



UPSC – IAS

Civil Services Examinations

Union Public Service Commission

General Studies

Paper 3 – Volume - 1

ECONOMY



G.S. PAPER – 3 VOLUME – 1

ECONOMY

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1 CHAPTER

Evolution of Indian Economy



Pre-independence period	<ul style="list-style-type: none"> ● A period of near-stagnation, with little change in the structure of output or productivity levels.
Mid 1930s	<ul style="list-style-type: none"> ● The National Planning Committee was created in 1938 by Britishers who saw the necessity for economic planning in India. ● India was pursuing growth for the benefit of a foreign country, the United Kingdom.
Economic profile of India on eve of independence	<ul style="list-style-type: none"> ● A classic scenario of the colonial economy is in full disarray. ● Agriculture and manufacturing both had fundamental problems, with the government playing only a minimal role.

Indian Economy before British Rule

- **Type: An independent economy.**
- **Agriculture : main source** of livelihood for most people
 - Economy characterised by various kinds of manufacturing activities.
 - Eg: **Handicraft** industries in the fields of **cotton and silk textiles**,
 - **Metal and precious stone works etc.**
- **Bengal :** Famous for **Textile Industry especially - Muslin** (malmal)
- **Indian Products** enjoyed a **worldwide reputation** for fine quality of material used and the high standards of craftsmanship seen in most imports from India.



Indian Economy during British Rule



Agriculture Sector	<ul style="list-style-type: none"> ● Economy type: fundamentally agrarian ● People's engagement: About 85% of the country's population derived livelihood directly or indirectly from agriculture ● Agricultural productivity became low, the sector experienced some growth due to the expansion of the aggregate area under cultivation. ● Causes of Stagnation in the Agricultural sector <ul style="list-style-type: none"> ○ Land settlement systems introduced by the Britishers: zamindari system implemented in Bengal diverted the profit accruing out of the agriculture sector to the zamindars instead of the cultivators. ○ Low levels of technology. ○ Lack of irrigation facilities. ○ Negligible use of fertilisers, ● Increased cultivation of Cash Crops: Relatively higher yield of cash crops due to commercialisation of agriculture.
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	<ul style="list-style-type: none"> ● British policy was hardly of any use since instead of producing food crops, cash crops were produced which were to be ultimately used by British industries back home. ● Some progress was made in irrigation, but India's agriculture was starved of investment in terracing, flood-control, drainage and desalination of soil.
Industrial Sector	<ul style="list-style-type: none"> ● India could not develop a sound industrial base under colonial rule. ● Country's handicraft industries declined and no modern industrial base was developed. ● Britain's Motive behind the policy: <ul style="list-style-type: none"> ○ To reduce India to the status of a mere exporter of important raw materials for the upcoming modern industries in Britain. ○ To turn India into a sprawling market for the finished products of those industries so that their continued expansion could be ensured to the maximum advantage of their home country — Britain. ● Effects of the policies <ul style="list-style-type: none"> ○ Massive unemployment due to decline of handicraft industry ○ Demand in the Indian consumer market was deprived of the supply of locally made goods leading to increased imports of cheap manufactured goods from Britain. ○ Beginning of Modern Industry: During the second half of the nineteenth century, modern industry began to take root in India but its progress remained very slow. ○ Cotton textile mills: Dominated by Indians <ul style="list-style-type: none"> ■ Location: Maharashtra & Gujarat, ○ Jute mills: Dominated by the foreigners <ul style="list-style-type: none"> ■ Location: Bengal. ○ Iron and steel industries: arrived in the beginning of 20th century. <ul style="list-style-type: none"> ■ 1907: Tata Iron and Steel Company (TISCO) was incorporated. ○ Other industries: sugar, cement, paper etc. came up after WW-II.
Foreign Trade	<ul style="list-style-type: none"> ● Restrictive policies of production, trade and tariff by the British adversely affected the structure, composition and volume of India's foreign trade. ● Policies of British: monopoly control over India's exports and imports. ● During the colonial period, large export Surplus was the generated ● Effect of their Policies: India became an exporter of primary products such as raw silk, cotton, wool, sugar, indigo, jute etc. and an importer of finished consumer goods like cotton, silk and woollen clothes and capital goods like light machinery produced in Britain. ● The opening of the Suez Canal further intensified British control over India's foreign trade ● Export surplus generation costed badly to the country's economy.

	<ul style="list-style-type: none"> ● Several essential commodities like food grains, clothes, kerosene etc. Were scarcely available in the domestic market. ● did not result in any flow of gold or silver into India; instead it was used to make payments for the expenses incurred by an office set up by the colonial government in Britain, expenses on war fought by British ● All of this led to the drain of Indian wealth.
<p>Demographic Condition</p>	<ul style="list-style-type: none"> ● 1st census: 1881 ● There was unevenness in India's population growth. ● Till 1921: India was in the first stage of demographic transition. ● After 1921: The second stage of transition began. ● Neither the total population of India nor the rate of population growth at this stage was very high. ● Social development indicators: <ul style="list-style-type: none"> ○ The overall literacy level: less than 16 % ○ The female literacy level: 7% ○ Absence of Public health facilities to large chunks of population or, highly inadequate. ○ Water and air-borne diseases were rampant ○ The overall mortality rate was very high and in that. ○ The infant mortality rate: 218 per thousand in contrast to the present infant mortality rate of 33 per thousand. ○ Life expectancy: 32 years in contrast to the present 69 years. ● Extensive poverty: Contributed to the worsening profile of India's population of the time.
<p>Occupational Structure</p>	<ul style="list-style-type: none"> ● Agricultural sector: Accounted for the largest share of the workforce, remained high at 70-75%. ● Manufacturing Sector: Accounted for 10% share of workforce ● Service Sector: It accounted 15-20 % share of workforce ● Growth of Regional Variation: Parts of the then Madras Presidency, Bombay and Bengal witnessed a decline in the dependence of the workforce on the agricultural sector with a commensurate increase in the manufacturing and the services sectors. ● An increase in the share of the workforce in agriculture during the same time in states such as Orissa, Rajasthan and Punjab.
	<ul style="list-style-type: none"> ● Development of basic infrastructure such as railways, ports, water transport, posts and telegraphs. ● Roads: Constructed in India prior to the advent of British rule but were not fit for modern transport.

	<ul style="list-style-type: none"> ○ Purpose: For mobilising the army within India and drawing out raw materials from the countryside to the nearest railway station or the port to send these to far away England or other lucrative foreign destinations. ● Railways: Introduced by The British in India in 1850 and it is considered as one of their most important contributions. <ul style="list-style-type: none"> ○ Impact on Indian Economy: ○ it enabled people to undertake long distance travel and thereby break geographical and cultural barriers ○ It fostered commercialisation of Indian agriculture which adversely affected the self-sufficiency of the village economies in India. ○ The volume of India's exports undoubtedly expanded but its benefits rarely accrued to the Indian people. ○ The social benefits, which the Indian people gained owing to the introduction of the railways, were outweighed by the country's huge economic loss. ● Inland trade and sea lanes <ul style="list-style-type: none"> ○ These measures by Britishers were far from satisfactory. ○ The inland waterways also proved uneconomical as in the case of the Coast Canal on the Orissa coast. ● Telegraph System: The introduction of the expensive system of electric telegraph in India served the purpose of maintaining law and order. ● The postal services: Despite serving a useful public purpose, they remained inadequate.
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Economy after Independence



1950	<ul style="list-style-type: none"> ● Adoption of a particular strategy of economic development. <ul style="list-style-type: none"> ○ Rapid industrialization: Implementing centrally prepared FYP. ○ This process involved raising a massive amount of resources & investing them in the creation of large industrial state - owned enterprises (SOEs). ● Industries chosen : steel, chemicals, machines and tools, locomotives, Power. ● Investments were directed for creation of public enterprises. ● Goal: To establish a “socialistic pattern of society” by using democratic methods to bring a large chunk of productive resources under public ownership. ● Independent India : planned and mixed economy
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Planned and Mixed Economy



Planned or Socialist economy	Mixed economic system
<ul style="list-style-type: none"> ● An economic system: where the government controls production and pricing of goods and services. ● Sometimes referred as command economy, ● Government decides : <ul style="list-style-type: none"> ○ which goods and services to produce, ○ Production and distribution method, ○ Prices of goods and services. ● Govt.: central planner and heavy regulator and controller. ● Exs : North Korea, Iran, Libya, and Cuba. ● China - a command economy <ul style="list-style-type: none"> ○ Before turning to a mixed economy with both communist and capitalist ideals. 	<ul style="list-style-type: none"> ● Features of both a command and a free-market system. ● Partly controlled by the government and partly based on the forces of supply and demand. ● Most of Important economies in the world are now mixed economies, <ul style="list-style-type: none"> ○ operate under a combination of socialism and capitalism, & use fiscal or monetary policies ○ To stimulate growth during economic slowdowns. ● Mixed economic system includes a public and private sector. ● Limited government regulation in a mixed economy.



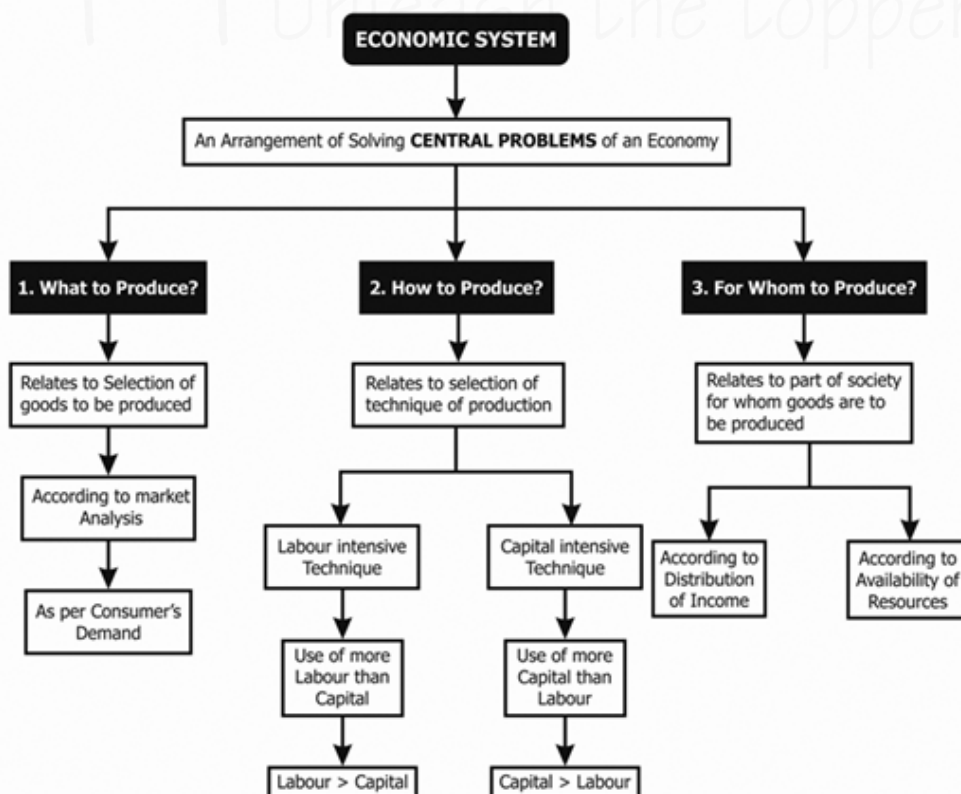
Micro and Macro Economy



Microeconomics	Macroeconomics
<ul style="list-style-type: none"> • Individual and business decisions are studied. • Supply and demand, as well as other factors that influence price levels. • Can be used to make decisions by potential investors. • Illustrates the commodities and services required for a healthy economy. • It also forecasts which items and services - to be high demanded in the future. • Professor Ragnar Frisch originated the term microeconomics. 	<ul style="list-style-type: none"> • Study of how countries and governments make business decisions. • Explores the entire economy from the top down to understand its direction and nature. • A method of analysing economic and fiscal policy. • Ensures that the country's economic resources are used to their full potential. • John Maynard Keynes is generally regarded as the father of contemporary macroeconomic theory.

Economic Systems

- Set of **institutional arrangements** and coordinating mechanism **to allocate resources and distributes goods** and services across the whole nation





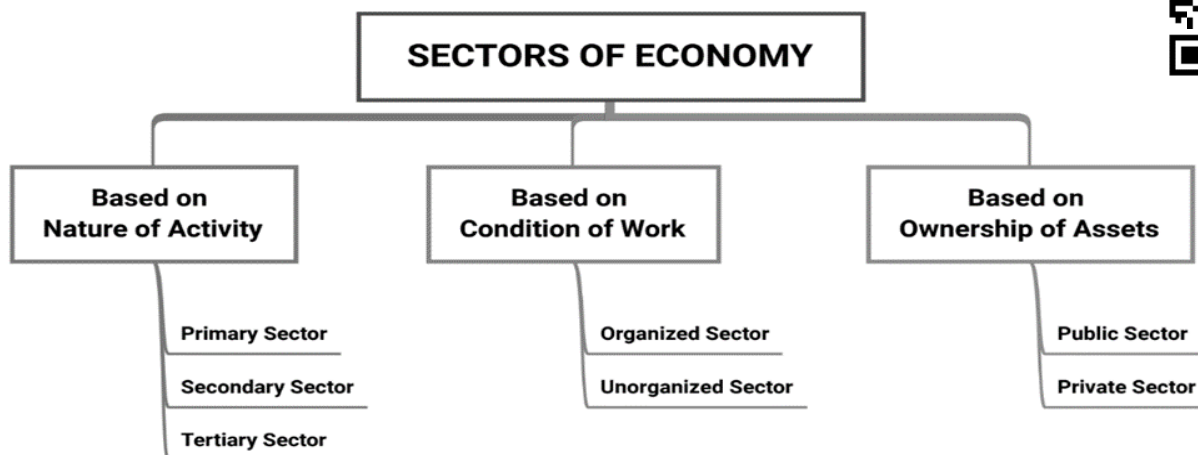
Different Economic Systems

Capitalist economy	<ul style="list-style-type: none"> ● products generated in a capitalist economy are distributed among individuals based on purchasing power, ability to purchase goods and services, rather than on what they want. ● A person must have sufficient funds to purchase products and services. ● Despite demand goods may not be produced due to lack of purchasing power.
Socialist economy	<ul style="list-style-type: none"> ● Government decides what, how and for whom products to be made. ● Individual purchasers: Not given much consideration. ● In theory, sharing under socialism based on <ul style="list-style-type: none"> ○ What each individual requires rather than what they can afford. ● No separate estate in a socialist regime.
Mixed economy	<ul style="list-style-type: none"> ● Economy never permanently inclined towards either state intervention or the free market, but always a balanced mix of the state and the market according to the requirements of the socio-economic situation of the economy.

Difference b/w Capitalist, Socialist and Mixed Economies

Parameters	Capitalist economy	Socialist economy	Mixed economy
Ownership	Private	Public	Both public and private
Price determination	by the market forces	by the central planning authority.	by central planning authority, and market forces.
Motive of production	Profit making	Social welfare	Profit making in private sector and welfare in public sector
Role of government	No role	Under complete control	Full role in public and limited in private sector
Competition	Exists	No competition	only in private sector
Income Distribution	Very unequal	Quite equal	Considerable inequalities exist

Sectors of Economy



Based on Nature of Economic Activity

Primary Sector

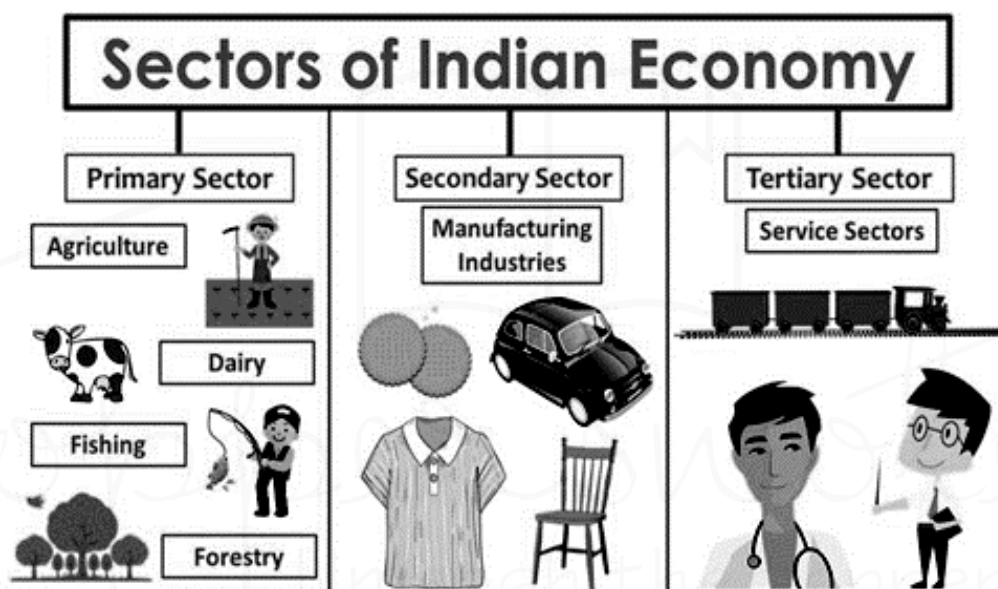
- Industries involved in the **extraction of natural resources** or the **manufacturing of raw materials**.
- **Eg. Agriculture, fishing, and mining etc.**

Secondary Sector

- Industries involved in the **production of useful items or completed commodities**
- **Eg: heavy and light industries** (steel, chemical, and automobile) (food, apparel, cosmetics).

Tertiary Sector

- Provide **services to other firms or final consumers**.
- **Eg:** Retail, healthcare, and other industries.



Quaternary sector	<ul style="list-style-type: none"> ● Involved in the creation and dissemination of knowledge. ● Eg: Research and development, Education etc
Quinary sector	<ul style="list-style-type: none"> ● Highest levels of decision making in an economy.
Pink Collar Jobs	<ul style="list-style-type: none"> ● job that is traditionally considered to be women's work or women-oriented jobs. ● need not require much professional training ● Eg: babysitter, florist, day care worker, nurses etc.

Based on Condition of Work

Organized Sector

- Covers those enterprises or places of work where **terms of employment are regular**
- **Registered by the government** and have to **follow its rules and regulations** which are given in various laws such as the Factories Act, Minimum Wages Act, Payment of Gratuity Act, Shops and Establishments Act etc.

Unorganized Sector

- Characterized by **small and scattered units** which are **not in control of the government**. There are **rules and regulations** but these are **not followed**.
- **Low-paid jobs** and often not regular.
- **Employment is not secure** and depends on the whims of the employer.
- **not covered by any of the Acts pertaining to welfare Schemes** as mentioned in Schedule-II of Unorganized Workers Social Security Act, 2008.
- **home-based worker or a self-employed worker or a wage worker**

Based on Ownership of Assets

Public Sector

- **Ownership:** under **Government**.
- Majorly **aimed to produce public goods** and services.
- **Eg:** Railways, Indian Postal Services, etc.

Private Sector

- **Ownership:** under **private individuals** or companies.
- **Eg:** companies like Tata Iron and Steel Company Limited (TISCO) or Reliance Industries Limited (RIL) are privately owned.

Sunrise Industry

- Sector that is **just in its infancy** but shows promise of a rapid boom.
- Characterized by **high growth rates, high degree of innovation** and generally has plenty of **public awareness** about the sector and **investors get attracted** to its long-term growth prospects.
- **Eg:**
 - Information Technology
 - Telecom Sector
 - Healthcare
 - Infrastructure Sector
 - Retail Sector
 - Food Processing Industries
 - Fisheries

3

CHAPTER

National Income



- **National income:** The total value of **final goods and services produced by the normal residents during an accounting year, after adjusting depreciation.**
 - It is Net National Product (NNP) at Factor Cost (FC)
 - It does not include taxes, depreciation and non-factor inputs (raw materials)
- Also **useful in determining the country's progress.**
- It Includes: **Wages, interest, rent, and profit received** by components of production such as: **labour, capital, land, and entrepreneurship**
- **Domestic Income:** Total value of final goods and services produced within a domestic territory during an accounting year, after adjusting depreciation.
 - It is NDP at Factor Cost.
- Both NNP and NDP can be measured at constant prices (real income) or market prices (nominal income)
- **National income: Domestic Income + NFIA**

Some Important Terms	
Factor Cost	<ul style="list-style-type: none"> ● Total cost of all the factors of production consumed or used in producing a good or service.
Basic Price	<ul style="list-style-type: none"> ● Amount a producer receives from a purchaser for a unit of a good or service provided as output, minus any tax due and any subsidy due on that unit as a result of its production or sale.
Market Price	<ul style="list-style-type: none"> ● Price at which a thing is sold in the market. ● Covers wages, rent, interest, input prices, profit, & other costs of production. ● Also covers government-imposed taxes & government-provided producer subsidies.
Depreciation	<ul style="list-style-type: none"> ● The wear and tear of capital assets ● Capital consumption allowance - another term for depreciation.
Transfer Payments	<ul style="list-style-type: none"> ● A monetary payment for which no goods or services are exchanged. ● Efforts by local, state, and federal governments to redistribute money to individuals in need are usually referred to as transfer payments. ● Transfer payments such as Social Security and unemployment insurance are popular in the United States. ● Transfer payments are not typically used to describe corporate bailouts and subsidies.

Aspects of National Income

Gross Domestic Product (GDP)

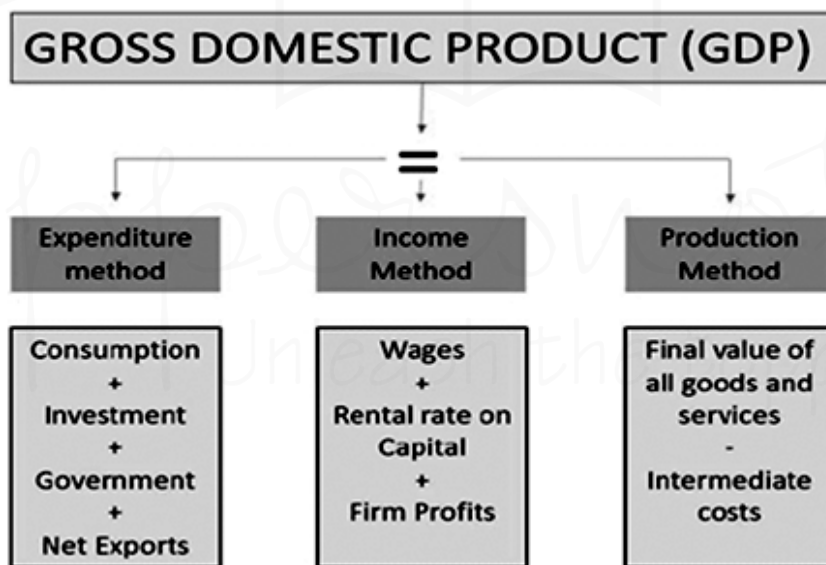
- Total value of **goods and services produced in a country.**
- Economic indicator used to **gauge a country's economic growth.**



- Estimated **at regular periods** (such as quarterly, yearly).
 - For India it is from **1st April to 31st March**.
- **Production area for calculation of GDP** includes
 - A **country's geographical borders** including its **Exclusive Economic Zones (EEZ)** (up to 200 nautical miles or 360 kms)
 - A **country's embassy** in different nations
 - **Production in moving vehicles** like ships, aircraft, etc.
- **Goods included:** all final goods and services **produced by the normal residents and non-residents in the domestic territory** of the country
 - does **not include Net Factor Income from Abroad (NFIA)**
- **Calculated by Central Statistics Organization**, Ministry of Statistics and Programme.
- 'Quantitative concept' and indicates **internal strength of the economy**.
- **Used by the IMF & World Bank in comparative analyses** of member economies.

GDP = consumption + investment + government spending + exports - imports

Methods for Calculating GDP



Nominal GDP	Real GDP
<ul style="list-style-type: none"> ● Total financial business value produced inside the country. ● Without Inflation adjusted. ● At Current year prices. ● High Worth ● Compares quarters of a year. 	<ul style="list-style-type: none"> ● GDP metric adjusted: With changes in the general price level. ● Inflation-adjusted ● At regular prices ● Low Worth ● Compares two or more FYs
$\text{Nominal GDP} = \text{Current Year Production} \times \text{Current Year Price}$	$\text{Real GDP} = \text{Current Year Production} \times \text{Base Year Price}$
<ul style="list-style-type: none"> ● does not truly indicate the real performance of economy 	<ul style="list-style-type: none"> ● only change in real production of goods and services is captured.

GDP Deflator

- **Ratio of Nominal GDP to Real GDP**
- gives an **idea of how the prices have moved from the base year to the current year.**

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

GDP Growth Rate:

- Measures **how fast the economy is growing.**
- Measures the **change in GDP in two consecutive years** or quarters.

$$\text{GDP Growth Rate} = 100 \times [(\text{GDP current year/quarter} - \text{GDP prev. year/quarter}) / \text{GDP prev. year/quarter}]$$

- **Real Economic Growth Rate** takes into account the **buying power** and is **inflation-adjusted.**

GDP at Factor Cost (GDPFC)

- Factor cost is the cost of producing a commodity. It includes the cost of land, labour, capital and the profits of the producer.

GDP at Market Price (GDPMP)

- Market price includes net indirect taxes along with the factor cost. (Net indirect tax is the difference b/w total indirect tax and subsidies)

$$\text{GDPMP} = \text{GDPFC} + \text{Indirect tax} - \text{Subsidy}$$

Gross Value Added (GVA)

- **economic productivity metric** that measures contribution of a corporate subsidiary, company, or municipality to an economy, producer, sector, or region.
- **used to adjust GDP** and measure how much money a product or service has contributed toward meeting a company's fixed costs.

$$\text{GVA} = \text{GDP} + \text{Subsidies} - \text{Taxes}$$

Net Domestic Product (NDP)

- **Net worth** of all goods and services **generated inside a country's geographic borders.**
- **Value of depreciation** of national capital assets such as **machinery, houses, and cars** is **subtracted** from the GDP to calculate NDP
- **Other considerations:** such as asset **obsolescence and complete destruction**, also taken into account by the NDP.



$$\text{Net Domestic Product (NDP)} = \text{Gross Domestic Product (GDP)} - \text{Depreciation.}$$

- **Significance**
 - To understand the historical **situation of the loss** due to depreciation to the economy.
 - To **understand and analyze the sectoral situation** of depreciation in industry and trade in comparative periods.
 - **Showcase the achievements of the economy** in the area of R&D, which have tried curing the levels of depreciation in a historical time period.

Gross National Product (GNP)

- **Total value of all goods and services** produced by citizens and enterprises in a country, regardless of **where they are produced**
- It is the **GDP of a country added with its income from abroad**.
- 'Income from Abroad' includes:
 - **Trade Balance:** net outcome at year end of the total exports and imports of a country
 - **Interest on External Loans:** balance of **interest on the money lent by the country and the interest on the money it has borrowed** from other countries.
 - **India** has always been a '**net borrower**' from the world economies.
 - **Private Remittances:** account of the '**private transfers**' by **Indians working abroad** (to India) and **foreign nationals working in India** (to their home countries).



GNP(Y) = Consumption expenditure (c) + Investment (I) + Government expenditure (G) + Net exports (X) + Net income from Abroad(Z).

- **$Y = C + I + G + X + Z$**

- **Factors to GNP:** Manufacturing of items such as **equipment, machinery, agricultural products, and cars** & some services such as **consulting, education, and health care**.
- **The cost of delivering services is not calculated.**
- When a **citizen holds dual citizenship** : **GNP per capita** is utilized to calculate GNP on a **country-by-country basis**.
- In that situation, their **earnings are counted twice**, as each country's GNP.

Net National Product (NNP)

- **Value generated by removing depreciation** from the gross national product.
- **Determines how much a country can consume** in a specific time span.



NNP = GNP – Depreciation

or

NNP = GDP + Income from Abroad – Depreciation

- When a country's net national product (**NNP**) **dips or falls**,
 - Businesses **contemplate shifting to industries** that are **considered recession-proof**.

Personal Income	<ul style="list-style-type: none"> ● Amount of money earned collectively by the citizens of a country. ● Ex.: Money obtained from employment, dividends and distributions paid by investments, rents derived from property ownership, and profit sharing from enterprises. ● Taxation is imposed on personal income in most cases. <div style="border: 1px solid black; padding: 5px; margin-top: 5px;"> <p>PI = National Income – Undistributed Profits – Net interest paid by households – Corporate tax + Transfer payments to the households from the government and firms</p> </div>
Personal Disposable Income	<ul style="list-style-type: none"> ● Income available to the households that they can spend as they wish ● Income available after payment of taxes and other non-tax payments <div style="border: 1px solid black; padding: 5px; margin-top: 5px;"> <p>PDI = PI – Personal tax payments – non-tax payments</p> </div>

National Disposable Income	<ul style="list-style-type: none"> ● sum of the gross (or net) disposable incomes of the institutional sectors. <div style="border: 1px solid black; padding: 5px; margin-top: 5px;"> <p>Gross (or net) NDI = gross (or net) national income (at market prices) - current transfers payable to non-resident units.</p> </div>
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Methods of computing National Income



Income Method	<ul style="list-style-type: none"> ● Estimated by adding all production factors (rent, salary, interest, profit) & mixed-income by self-employed. ● We add all net income payments received by all citizens of a country in a given year using this procedure. ● Net incomes from all factors of production are added. <ul style="list-style-type: none"> ○ Eg: net rents, wages, interest, and profits. ● Income received in the form of transfer payments is not included. <div style="border: 1px solid black; padding: 5px; margin-top: 5px;"> <p>Net National Income = Compensation of Employees + Operating surplus mixed (W +R +P +I) + Net income + Net factor income from abroad.</p> <p>Where,</p> <ul style="list-style-type: none"> ■ W = Wages and salaries ■ R = Rental Income ■ P = Profit ■ I = Mixed Income </div>
Product/Value Added Method	<ul style="list-style-type: none"> ● Aggregate value of final goods and services produced in a country throughout a financial year at market prices. ● To calculate GNP, <ul style="list-style-type: none"> ○ data from all productive activities are gathered and analysed, including : <ul style="list-style-type: none"> ■ agricultural goods, ■ minerals, and ■ industrial products ■ Contributions to production made by transportation, insurance, communication, attorneys, doctors, and teachers, etc. <div style="border: 1px solid black; padding: 5px; margin-top: 5px;"> <p>National Income = GNP – Cost of Capital – Depreciation – Indirect Taxes</p> </div>
Expenditure Method	<ul style="list-style-type: none"> ● National Income is measured as the flow of expenditure. ● Total expenditure by the society summed up includes: <ul style="list-style-type: none"> ○ Personal consumption expenditure, ○ Net domestic investment, ○ Government expenditure on goods and services, and ○ Net foreign investment. <p>National Income = National Product = National Expenditure</p>



Standing Committee on Economic Statistics

- **Constituted by:** Ministry of Statistics and Programme Implementation (MOSPI)
- **Chairman:** former **Chief Statistician**
- **Functions**
 - **Analyse and Develop:** country's surveys on employment, industry, and services.
 - **Look at the current framework** of data sources, indicators, and definitions.
 - For **index of industrial production, periodic labour force surveys, time use surveys, economic censuses, and unorganised sector statistics.**
 - **4 standing committees** on : labour force statistics, industrial statistics, services sector, and unincorporated sector firms will be absorbed into the SCES.
 - **108 economists and social scientists** expressed worry over "**political involvement**" in influencing statistical data in India.
 - **Appealed for the statistical organisations'** "**institutional independence**" and integrity to be restored.