producing other goods but not for meeting immediate needs of the consumer are called capital goods.
   - These goods are of durable character.
   - *For Example:* tools, implements, machinery, plants, tractors, buildings, transformers, etc.

Intermediate Goods

- Goods that are used by a business in the production of other goods or services. It is also referred to as producer goods. Intermediate Goods are used to make Consumer Goods.
- *For Example:* Timber and steel rods are intermediate products because they are sold by the timber merchant or the steel dealer to the builder who uses them to produce the final product - a house or a building.

Difference between Services and Goods		
Basis	**Services**	**Goods**
Nature	An activity or process. e.g., watching a movie in a cinema hall	A physical object. e.g. video cassette of movie
Type	Heterogeneous	Homogenous
Intangibility	Intangible e.g., doctor treatment	Tangible e.g., medicine
Inconsistency	Different customers having different demands e.g., mobile services	Different customers getting standardized demands fulfilled. e.g., mobile phones
Inseparability	Simultaneous production and consumption. e.g., eating ice-cream in a restaurant	Separation of production and consumption e.g., purchasing ice cream from a store
Inventory	Cannot be kept in stock. e.g., experience of a train journey	Can be kept in stock. e.g., train journey ticket
Involvement	Participation of customers at the time of service delivery. e.g., self-service in a fast food joint	Involvement at the time of delivery not possible. e.g., manufacturing a vehicle

1.6 Types of Countries in terms of Economy

Developed Country

- A developed country or industrialized country has advanced technological infrastructure.
- Development entails a modem infrastructure (both physical and institutional), and a move away from low value added sectors such as agriculture and natural resource extraction.
- Developed countries, in comparison, usually have economic systems based on economic growth in the secondary, tertiary and quaternary sectors and high standards of living.

Developing Country

- A developing country or underdeveloped country, is a nation with an underdeveloped industrial base, and a low Human Development Index (HDI) relative to developed countries.
- A developing country is a country that has not reached the Western-style standards of democratic governments, free market economies, industrialization, social programs, and human rights guarantees for their citizens.
- There is no universal criterion as to what makes a country developing or developed although there are general markers such as a nation's GDP per capita, HDI, demographic state etc.

Newly Industrialized Country (NIC)

- The category of newly industrialized country (NIC) is a socio-economic classification applied to several Countries around the world.
- Newly industrialized country (NIC) is one which has adopted the market model of growth; is showing rapid growth of economy for a considerable period of time; falls between a developed country and a developing country characterized by rapid export-driven economic growth and migration of workers from rural to urban areas. For example, India, Brazil, South Africa etc.
- NICs usually share some other common features, including:
  - A switch from agriculture to industrial economies, especially in the manufacturing sector.
  - An increasingly open-market economy, allowing free trade with other nations in the world.
  - Emerging MNCs.
  - Strong capital investment from foreign countries.

Least Developed Countries (LDCs) or Fourth World countries

- They are countries which according to the United Nations exhibit the lowest indicators of socio-economic development, with the lowest Human Development Index ratings of all countries in the world. The concept of LDCs originated in the late 1960s.

A country is classified as a Least Developed Country if it meets three criteria:

- Poverty, as of 2015 a country must have per capita less than US $1,035 to be included on the list, and over $1,242 to graduate from it.
- Human resource weakness (based on indicators of nutrition, health, education and adult literacy).
- Economic vulnerability (based on instability of agricultural production,. instability of exports of goods and services, economic importance of non-traditional activities, merchandise export concentration, handicap of economic smallness, and the percentage of population displaced by natural disasters).

Indian Economy

PRACTICE QUESTIONS

1. With reference to India, consider the following:

1. Nationalization of banks
2. Formation of regional rural banks
3. Adoption of villages by bank branches

Which of the above can be considered as steps taken to achieve the “financial inclusion” in India?

(a) 1 and 2 only (b) 2 and 3 only
(c) 3 only (d) 1, 2 and 3

2. A “closed economy” is an economy in which

(a) The money supply is fully controlled
(b) Deficit financing takes place
(c) Only exports take place
(d) Neither exports nor imports take place

3. Economic Growth is usually coupled with

(a) Deflation (b) Inflation
(c) Stagflation (d) Hyperinflation

4. India is regarded as a country with “” this is due to

(a) Its high population in the age group below 15 years
(b) Its high population in the age group of 15 to 64 years
(c) Its high population in the age group above 65 years
(d) Its high total population

5. A consumer is said to be in equilibrium, if

(a) Able to fulfill his need with a given level of income
(b) Able to live in full comfort with a given level of income
(c) Can fulfill his needs without consumption of certain items
(d) Able to locate new sources of income

6. Consider the following statements about Cash Reserve Ratio:

1. It is the ratio of deposits which banks have to keep with RBI.
2. The increase in CRR will lead to increase in lending capacity of banks.
3. Banks get a fixed interest on CRR from RBI

Which of the above statements are incorrect?

(a) 1 and 2
(b) 2 and 3
(c) 1 and 3
(d) None of the above

7. The balance of payments of a country is a systematic record of

(a) all import and transactions of a during a given period normally a year
(b) goods exported from a country during a year
(c) economic transaction between the government of one country to another
(d) capital movements from one country to another

8. A country is said to be in a debt trap if

(a) It has to abide by the conditionalities imposed by the International Monetary Fund
(b) It has to borrow to make interest payments on outstanding loans
(c) It has been refused loans or aid by creditors abroad
(d) The World Bank charges a very high rate of interest on outstanding as well as new loans

9. Agricultural income tax is assigned to the State Government by:
(a) The Finance Commission
(b) The National Development Council
(c) The Inter-state Council
(d) The Constitution of India

10. Bank Rate implies the rate of interest:
(a) Paid by the Reserve Bank of India on the deposits of commercial banks.
(b) Charged by banks on loans and advances
(c) Payable on bonds
(d) At which the Reserve Bank of India discounts the Bills of Exchange

11. Disguised unemployment generally means:
(a) large number of people remain unemployed
(b) alternative employment is not available
(c) productivity of labour is zero
(d) productivity of workers is low

12. Which of the following can be called as 'factors of production'?
1. Consumer goods
2. Human labour
3. Land
4. Capital goods

Select the correct answer using the codes below.
(a) 1, 2 and 3 only
(b) 2, 3 and 4 only
(c) 2 and 3 Only
(d) 1, 2 and 4 only

13. In the context of Indian economy, 'Open Market Operations' refers to
(a) borrowing by scheduled banks from the RBI
(b) lending by commercial banks to industry and trade
(c) government securities by the RBI
(d) None of the above

14. The term 'Green GDP' is used to
(a) Express the proportion of GDP of a country which has been spent to fight climate change
(b) Measure the proportion of GDP produced through green resources
(c) Express GDP of a country after adjusting for environmental damages
(d) Measure the monetary value of the natural resources of the country

15. Which of the following best describes the term Angel investor?
(a) Investors who provides credit to the infrastructure projects which are stalled for years.
(b) Investors who buy government securities especially related to social sector schemes.
(c) Investor who provides financial backing to entrepreneurs for starting their business.
(d) Investors who invest in service sector industries.

16. Which of the following are considered as core industries in India?
1. Fertilizers
2. Iron
3. Textile
4. Crude Oil
5. Food processing

Select the correct answer using the codes given below.
(a) 1, 2 and 3 only (b) 3, 4 and 5 only
(c) 1 and 4 only (d) 2, 3 and 5 only

17. Which of the following measures can be used to curb inflation in an economy?
1. Export promotion
2. Reducing fiscal deficit
3. Tightening credit

Select the correct answer using the code given below.
(a) 1 and 2 only (b) 2 and 3 only
(c) 3 only (d) 1 and 3 only

106. Supply of money remaining the same when there is an increase in demand for money, there will be

(a) a fall in the level of prices

(b) an increase in the rate of interest

(c) a of interest

(d) an increase in the level of income and employment

107. Increases in absolute and per capita real GNP do not connote a higher level of economic development, if:

(a) industrial output fails to keep pace with agricultural output.

(b) agricultural output fails to keep pace with industrial output.

(c) poverty and unemployment increase.

(d) imports grow faster than exports.

108. What is/are the most likely advantages of implementing 'Goods and Services Tax (GST)'?

1. It will replace multiple taxes collected by multiple authorities and will thus create a single market in India.
2. It will drastically reduce the „Current Account Deficit" of India and will enable it to increase its foreign exchange reserves.
3. It will enormously increase the growth and size of the economy of India and will enable it to overtake China in the near future.

Select the correct answer using the code given below:

(a) 1 only (b) 2 and 3 only

(c) 1 and 3 only (d) 1, 2 and 3

Indian Economy

ANSWER KEY

1. (d)	2. (d)	3. (b)	4. (b)	5. (a)	6. (b)	7. (a)	8. (b)
9. (d)	10. (d)	11. (c)	12. (b)	13. (c)	14. (c)	15. (c)	16. (c)
17. (b)	18. (c)	19. (d)	20. (c)	21. (c)	22. (d)	23. (b)	24. (a)
25. (b)	26. (d)	27. (b)	28. (a)	29. (c)	30. (a)	31. (d)	32. (d)
33. (c)	34. (c)	35. (b)	36. (d)	37. (b)	38. (d)	39. (b)	40. (c)
41. (c)	42. (b)	43. (d)	44. (b)	45. (c)	46. (c)	47. (c)	48. (a)
49. (a)	50. (d)	51. (c)	52. (b)	53. (a)	54. (a)	55. (a)	56. (c)
57. (c)	58. (a)	59. (d)	60. (a)	61. (c)	62. (b)	63. (a)	64. (a)
65. (a)	66. (a)	67. (d)	68. (a)	69. (b)	70. (c)	71. (a)	72. (d)
73. (c)	74. (b)	75. (c)	76. (d)	77. (c)	78. (b)	79. (c)	80. (b)
81. (d)	82. (a)	83. (a)	84. (b)	85. (b)	86. (a)	87. (a)	88. (c)
89. (b)	90. (c)	91. (a)	92. (a)	93. (b)	94. (c)	95. (b)	96. (c)
97. (d)	98. (a)	99. (c)	100. (c)	101. (d)	102. (b)	103. (d)	104. (a)
105. (b)	106. (b)	107. (c)	108. (a)				