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Economics

The term *economics* is derived from the ancient Greek word *oikonomia*, which means “management of a household”.

Adam Smith defined economics “as the study of the nature and causes of the generation of wealth of a nation”. The subject matter of economics has been divided into two parts: Microeconomics and Macroeconomics. These terms were first coined and used by **Ragnar Frisch** and have now been adopted by economists all over the world.

Microeconomics

Microeconomics occupies a vital place in economics and it has theoretical and practical importance.

It is microeconomics that tells us how a free-market economy with its millions of consumers and producers works to decide about the allocation of productive resources among thousands of goods and services.

Microeconomics analysis is also usefully applied to the various applied branches of economics such as Public Finance and International Economics.

Macroeconomics

Macroeconomics analyses the behaviour of the whole economic system in totality or entirety, such as total employment, national product or income, the general price level in the economy. Therefore, macroeconomics is also known as “**aggregative economics**”.

Microeconomics vs Macroeconomics

In short, macroeconomics studies the functioning of the economy as a whole and microeconomics analyses the behaviour of individual components like industries, firms and households.

Thus, microeconomics deals with the theory of the firm and the behaviour and problems of individuals and firms.

It is concerned with pricing theory, demand concepts and theories of market structure.

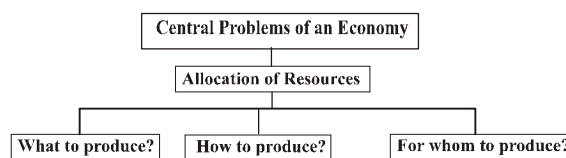
Macroeconomics is concerned with such economic variables as the aggregate output of an economy, the extent to which the resources are employed, the level and determination of national income, balance of payments, etc.

Central problems of an economy

To put it simply, **choice problem** is the central problem of an economy. Scarcity of resources having alternative uses in

relation to demand for them gives rise to choice problem. Every society has to decide how much each of the resources is to be used in the production of different goods and services. Thus, **allocation of resources** is the fundamental problem. Related to it are the following three central problems faced by every economy:

- (i) What to produce
- (ii) How to produce
- (iii) For whom to produce



(i) What to produce and in what quantity

It is the problem of choosing which commodities should be produced and in what quantities. Food or clothes? More food and less clothes or *vice versa*? Wheat or sugarcane? More butter or more tanks? In case of more tanks, some resources will have to be diverted from butter, but the economy cannot have more tanks and more butter at the same time. Society has to choose between consumer goods (e.g., clothes, shoes, sugar, wheat) and producer goods (e.g., tools, machines, trucks); between necessity goods and luxury goods. Besides, all goods cannot be produced as the resources are limited. Here, the guiding principle is to allocate resources in a way that *generates maximum aggregate utility*.

(ii) How to produce

It is the problem of choosing the method or technique of production. This arises because a commodity can be produced in more than one method: more labour and less capital or *vice versa* (i.e. labour-intensive technique or capital-intensive technique); large-scale production or small-scale production. For instance, a given amount of wheat can be produced either by using more land and less capital (manure, seeds, tubewell, etc.) or less land and more capital. Similarly, a given quantity of clothes can be manufactured by combining factors of production in different proportions, making it capital-intensive or labour-intensive. The guiding principle in such cases is to adopt those techniques which **involve the least possible cost** to produce per unit of commodity. At macro level the most efficient technical method is the one which uses the least amount of scarce resources.

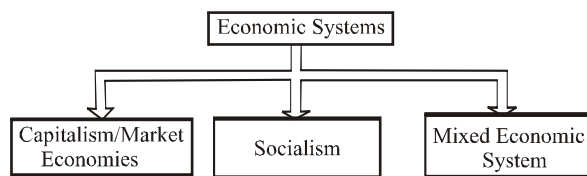
(iii) For whom to produce

It is the problem of distribution of income among factors of production which help in production. Who will consume the goods and services produced? A few rich and many poor or *vice versa*. Goods and services are produced especially for the people who can purchase them. And purchasing power depends upon their income, which, in turn, depends mainly on the distribution of income from output among factors of production which help to produce it.

It may be noted that the above problems are not separate or independent of each other, but are the different forms of the same basic problem, namely, to make a choice among alternative uses of scarce resources to obtain maximum satisfaction.

Economic Systems

An economy refers to an organisation through which people earn their living. An economic system refers to those norms and rules or institutions which direct an economy.



Invisible Hand in Capitalism or Market Economy

Capitalism is a system in which economic relations are directed through the principle of free play of market forces. Which is why capitalism is often characterised as 'market economy'. Producers and consumers are free to exercise their choices. There is no central authority to direct the economy. Instead, the economy is self-driven through an invisible hand or through the free play of the forces of market demand and market supply.

Characteristic Features of Capitalism

1. **Private Property:** In market economies people have the right to hold and use private property in any manner they like. This right of the people is protected by the government. All means of production, namely, machines, tool, land, mines, etc., are owned privately. Capitalists are free to hold and expand their capital to any extent. They also enjoy the freedom to buy or sell any property. They can enter into any contract in respect of their property. On the death of a person, his property passes on to his successors. Freedom of the people to use their private property is subject to the law of the land.
2. **Price Mechanism:** Price mechanism is the principal guiding mechanism that guides the producers and consumers in their decision-making. Price mechanism

refers to relative price structure determined by the interaction of the forces of demand and supply without any external interference. **Price mechanism helps producers to decide what to produce and how much to produce, how to produce and for whom to produce.**

3. **Freedom of Enterprise:** Every individual is free to use his means of production in any manner he likes. He may set up any business or industry of any size at any time and place. In other words, an entrepreneur can take independent decisions with regard to what, where and how much to produce.
4. **Competition and Cooperation:** Because of freedom of enterprise there are a large number of producers of almost every commodity. These producers compete with one another. Buyers compete with one another in order to buy a given product. In the factor market, workers compete for jobs. On the other hand, there is cooperation. It is through the cooperation of workers (or through their cooperative efforts) that inputs are converted into outputs, resulting in value addition.
5. **Profit Motive:** The desire to earn profit is the chief motive of undertaking production activity. Every value-addition activity is prompted by profit. Entrepreneurs engage themselves in those enterprises which are likely to yield maximum profits.
6. **Sovereignty of the Consumer:** Under market economies, consumer is a sovereign. The entire production structure is oriented to fulfil consumers' demands.
7. **Labour as a Commodity:** Like any other commodity, labour is bought and sold in the factor market. Labour becomes a commodity because people, deprived of the means of production, are unable to make use of their own labour; they are compelled to sell their labour to earn their livelihood.
8. **Self-interest:** In market economies, self-interest is the principal guiding force. By self-interest we mean the urge to maximise personal welfare.

Central Planning in Socialism or Command Economies

These are economies in which resources (or means of production) are collectively owned by the society as a whole, and there is a central authority to decide about the allocation of resources with a view to achieving maximum social welfare along with equitable distribution of income. In such economies, the state plays the central role in directing all economic activities in a manner such that all members of the community get equal opportunities of participating in the process of growth and enjoying the fruits thereof.

Characteristic Features of Command Economies

1. **Social or Collective Ownership:** All means of production are socially owned. No individual can keep capital at will

in the form of machines, factory premises, etc. Government represents the society under this system and uses the means of production as it deems fit.

2. **Central Planning Authority:** Under this economic system, government appoints a central planning authority to decide about what to produce, how much to produce, how to produce and for whom to produce. It undertakes detailed survey of the country's available physical and human resources and formulates an exhaustive plan for achieving the set objectives.
3. **Set Objectives:** It is not a purposeless economy; rather it has set objectives before it. These objectives are fully endorsed by the society and efforts are made to achieve them according to plans. The social and economic objectives relate to rapid industrialisation, high standard of living, full employment and social equity.
4. **Economic Planning:** Economic planning is of central significance in command economies. Objectives are comprehensively considered and specified in the light of the given resource power of the nation. Efficient allocation of the scarce means to alternative uses is taken as the supreme goal, and efficiency is defined not in terms of maximisation of profits but in terms of maximisation of social welfare.
5. **Government Control:** Plans are formulated and enforced strictly under government control. The central planning authority formulates the plan and forwards it to the government for implementation. Every economic activity, i.e., exchange, distribution, consumption, investment, prices, and foreign trade is fully controlled by the government.
6. **Lack of Competition:** State being the chief entrepreneur, there is lack of competition. In this respect, command economies are just opposite of the free economies. State assumes the role of a monopolist. Prices of goods and services are determined through government's discretion.
7. **Limited Private Sector:** Public sector dominates the economy. Private sector has a very limited role to play. Large industries and public utility services like railways, post and telegraph, etc. are directly controlled by the government. Very few opportunities are available to the people in general to produce goods and services for private profit.

A Critical Mix in Mixed Economies

These are economies where market forces (or the forces of supply and demand) are free to operate but not without 'watch and ward' by the state or some central authorities. Unlike communism, it is not a consciously created system focusing on equality and social justice. Also, unlike free economies, it is not a spontaneous economic order where all economic decisions are taken in pursuit of self-interest. Instead, a mixed economy is a midway between command economies and free

economies. It is an economy in which the choice is not between self-interest or social interest but between 'how much of self-interest' and 'how much of social interest'. Both self-interest and social interest are simultaneously pursued.

Characteristic Features of Mixed Economies

1. **Co-existence of the Private and the Public Sectors:** The most important feature of a mixed economy is that under it both public and private sectors work hand in hand. Industries of national importance like basic industries, arms and ammunition industries, power generation, etc. are set up in the public sector. Consumer goods industries, small industries, agriculture, etc., are left in the domain of the private sector. It is like a PPC model (Private Public Co-operation model) which serves as the undercurrent of growth and development.
2. **Directive Planning and Government Control:** It is the endeavour of the government to launch democratic plans with a view to giving the desired direction to the process of growth and development. These plans aim at progressive development of both public and private sectors.
3. **Private Property and Economic Equality:** Under mixed economy, people are free to acquire private property. But, in the interest of equitable distribution of wealth and income in the country, the government adopts suitable measures to combat concentration of wealth in the hands of a few people. Government imposes various taxes on richer sections of the society (of course, on progressive basis) and offers subsidy to poorer sections of the society with a view to promoting equity and social justice.
4. **Regulated Price Mechanism:** Under mixed economy, one finds free-play price mechanism but not without government intervention. Prices of goods are by and large determined by market forces, but prices of social goods are fixed by the government. It is a situation of regulated price mechanism.
5. **Profit Motive and Social Welfare:** Production is undertaken not exclusively to maximise profits or to maximise social welfare. Rather, it is a critical mix of both profit maximisation and welfare maximisation, which govern production decisions. Competition is promoted, but concentration (of economic power) is not allowed.

Positive and Normative Economic Analyses

Positive economic analysis: Positive economic analysis deals with the things '*as they are*'. It 'studies the actuals' as they are and not what is desirable. It analyses the cause-and-effect relationship involved in the actuals and remains strictly neutral and silent with regard to ends. The ethics of economic

decisions are not touched. Examples are: 'India is over-populated' or 'Prices have been rising in India' or 'Increase in real per capita income raises the standard of living of the people'. It may be mentioned that **Prof. Robbins** considered economics as purely a positive science.

Normative economic analysis: It deals with things as '*they ought to be*'. It tells how the economic problems should be solved. In other words, it passes moral judgements expressing good or bad aspects of economic decisions. Thus,

it deals with the idealistic situation instead of the actual situation. The underlying idea prevailing in normative analysis is whether the economic decisions are desirable or not. Examples of normative economic analysis are: 'Rich people should be taxed more' or 'Free education should be given to the poor' or 'Interest-free loans should be given to the poor farmers'. Needless to mention that **Marshall** regarded economics as a normative science which prescribes courses of action that achieve social goals.

Theory of Demand

Meaning of Demand

The demand for a commodity is the amount of it that a consumer will purchase or will be ready to take off from the market at various given prices during a specified time period. This time period may include a day, a week, a month, a year or any given time period. It is noteworthy that mere desire for a commodity does not constitute demand for it, if it is not backed by the ability to pay.

Demand and Utility

People demand goods because they satisfy the wants of the people. The word *utility* means the want-satisfying power of a commodity.

The Law of Demand

The law of demand explains the relationship between the price and the quantity demanded. According to the law of demand, other things being constant, if the price of a commodity falls, its quantity demanded will rise, and if the price of the commodity rises, its quantity demanded will decline. Thus, **there is an inverse relationship between the price and the quantity demanded**, other things remaining the same.

Assumptions of Law of Demand

In the statement of the law, we have used the phrase 'other things being constant', which means the law will be valid as long as other things remain constant (unchanged). These are the assumptions of the law of demand. By "other things" we mean factors other than price that influence the demand for a commodity. They should not change during the period of operation of the law of demand as shown below:

1. There should be no change in the price of related goods (substitutes and complements).
2. There should be no change in the income of the consumer.
3. There should be no change in the taste, preferences and habits of the consumer.

4. There should be no change in the number of family members, weather, etc.

In short, the law of demand shows change in demand occurring due to change in the price of the commodity only.

Exceptions to the Law of Demand

The law of demand is generally believed to be valid in most of the situations. However, the following exceptions to the law of demand have been pointed out:

Giffen Goods: An exception to the law of demand was pointed out by **Sir Robert Giffen**, who observed that when the price of bread increased, the low-paid British workers in the early 19th century purchased more bread and not less of it, and this was contrary to the law of demand described above.

The reason given for this is that **Giffen goods are inferior goods in whose case the negative income effect is very large which more than offsets the substitution effect**. So in their case, the quantity demanded varies directly with the price.

Such goods in whose case there is a direct price-demand relationship are called Giffen goods after the name of Robert Giffen.

Goods expected to become scarce or costly in future are purchased by the households in increased quantities even when their prices are soaring upwards. This is due to the fear of further rise in prices.

Goods of ostentation: Status symbol goods are purchased not because of their intrinsic value but because of status or prestige value. The same jewellery when sold at a lower price sells poorly but when offered at four times the price, sells quite well. Similarly, demand for cars has been rising in spite of the fact that its price has been rising continuously.

According to **Thorstein Veblen**, some consumers measure the utility of a commodity entirely by its price, i.e. for them, the greater the price of a commodity, the greater its

utility. Diamonds are often given as an example of this case. They are considered as prestige goods in the society and for the upper strata of the society. The higher the price of diamonds, the higher their prestige value and therefore the greater their utility or desirability. In this case, the consumer will buy less of diamonds at a low price because with the fall in price their prestige value goes down. On the other hand, when the price of diamonds goes up, their prestige value will go up and therefore their utility and desirability. As a result, at a higher price the quantity demanded of diamonds by a consumer will increase.

Necessities: The law of demand is not seen operating in the case of necessities of life such as foodgrains, salt, matches, milk for children. etc. A minimum quantity of these goods has to be bought whether the prices are high or low. In such cases, the law of demand fails to operate.

Ignorance: Being ignorant of prevailing prices, a consumer may buy more of a commodity when its price has in fact gone up.

Miscellaneous: Future change in prices, change in weather conditions, change in fashion and loss of faith are some of the other exceptions where the law may not hold good.

Determinants of Demand

The following are the factors which determine the demand for goods:

1. **Price of the Commodity:** Normally, rise in price is accompanied by contraction in demand and fall in price is accompanied by expansion in demand. This relationship between price and demand is called the law of demand.
2. **Tastes and Preferences of the Consumers:** The demand for goods and services depends on the individual's tastes and preferences. These terms are used in a broad sense. They include fashion, habit, custom, etc. Tastes and preferences of the consumers are influenced by advertisement, change in fashion, climate, new inventions, etc. Other things being equal, demand for those goods increases for which consumers show a favourable change in tastes and preferences. Contrary to this, an unfavourable change in consumers' preferences and tastes for a product will cause a fall in its demand.
3. **Incomes of the People:** Experience shows that there is a positive relationship between the income of a consumer and his demand for a good. An increase in income would generally cause an increase in demand for a commodity. Such goods in case of which positive relationship is found between income and demand are called **normal goods**; e.g. full-cream milk, wheat and cheese. However,

there are certain goods in case of which inverse relationship is found between income and demand: an increase in income causes a decrease in demand. Such goods are called **inferior goods**; e.g. toned milk, bajra, etc.

4. **Changes in Prices of Related Goods:** The demand for a commodity depends not only on its own price, but also on the prices of related goods. Related goods are broadly classified as **substitute goods** and **complementary goods**.

(i) Substitute Goods: Substitute goods are those goods which can be substituted for each other, such as tea and coffee, or Limca and Coke. For example, when the price of tea as well as the incomes of the people remains the same but the price of coffee falls, the consumers would demand less of tea than before. Tea and coffee are very close substitutes; therefore, when coffee becomes cheaper, the consumers substitute coffee for tea, and as a result the demand for tea declines.

(ii) Complementary Goods: Complementary goods are those goods which complete the demand for each other, such as car and petrol or pen and ink. There is an inverse or negative relationship between the demand for the first goods and the price of the second which happens to be complementary to the first.

For the goods which are complementary to each other, the change in the price of any of them would affect the demand of the other. For instance, if the price of milk falls, the demand for sugar will also be affected. When people would take more milk or would prepare more *khoya*, *burfi*, *rasgullas* with milk, the demand for sugar would also increase.

5. **The number of consumers in the market:** The greater the number of consumers of goods, the greater the market demand for them. For instance, in India the demand for many essential goods, especially foodgrains, has increased because of the increase in the population of the country and the resultant increase in the number of consumers for them.
6. **Changes in propensity to consume:** People's propensity to consume also affects the demand for goods. The income of the people remaining constant, if their propensity to consume rises, then out of the given income, they would spend a greater part of it with the result that the demand for goods will increase. On the other hand, if their propensity to save increases, that is, if the propensity to consume declines, then the consumers would spend a smaller part of their income on goods with the result that the demand for goods will decrease. It is thus clear that with income remaining constant, change in propensity to consume of the people will bring about a change in the demand for goods.

Kinds of Demand

Among the four main determinants of demand, namely, price of commodity itself, price of related goods, income of the consumer and taste of the consumer, it is the taste of the consumer which cannot be measured since it is influenced by many factors — social, political, religious, geographical, etc. If we exclude this immeasurable factor, we are left with three determinants. Accordingly, there are three types of demand as explained below:

- (i) **Price-demand:** Price-demand refers to the relationship between the price of a commodity and its demand, presuming other things being constant. Alternatively, it shows the demand for a commodity in relation to its price, when other factors are kept constant (unchanged). Put in the form of an equation:

$$D_x = f(P_x)$$

Here, D_x stands for Demand for commodity 'x'

f is function of (or depends on)

P is price of commodity 'x'

The equation shows that demand (D) for commodity 'x' is a function (f) of or depends upon the price (P) of commodity 'x'. Law of demand is related to price-demand.

- (ii) **Income-demand:** It refers to the quantity demanded of a commodity in relation to the income of a consumer, other things being equal. In other words, it shows the relationship between the consumer's income and the demand for the commodity, when other things remain constant. Expressed in the form of an equation:

$$D_x = f(Y)$$

Here, D_x stands for Demand for commodity 'x'

f is function of (or depends on)

Y is income

That is, demand (D) for commodity 'x' is a function (f) of or depends upon the money income (Y) of the consumer.

- (iii) **Cross-demand:** Other things being constant, the relationship between the price of a commodity and the demand for its related goods (substitute goods or complementary goods) is known as cross-demand. When demand for another related goods change with a change in price of a commodity, the case is of cross-demand. Put algebraically:

$$D_o = f(P_x)$$

Here, D_o stands for Demand for related commodity 'o'

f is function of

P_x is Price of commodity 'x'

It indicates that the demand (D) for other related goods 'o' is a function (f) of price (P) of commodity 'x'.

Types of Demand

Individual and Market Demand

Individual demand means the quantity demanded by an individual consumer at various prices at a given point of time. Market demand means the total quantity demanded by all the buyers at various prices. It reflects the nature of competition and the form of market structure. It provides useful guidance to the management in deciding its market strategy and related corporate policy.

Industry Demand and Company Demand

Industry demand is the total demand for the product of a particular industry; for example, the total demand for shampoo in the country. On the other hand, the demand for any particular brand of shampoo, say, *Sunsilk*, *L'Oreal*, *Clinic Plus*, *Clinic All Clear*, *Pantene* and so on is called company demand. Theoretically, an industry should consist of all firms producing an identical product. In practice, however, we take a broad definition of industry, that is one which covers all firms producing similar products which are close substitutes.

Autonomous Demand and Derived Demand

Autonomous demand refers to the demand for a product which is wanted for itself. The demand for any type of food, furniture, T.V., fridge, washing machine, bike, car etc., may be taken as autonomous demand. Autonomous demand is demand for consumer goods or final goods; it is also known as **direct demand**.

Derived demand, on the other hand, is derived from another direct demand. For instance, the demand for a plot is a direct demand; but the demand for cement, bricks, iron and steel etc., needed for the construction of a house is derived demand.

Joint and Rival Demand

When two goods are used together to satisfy a particular want, they are said to be jointly demanded. The demand of car owners for petrol, tyres lubricating oil and spark plugs may be regarded as joint demand.

Rival demand refers to the case of a product which is demanded for two or more purposes. A good example is cement, which is demanded by industry as well as house construction. If the demand for cement in one use goes up, the supply of cement to the other use will be curtailed. This will change the price of cement and also bring about a change in the demand pattern for cement. Rival demand is also known as **composite demand**.

Elasticity of Demand

Concept and Kinds of Elasticity of Demand

Elasticity of demand is defined as the responsiveness of the quantity demanded of goods to changes in one of the variables on which demand depends. In other words, it is the percentage change in the quantity demanded divided by the percentage of one of the variables on which demand depends. These variables are price of the commodity, prices of the related commodities, incomes of the consumers and other various factors on which demand depends. Thus we have (i) price elasticity, (ii) cross elasticity, (iii) elasticity of substitution, and (iv) income elasticity.

Uses of Elasticity of Demand

Usefulness to a Monopolist: A monopolist usually fixes the

price himself and leaves the supply to be determined by the demand of the consumers. If the demand for his product is very elastic, he will keep the price low to maximise monopoly profit. On the other hand, if the demand is inelastic, he fixes a higher price and sells a slightly smaller quantity.

Usefulness to the Government: While levying taxes, the Finance Minister takes into consideration the elasticity of demand for the commodities on which taxes are being imposed. High rates of taxation on goods with inelastic demand bring higher amounts of revenues whereas the same on goods having elastic demand may not fetch the desired revenues of the government.

Usefulness in International Trade: India, for example, can obtain better and higher prices for tea from its exports to the UK, if the latter's demand for Indian tea is inelastic. Thus, the terms of international trade are determined by the elasticity of demand for each other's product.

Concept of Supply

The price of a commodity is determined by its demand and supply.

The meaning of supply

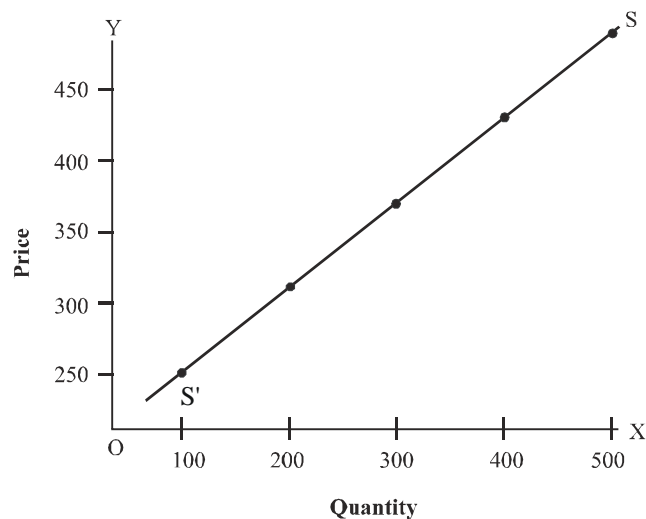
Supply refers to the schedule of the quantities of goods that will be offered for sale at various prices.

Law of supply: The law of supply relates to functional relationship between the price of a commodity and its supply.

The quantity supplied generally varies directly with price. That is, the higher the price, the larger the quantity supplied.

According to the law of supply, when the price of a commodity rises, the quantity supplied of it in the market increases, and when the price of a commodity falls, its quantity supplied decreases, other factors determining supply remaining the same. Thus, according to the law of supply, the quantity supplied of a commodity is directly or positively related to its price.

It is due to this direct relationship between the price of a commodity and its quantity supplied that the supply curve of a commodity slopes upward to right as seen from supply curve SS' in the following figure:

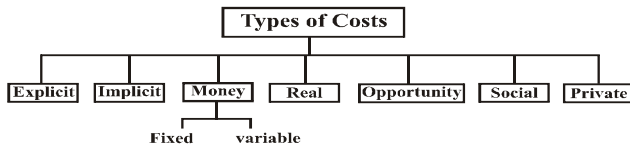


Supply curve showing direct relationship between price and quantity

Theory of Cost

Meaning of Cost

Ordinarily, money expenditure incurred by a firm in the production of a commodity is called the cost of production. A firm requires *factor inputs*, also called factors of production (land, labour, capital, etc.), and *non-factor inputs* (raw material, fuel, power, etc.) for producing a commodity. These inputs are to be paid for since they are scarce. The firm pays in the form of money, e.g., rent to the landlord, salaries and wages to the labour, interest to the capitalist and expenditure on other inputs like raw material, power, transportation, insurance charges, etc. These are costs to the firm and are called **money costs** because these are paid in the form of money. There are different types of costs:



Explicit Costs and Implicit Costs

“Explicit costs are those cash payments which the firms make to outsiders for their services and goods.” — Leftwich

Explicit costs are actual money expenditure incurred on purchasing and hiring inputs. These costs are recorded in the firm’s account books. We know that, for producing a commodity, a firm incurs expenses on hiring factor inputs (like services of land, labour, capital, etc.) and on buying non-factor inputs (like raw material, power, etc.). For example, a firm gets land on lease and pays rent. It hires labour and pays them wages. It borrows money and pays interest. Similarly, it spends money on transportation, raw material insurance premium, fuels, advertising and on making up depreciation of machinery. All these money expenses are known as explicit costs of production. Mind you these costs include **payments made to others and not to the owner himself for self-owned, self-supplied resources.**

“Implicit costs are costs of self-owned of self-employed resources.” — Leftwich

Implicit costs are estimated values of inputs supplied by the owner of the production unit himself. For instance, an entrepreneur may utilise his own building or his own capital or may act as a manager of his firm himself. For these productive services, he does not pay rent or interest or salary to himself although the payments accrue to him. These are, in a way, implicit rewards or imputed costs of various factors

owned and supplied by the owner himself.

The main difference between explicit and implicit costs is the following: in explicit cost, payment is made to others; in implicit cost, payment is not made to others; rather, it becomes due to the owner for the use of his own factors or production.

In Economics, the sum of explicit costs and implicit costs (for imputed costs) constitute the total cost of production of a commodity.

Money Cost and Real Cost

Money cost of production refers to the money expenditure incurred on hiring and buying of inputs for producing a given amount of commodity.

According to Marshall, money cost measures the amount of money which a producer spends on producing a particular commodity. For example, all money expenditure in the form of rent, wages, interest, etc., and money spent on non-factor inputs like raw materials, transport, advertising, insurance charges, power, fuel, etc., are included in money cost. If a producer spends `one lakh in manufacturing 100 transformers, then its money cost will be taken as `one lakh. **Money cost is further subdivided into two parts, namely, fixed cost and variable cost.**

Real cost refers to the sacrifice, discomfort, toil and pain involved in supplying the factors of production by their owners. Money paid for hiring a factor is money cost but sacrifice and efforts of the factor or its owner in producing a commodity is real cost. Since elements like sacrifice, pain and discomfort are subjective (i.e., internal to the person concerned), it is, therefore, difficult to measure the real cost. For instance, abstinence and sacrifice involved in saving and accumulation of capital or pain and discomfort felt by the owner in the production of goods are indicators of real cost which cannot be measured.

Opportunity Cost

Opportunity cost, on the other hand, is concerned with the cost of forgone opportunity; it involves a comparison between the policy that was chosen and the policy that was rejected. For example, the cost of lending or using capital is the interest that it can earn in the next best use of equal risk.

Opportunity costs relate to sacrificed alternatives; they are not recorded in the books of account in general.

The concept of opportunity cost is linked with the concept of **scarcity of resources**. If the resources are unlimited, there can be no opportunity cost. However, the factors of production (resources) are scarce in relation to the

demand for them. Further, these factors of production have many alternative uses. When a factor unit is employed for one use, the next best use for which this factor could have been put, is forgone. Opportunity cost of the factor is the cost of the next best alternative that has been forgone. In other words, it is the cost of displaced alternative. For example, the opportunity cost of a quintal of rice is the amount of wheat that could be produced with the same factors of production.

According to Leftwich, **“Opportunity cost of a particular product is the value of the forgone alternative product that the resources used in its production could have produced.”** For example, a driver can be used to drive a taxi, a personal car, a highway truck, a tractor or a road-building bulldozer. He cannot be put to all these employments at the same time. His employment as a taxi driver means the loss of an opportunity of employing him as a truck driver. The sacrifice of an alternative opportunity from the viewpoint of the transport firm is an opportunity cost.

The concept of opportunity cost is significant for a managerial economist. It can be used to determine factor price. The factor of production needs to be paid a price that is at least equal to what it commands for alternative use. If the factor price is less than the factor opportunity cost, the factor will quit and get employed in the better-paying alternative.

The concept of opportunity cost is also applicable to public expenditure. For the economy as a whole, the cost of increasing the defence budget is the civilian benefits that have been forgone or sacrificed.

It is also applicable to public expenditure. For the economy as a whole, the cost of increasing the defence budget is the civilian benefits that have been sacrificed.

Private Cost and Social Cost

Private cost refer to the cost incurred by an individual firm in producing a commodity. It is in fact the money cost which a firm incurs on hiring and purchasing inputs for producing a commodity. This cost has nothing to do with the society.

Social cost refers to the disadvantages of producing a commodity that are suffered by the society as a whole. It does not take into consideration money cost but something like cost in the form of disadvantages which are borne by the society directly or indirectly. For instance, when trees of a forest are felled indiscriminately by a private contractor, the society incurs social cost in the form of floods, soil erosion, and loss of sanctuary for animals. Similarly, the society pays social costs in the shape of health hazards connected with air pollution when buses and cars emit smoke while plying in the interior of big cities.

The cost of establishing a factory to produce a commodity constitutes private cost to its owner but at the same time it costs to the society as well. For instance, it causes an increase

in the laundry and medical bills of the people living in the factory area. The cost of purifying water by the municipal authorities goes up when the factory’s pollutants flow into the river running nearby. Although these costs do not enter into private producer’s production account, yet they constitute social costs of production since they involve expenditure by some members of the society. It is another matter that it is rather impossible to have exact calculation of social costs. **Thus, in price theory, we deal with money costs involving both implicit and explicit costs of production.**

Short-run vs Long-run Costs

Short-run costs are those costs that vary with output when fixed plant and capital equipment remain the same. Long-run costs are those that vary with output when all input factors including plant and equipment vary.

Short-run costs are more relevant when a firm has to decide whether or not to produce more in the immediate future. In this case, setting up of a new plant is ruled out and the firm has to manage with the given plant. Long-run costs become relevant when the firm has to decide whether to set up a new plant. Long-run costs can help the businessman in planning the optimum scale of production.

Costs in the Short Run

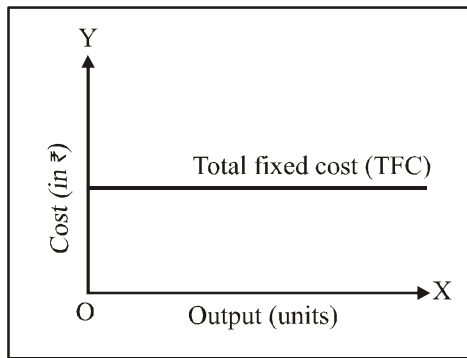
Since short-run costs are closely related to short-run productivity, for each measure of short-run productivity there is a cost counterpart. Just as there are fixed and variable inputs, there are fixed and variable costs. Just as there are total, average and marginal measures of productivity, there are total, average and marginal measures of costs. In short, cost is the reciprocal of productivity. The short-run costs may be classified as follows:

Fixed Cost and Variable Cost

The total money cost incurred during short period by a firm in producing a commodity has been classified by **Prof. Marshall** into two groups — fixed costs and variable costs.

(i) Fixed Costs: Fixed costs are the costs which do not change with change in the level of output. These are primarily incurred on fixed factors like machines, building, etc. Fixed costs do not change when the level of output is increased or decreased. Fixed costs remain even if the output is zero. In fact, fixed costs are incurred even before output actually starts. These have to be borne even if no output is produced. For instance, a sugar mill usually remains closed for about three months during a year for want of raw materials (sugarcane). Still, the mill owner has to incur certain costs like rent of building, interest on past borrowings, salaries of permanent employees, municipal taxes, insurance premium, etc. These costs are called fixed costs or **supplementary costs** or

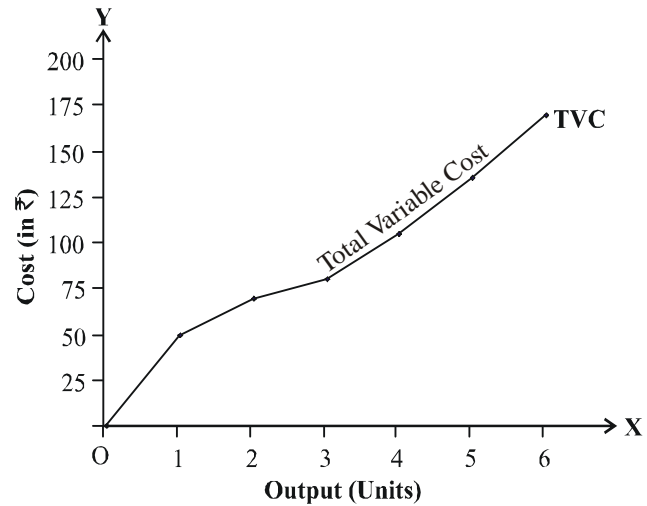
overhead costs. They remain the same during a short period whether the amount of production is less or more or nil. Fixed cost and variable cost are formally called Total Fixed Cost (TFC) and Total Variable Cost (TVC). These are shown in the following table and depicted. The point to be noted is that Total Fixed Cost (TFC) is constant, i.e., ₹ 150, whether output is zero or four units. Since TFC remains the same at all levels of output, the TFC curve is equidistant from the horizontal axis (i.e., x-axis). As a result, the TFC curve is a straight line parallel to x-axis.



Total Fixed Cost	
No. of units produced	TFC (₹)
0	150
1	150
2	150
3	150
4	150

(ii) Variable Costs: These are the costs which vary directly with the change in the level of output. These are costs which are incurred on variable inputs. Such costs increase when output increases and decrease when output falls. That is why they are called **direct costs** since they vary (change) directly with the change in the level of output. In other words, variable costs are incurred so long as production continues, but the moment production stops, variable costs also cease. The costs incurred on raw material, power, fuel, wages of temporary labour, wear and tear of machines, etc., are examples of variable costs. Continuing the above example, when a sugar mill is working, the mill owner has to incur costs on sugarcane, power, wages of temporary labour, etc. If production of sugar has to be increased, these costs will also increase; if production has to be decreased, these costs will also decrease. And if the sugar mill closes, variable costs will also fall to zero. These have been shown in the following table and depicted. Total cost incurred on variable factors is

called Total Variable Cost (TVC). It is clear from the table that TVC is zero for zero output but increases as output increases. The TVC curve also represents the same. The curve is upward sloping, which indicates that the total variable costs go on increasing with increase in output. Variable costs are called **prime costs** or **direct costs** because these are costs of direct labour and direct material incorporated into the product.



Total Variable Cost	
No. of units produced	TVC (₹)
0	0
1	50
2	70
3	80
4	105
5	135
6	170

Fixed costs are present only in the short run, but in the long run all costs are variable.

Importance: The significance of distinction in costs lies in the fact that when a firm is incurring losses, it still continues its production if the market price covers at least its variable costs during short period. In other words, the firm will be ready to incur losses equal to fixed costs rather than stop production in the short period. However, in the long period, market price must cover the firm's fixed and variable costs; otherwise, the firm will stop production.

Average Cost and Marginal Cost

Average Cost (AC): It is per unit cost of production of a commodity. According to Ferguson, "Average Cost is total cost divided by output". AC is calculated by dividing the

total cost by the number of units produced. Suppose the total cost of production of 25 chairs is ₹ 2,500. In this case, cost per chair or

$$\begin{aligned} \text{Average cost} &= \frac{\text{Total Cost}}{\text{No. of units produced}} \\ &= \frac{2500}{25} = ₹ 100 \end{aligned}$$

AC can also be measured by adding AFC and AVC, i.e.,
 $AC = AFC + AVC$

Average Fixed Cost (AFC)

Average Fixed Cost is per unit fixed cost. It is Total Fixed Cost divided by output.

$$AFC = \frac{TFC}{Q}$$

(Here, AFC = Average Fixed Cost; TFC = Total Fixed Cost; Q = Quantity of output.)

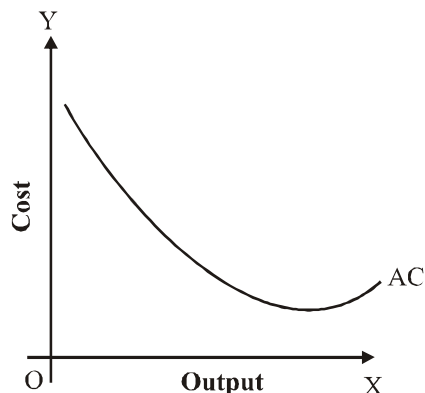
Since fixed cost is constant, the greater the output, the lower will be the fixed cost per unit of output.

Average Variable Cost (AVC)

Average Variable Cost is per unit variable cost. It is total variable cost divided by output. That is,

$$AVC = \frac{TVC}{Q}$$

(Here, AVC = Average Variable Cost; TVC = Total Variable Cost; Q = Quantity of output.)

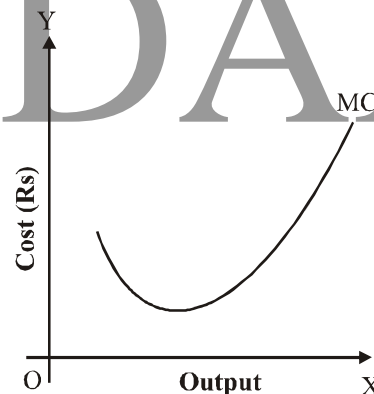


Why is AC curve U-shaped? AC curve is a U-shaped curve due to *operation of law of returns*. As output is increased, AC first falls, reaches its minimum and then rises. The minimum point of AC curve indicates the lowest per unit cost of production. This point of output is also the point of optimum capacity of a firm.

Marginal Cost (MC): Marginal cost is the addition to

the total cost when an additional (extra) unit of a commodity is produced or when the output is increased by one unit. In economics, **marginal means additional** — whether it is used in the context of cost or revenue or product or even utility. Thus, MC is the additional cost of producing an additional unit of a commodity. It is attributable to the addition of one more unit to the output. Continuing the above example, suppose it costs ₹ 2,500 to manufacture 25 chairs and ₹ 2,620 to manufacture 26 chairs. In this case, MC will be ₹ 120 (= 2620 - 2500), which is the addition to the total cost (₹ 2,500) when an additional unit (26th chair) is produced. Again, remember, since MC is the additional cost, it is in fact an addition to the variable cost and not to the fixed cost because the latter (FC) remains the same in the short period.

Why is MC curve U-shaped? The given figure depicts the behaviour of MC graphically. The MC curve is also U-shaped, which indicates that MC falls in the beginning, then remains constant and ultimately rises. The reason is the **operation of the law of returns**. Initially, the production is subject to the law of increasing returns (i.e., decreasing cost), then to the law of constant returns (i.e., constant cost) and ultimately to the law of diminishing returns (i.e., increasing cost). Once we understand why MC curve is U-shaped, it follows that AVC and ATC curves are also U-shaped. Moreover, MC curve cuts AVC and ATC curves at their minimum points.



Area under MC curve = TVC

Average Cost and Marginal Cost

The average cost is found by dividing the total cost by the number of units produced. But the marginal cost means the addition made to the total cost in producing an extra quantity. It is the extra cost that has to be incurred when producing an extra unit of a commodity, i.e., the cost of producing a marginal unit of a firm's product. The relationship between the average cost and the marginal cost can be explained by the following rules:

- (i) If the average cost is rising, the marginal cost will be greater than the average cost.
- (ii) If the average cost is constant, the marginal cost will be equal to the average cost.
- (iii) If the average cost is falling, the marginal cost will be less than the average cost.

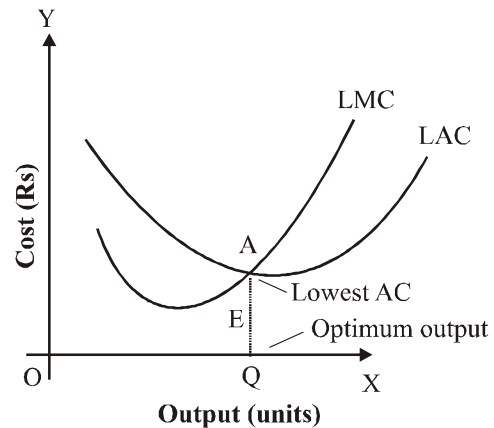
Long-Run Costs (Average Cost & Marginal Cost)

We have studied the distinction between short run (period) and long run (period). Briefly, long run is a time period during which quantities of all the factor inputs can be varied (changed). In other words, in the long run, all factor inputs are variable. Hence, there is no distinction between fixed costs and variable costs. Therefore, only Long-Run Average Costs (LAC) and Long-Run Marginal Costs (LMC) curve are mostly discussed. Following implications are noteworthy:

- (i) Distinction between total costs and total variable costs disappears. Simply, the term 'total costs' is used.
- (ii) There are no Total Fixed Cost (TFC) and Average Fixed Cost (AFC) curves in the long run because fixed costs do not exist.
- (iii) There is no distinction between average total costs and average variable costs because of the absence of fixed costs. Instead, only the term 'Long-Run Average Cost (LAC)' is used.
- (iv) Marginal cost is denoted by Long-Run Marginal Cost (LMC).

Shapes of LAC and LMC curves: From the given figure, it is clear that the LAC curve and the corresponding LMC

curve are approximately U-shaped. This indicates that LAC curve declines initially, then remains constant for a while and finally rises. At the output OQ, the average cost is the lowest, which indicates that OQ output is the optimum output which is being produced at the lowest average cost. Constant returns prevail for a while, which is indicated by flat portion in the middle of LAC curve. Production is considered most efficient at this level. Beyond OQ, as output increases, AC starts rising.



Difference: The nature of curves in the long run and short run is different. In the long run, the U-shape of the LAC curve implies the U-shape of the LMC curve, whereas in the short run, the U-shape of the Marginal Cost Curve implies the U-shape of the Average Cost Curve. Again, in the long run, the U-shaped average cost and marginal cost curves are flatter than those in the short run.

Factors of Production

Meaning

Production of goods and services requires the use of factors of production, which are also called **agents of production**. The volume of production and therefore national income depends upon the supply of various factors of production and their productivity. Since economic growth consists of expansion in total production or national income, the supply and productivity of the factors are vital to the process of economic growth.

Fraser defines "factor of production as a group or class of productive sources."

Classification of factors of production

Factors of production have been classified as *land, labour, capital and organisation* (or *entrepreneurship*).

Land

Meaning and Significance: *Land* in economics does not mean mere soil. It is synonymous with all natural resources available from air, water, from above the land surface and below it, which can be used for production.

In the words of **Marshall**, *land* means "the materials and the forces which nature gives freely for man's aid, on land and in

water, in air and light and heat.” Land stands for all natural resources which yield an income or which have exchange value.

Capital

Meaning of Capital: The term *capital* is used in various senses in economics. But when we talk of capital as a factor of production, to confuse capital with money is quite wrong. Of course, money is used to purchase various factors such as raw materials, machinery, labour which help to produce goods, but money itself does not directly help in the production of goods. The money which is available for investment and productive purposes has been called *money capital* or *financial capital* by some economists. But money capital is not the real capital. Real capital consists of machinery, tools, tubewells, factories, etc., which *directly* assist in the production of goods. Similarly, government securities and bonds, shares and debentures of public limited companies do not represent real capital. Securities, bonds, stocks, etc., possessed by individuals yield income to them, but they cannot be called real capital because they represent only titles of ownership rather than factors of production.

Capital has been rightly defined as “*produced means of production*”. This definition distinguishes capital from both land and labour, because both land and labour are not produced factors. Land and labour are often considered as *primary or original factors of production*. But capital is not a primary or original factor; it is a produced factor of production. Capital has been produced by man by working with nature. Therefore, capital may well be defined as *man-made instrument of production*. Capital thus consists of those physical goods which are produced for use in future production. Machines, tools and instruments, factories, canals, dams, transport equipment, stocks of raw materials are some of the examples of capital. All of them are produced by man to help in the production of further goods. According to Prof. Richard T. Gill, “*A country’s capital is its stock of produced or man-made means of production, consisting of such items as buildings, factories, machinery, tools, equipment and inventories of goods in stock.*”

Labour

The contribution of labour to the national production and income depends not only on the size of labour force but also on its quality. By quality of labour we mean how much productive it is, that is, what is its level of productivity. A

given labour force with higher productivity will yield a larger national product and income.

Division of labour

Division of labour is an important feature of modern industrial organisation. **It was first developed as theory by Adam Smith.**

Division of labour occupies so important a place in the modern production process and adds so greatly to the total output and wealth of a country that **Adam Smith**, the father of **economics**, selected it as the first topic for discussion in his book “*An Enquiry into the Nature and Causes of Wealth of Nations.*”

Division of labour may be simple or complex. Simple division of labour refers to the *production of a single commodity by a person*. In a society where simple division of labour prevails, every worker would be producing only one commodity. Some would be producing cloth, some would be making shoes, some others would be producing farm products but everybody would be producing either farm products or cloth or shoes. In the old village-societies, there prevailed this simple division of labour and, therefore, the old village society was composed of farmers who produced agricultural goods, weavers who made cloth, cobblers who made and repaired shoes, etc.

But, in the modern days, division of labour is of complex type. In fact, it is the complex division of labour which has increased so greatly the productivity of the modern productive system. *Complex division of labour means that the making of an article is split up into several processes and each process is carried out by a separate worker or a separate group of workers*. Every group of worker specialises only in one process in the production of a commodity. The process may be split up into sub-processes and thus division of labour may become more complex. In the modern tailoring shops, making of a shirt is broken up into different processes. Some workers only do the job of “cutting”, some others only do the work of “sewing”, and still a separate group of workers put buttons on it, etc. This is complex division of labour in the making of shirts.

Advantages of Division of Labour

1. Increase in productivity
2. The right man in the right place
3. Dexterity and skill
4. Inventions are facilitated
5. Saving of time
6. Economy in the use of tools

The Theory of Production: Returns to a factor

The theory of production is the story of production functions. It plays a double role in price theory. First, it provides a basis for the analysis of relation between costs and the amount of output. Costs govern supply of a product which, together with demand, determine the price of a product. The prices of inputs (factors) of production influence the cost of production and hence play a part in determining the prices of products. Secondly, the theory of production provides a basis for the theory of firm's demand for factors (inputs) of production. Demand for factors of production or inputs, together with their supply, determines their prices.

Production function: Transforming inputs into outputs

The act of production involves the transformation of inputs into outputs. Production is a transformation of physical inputs into physical outputs. The output is thus a function of factors which are also called *inputs*. The functional relationship between physical inputs and physical outputs of a firm is known as **production function**. Algebraically, production function can be written as

$$Q = f(L, K, M)$$

where Q stands for the quantity of output, and L, K and M stand for the quantities of factors, labour capital and raw materials respectively.

Concepts of Product

Regarding physical production by factors, there are three concepts:

- (1) Total Product
- (2) Average Product and
- (3) Marginal Product

Total product: Total product of a factor is the amount of total output produced by a given amount of the factor, other factors being constant. As the amount of a factor increases, the total output increases.

Average product: Average product of a factor is the total output produced per unit of the factor employed. Thus,

$$\text{Average Product} = \frac{\text{Total Product}}{\text{No. of units of a factor employed}}$$

If Q stands for total product, L for the number of a variable factor employed, then average product (AP) is given by:

$$AP = \frac{Q}{L}$$

Marginal product: The marginal product of a factor is the addition to the total production by the employment of an extra unit of a factor. Suppose two workers are employed to produce wheat in an agricultural farm and they produce 170 quintals of wheat per year. Now, if instead of two workers, three workers are employed and as a result total product increases to 270 quintals, then the third worker has added 100 quintals of wheat to the total production. Thus 100 quintals is the marginal product of the third worker.

Behaviour of TP, MP and AP

	Total Product	Marginal Product	Average Product
Stage I	First increases at increasing rate	Increases, reaches a maximum point and begins to diminish	Increases, but at a lower rate than that of the marginal product. Continues to increase and becomes maximum
Stage II	Continues to increase at diminishing rate and becomes maximum	Continues to diminish and becomes equal to zero	Becomes equal to MP and then begins to diminish
Stage III	Diminishes	Becomes negative	Continues to diminish but will always be greater than zero

The Law of Variable Proportions

The Law of Variable Proportions or non-proportional returns was initially called the **Law of Diminishing returns** by **Marshall**. Now it is recognised as one of the fundamental laws of economics. The Law of variable proportions deals with the short run. In the **short run**, factors of production are of two types: (i) fixed factors of production, (ii) variable factors of production. In the short run, the volume of production can be changed by altering the variable factors of production only. This is because the quantity of fixed factors cannot be changed due to the short span of time at the disposal of the producer.

According to Leftwich, "The law of variable proportions states that if the input of one resource is increased by equal increments per unit of time while the inputs of other resources

are held constant, total product (output) will increase, but beyond some point the resulting output increase will become smaller and smaller.” The law of variable proportion shows the production function with one factor variable while other factors of production are kept constant. The ratio of variable factors to fixed factors increases when the proportion of variable factor to fixed factors is increased.

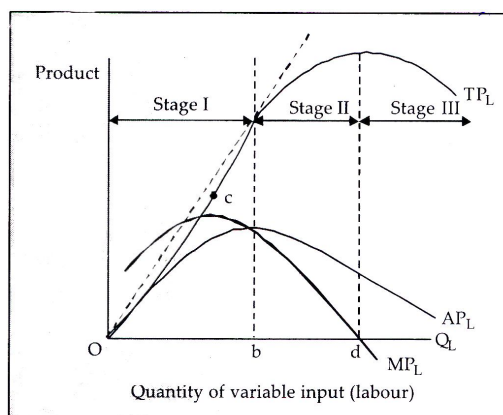
Assumptions of the Law

- 1 Only one variable factor unit is to be varied while all other factors should be kept constant.
- 1 Different units of a variable factor are homogeneous.
- 1 Techniques of production remain constant.
- 1 The law will hold good only for a short and a given period.
- 1 There are possibilities for varying the proportion of factor inputs.

Production Function with one variable input

Labour Input (L) (No. of workers)	Total Product (TP) (in quintals)	Average Product (AP) (in quintals)	Marginal Product (MP) (in quintals)	Remarks
1	50	50.00	50	
2	110	55.00	60	Stage I
3	135	45.00	25	
4	150	37.50	15	Stage II
5	160	32.00	10	
6	165	27.50	5	
7	165	23.57	0	
8	160	20.00	-5	Stage III
9	153	17.00	-7	

The above table shows changes in total product (second column) as labour force is varied by the entrepreneur. When the second worker is employed, both marginal and average production increase. But as more workers are employed, average production falls and the marginal product falls more speedily. The employment of the seventh person does not add to the total product, rather the marginal product is zero. After this, the employment of the next person would yield a negative marginal product. The behaviour of marginal product of labour shows three stages: in the first stage, it increases; in the second, it continues to decrease; and in the third stage, it is negative. This has been shown in the figure which shows the relationship between AP_L and MP_L curves.



Stages of the law of variable proportions

Stages of Variable Proportions

The three stages of the production function of the given firm are briefly examined below:

Stage I: Increasing Returns

Stage I goes from the origin to the point where the AP_L is maximum (i.e., from origin to point b). In this stage, TP_L is initially increasing at an increasing rate and then starts increasing at a decreasing rate from the point of inflection (point c) onwards. AP_L rises throughout in this stage. MP_L rises initially and then starts falling. The increase in AP_L and MP_L curve is due to the fact that fixed factor is underutilised. Increasing returns are due to indivisibility of factors and specialisation of labour.

Stage II: Diminishing Returns

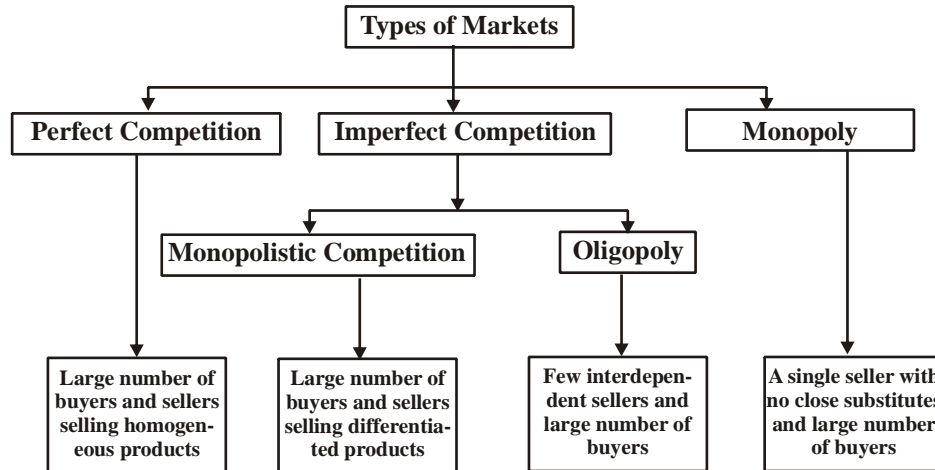
Stage II of production ranges from the point where AP_L is maximum to the point where MP_L is zero (i.e. from point b to d). In this stage, both AP_L and MP_L are positive but declining. A rational producer will always operate in this stage. The law of diminishing returns operates in stage II. It is the most fundamental law of production. Diminishing returns are due to non-optimal factor proportion and the curve MP_L shows a downward slope.

Stage III: Negative Returns

Every producer would prefer to avoid this stage as it is characterised by negative marginal product of labour (MP_L). Producing at this stage is uneconomical even with free labour. As shown in the figure, MP_L gets negative and falls below the x-axis.

Forms of Market

Market refers to the entire area where buyers and sellers of a commodity are in close contact (competition) with one another. Its essential ingredients are (i) Commodity or service, (ii) Buyers and sellers, (iii) Close contact among buyers and sellers, and (iv) Area where there is competition among buyers and sellers.



Forms of Market: The structure of a market is mainly determined by three factors: (i) Number of buyers and sellers, (ii) Nature of commodity, and (iii) Mobility of goods and factors (of production). The combined effect of these factors indicates the *degree of competition*.

Market Types				
Assumption	Perfect Competition	Monopolistic Competition	Oligopoly	Monopoly
Number of sellers	many	many	a few	one
Product differentiation	none	slight	none to substantial	extreme
Price elasticity of demand of a firm	infinite	large or small	small	zero
Degree of control over price	none	some	some	very considerable

Perfect Competition

Perfect competition is a market situation in which buyers and sellers operate freely and a commodity sells at a uniform price. It is a market in which a very large number of firms produce homogeneous goods and sell them at a uniform price. No seller can influence the prevailing market price by his independent action. In such a market, *industry is the price maker and firm is the price taker*. Thus, a commodity sells at the same price since every seller takes the price as given by the industry. The seller, at this given price, can only decide how much quantity of the product to sell in the market.

Very large number of buyers and sellers

The implication of “large number of sellers in the market” is that the share of each seller in total market supply is so small

that no single seller can influence the price. Hence, he has no option but to sell the product at the price given (determined) by the industry. It is because of this position that *each firm is said to be price taker in perfect competition*.

Homogeneous product

The implication of a product being homogeneous is that all firms have to charge the same price for the product: otherwise, no one will buy from the firm selling at a higher price.

Free entry and exit of firms

The implication of free entry and exit is that no firm can earn above-normal profit in the long run. In other words, each firm earns just normal profit (i.e. minimum profit which is necessary to carry on business).

Perfect Competition and Pure Competition

Pure competition is a market situation where (i) there are a very large number of buyers and sellers, (ii) products are homogeneous, and (iii) there is free entry and exit of firms. As a result, the product sells at a uniform price and no seller can influence the prevailing price. Thus, pure competition is a part and parcel of perfect competition since it fulfils the first three conditions of the abovementioned prerequisites of perfect competition.

Perfect competition is used in a wider sense because in addition to the three conditions of pure competition, it has to satisfy some more conditions, namely, perfect knowledge, perfect mobility and absence of transport cost, etc., as explained above. Thus, when compared to perfect competition, pure competition is used in a restricted sense.

Monopoly

‘Mono’ literally means one, ‘poly’ implies seller and so ‘monopoly’ means one seller. **Monopoly is a market situation where there is a single firm selling the commodity and there is no close substitute of the commodity sold by the monopolist.** It is very difficult for a new firm to enter the monopoly market. Consequently, a monopolist is more or less free to charge any price for his product by regulating its supply. It is in this sense that the seller under monopoly is said to be the price maker and not a price taker. A monopolist’s essential advantage is the absence of competitors which enables him to control his supply and thereby obtain the highest possible profit. The difference between the monopoly firm and the industry disappears since the firm itself constitutes the industry due to non-existence of any other firm dealing in the same product. Thus, the monopoly firm itself is the industry.

Main features of monopoly

- (i) Single seller of the commodity
- (ii) Absence of close substitute of a product
- (iii) Difficult entry of a new firm
- (iv) Negatively sloped demand curve
- (v) Price maker with constraint
- (vi) Price discrimination

Oligopoly

It is that form of imperfect competition where a few big firms compete for their homogeneous products (like steel and fertilisers) or differentiated products (like scooters and cars). Here, the entry of a new firm in the industry is quite difficult. In a way, the position of oligopoly lies between that of monopolistic competition and monopoly. Following are its main features:

- (i) **A few firms:** There are a few firms, each of which, produces a substantial part of total output of the industry. The number of firms is so small that each seller knows

that he can influence the price by his own action and that he can provoke rival firms to react.

- (ii) **Interdependence:** There is interdependence of firms in case of price-output decision as no firm can take independent decision.
- (iii) **Selling costs:** Heavy selling and advertisement costs are incurred to promote sales.
- (iv) **Price rigidity:** Mostly prices are stable since no firm dares to change the price for fear of retaliatory actions by rival firms.
- (v) **Indeterminate demand curve:** No firm can be certain of demand for its product due to unsure reaction of rival firms and, therefore, demand curve for its product is indeterminate.
- (vi) **Group behaviour** in the form of collective decision by firms is common.
- (vii) **The product** may be homogeneous (like steel) or differentiated (like cars).
- (viii) **The entry** of new firms in the industry is difficult.

The Kinked Demand Curve Theory of Oligopoly

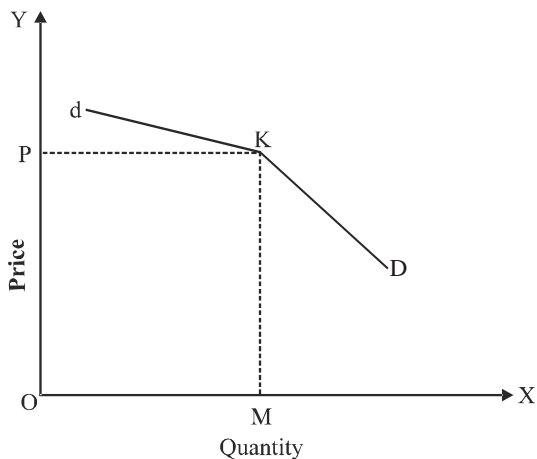
It has been observed that in many oligopolistic industries prices remain sticky or inflexible for a long time. They tend to change infrequently, even in the face of declining costs. Many explanations have been given for this price rigidity under oligopoly and the most popular explanation is **Kinked Demand Curve Hypothesis** given by an American economist **Sweezy**.

Many oligopolistic industries exhibit price rigidity or stability. Price rigidity refers to a tendency of no change in prevailing price. It may be due to the following reasons:

- (a) The oligopolistic industry has reached a stage of maturity.
- (b) Firms might have learned by experience that price war is harmful and firms have found satisfactory price level.
- (c) Firms have realised that they cannot increase their profit by lowering the price because other firms may follow the price cut by the firm.
- (d) Instead of reducing price, a firm may compete by non-price competition.

The demand curve facing an oligopolist, according to the kinked demand curve hypothesis, has a ‘kink’ at the level of the prevailing price. **The kink is formed at the prevailing price level because the segment of the demand curve above the prevailing price level is highly elastic and the segment of the demand curve below the prevailing price level is inelastic.**

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A kinked demand curve dD with a kink at point K has been shown. The prevailing price level is OP and the firm is producing and selling the output OM . Now, the upper segment dK of the demand curve dD is relatively elastic and the lower segment KD is relatively inelastic. This difference in elasticities is due to the particular competitive reaction pattern assumed by the Kinked Demand Curve Hypothesis.

Indian Economy

- 1 The economy of India is the **tenth largest** in the world by nominal GDP and the **third largest** by Purchasing Power Parity (PPP).
- 1 India is a **developing country** and our economy is a **mixed economy**.
- 1 In a mixed economy the public sector co-exists with the private sector.
- 1 **Dadabhai Naoroji** is known as the father of Indian politics and economics. He is also called the 'Grand Old Man of India'.
- 1 In his book *Poverty and Un-British Rule in India*, he describes his theory, i.e. the economic exploitation of India by the British. His theory is popularly called the **Economic Drain Theory**.

Basic Features of Indian Economy

- (i) Low per capita income
- (ii) Inequalities in income distribution
- (iii) Predominance of agriculture
- (iv) Rapidly growing population
- (v) Chronic unemployment
- (vi) Low rate of capital formation
- (vii) Dualistic nature of economy (features of a modern economy, as well as traditional)
- (viii) Mixed economy
- (ix) Follows labour-intensive techniques

Sectorial Distribution of Indian Economy

Indian Economy is divided into three main sectors: **(1) Primary Sector:** It includes agriculture, forestry, dairy, quarrying, etc. **(2) Secondary Sector:** It includes manufacturing sector, construction, power generation, etc. **(3) Tertiary Sector/ Service Sector:** it includes services like banking, insurance, telecommunication, information technology, warehousing, trading, etc.

In developed countries, the contribution to tertiary sector in their national income is generally around 65 per cent, that of secondary sector is around 30 per cent and of primary sector is around 5 per cent. In India, earlier the contribution of primary sector was quite dominating. In the year 1950-51, it was 61 per cent of total national income. This indicates the underdevelopment of our economy. Now the sectoral distribution of national income is changing in favour of tertiary sector. In the year 2011-12, the share of tertiary sector in national income was **59 per cent**, that of secondary sector **27.1 per cent**, while the share of primary sector has come down to **13.9 per cent**. It is a favourable change in sectoral distribution of national income. Thus, **the growth of our economy is now led by tertiary sector**.

National Income

- 1 The national income is the sum total of the value of all the final goods produced and services of the residents of the country in an accounting year and it also includes the net earned foreign income.
- 1 National income is a flow not a stock.
- 1 In India, national income estimates are related to the financial year (**April 1 to March 31**).

Measurement of National Income in India

In India, a systematic measurement of national income was first attempted in **1949**. Earlier, many attempts were made by some individuals and institutions.

Dadabhai Naoroji was the first to calculate the national income of India.

In **1949**, a **National Income Committee (NIC)** was appointed, with **P.C. Mahalanobis** as its Chairman, and **Dr. D.R. Gadgil** and **V.K.R.V. Rao** as members. The NIC not only highlighted the limitations of the statistical system of that time but also suggested ways and means to improve data collection systems. On the recommendation of the Committee, the **Directorate of National Sample Survey** was set up to collect additional data required for estimating national income.

In **1967**, the task of estimating national income was given to the **Central Statistical Organisation (CSO)**.

For comparison purposes, the national income is measured at constant prices with a base year. The base year at present is **2004-05**.

- 1 The Central Statistical Organisation is under the department of statistics. The Govt. of India is responsible for estimating the national income.
- 1 CSO was founded on the recommendation of **Prof. Mahalanobis**.
- 1 CSO is assisted by the National Sample Survey.

Concept of National Income

The various concepts of national income are as follows:

1. Gross Domestic Product (GDP) is the total money value of all final goods and services produced within the geographical boundaries of the country during a given period of time.

2. Gross National Product (GNP): Gross National Product refers to the money value of total output or production of final goods and services produced by the nationals of a country during a given period of time, generally a year.

As we include all final goods and services produced by nationals of a country during a year, we include the money value of goods and services produced by nationals outside the country in calculating the GNP. Hence, income produced and received by nationals of a country within the boundaries of foreign countries should be added to Gross Domestic Product (GDP) of the country. Similarly, income received by foreign nationals within the boundary of the country should be excluded from GDP.

In equation form:

$$\text{GNP} = \text{GDP} + X - M, \text{ where}$$

X = Income earned and received by nationals within the boundaries of foreign countries.

M = Income received by foreign nationals from within the country.

$$\text{If } X = M \text{ then } \text{GNP} = \text{GDP}.$$

Similarly, in a closed economy,

$$X = M = 0$$

$$\text{Then also } \text{GNP} = \text{GDP}$$

The money earned by the Indian working in USA is a part of India's GNP. But it is not a part of GDP since it is earned abroad. Therefore the boundaries of GNP are determined by the citizens of a country whereas the boundaries of GDP are determined by the geographical limits of a country.

It is also clear that the difference between GDP and GNP is due to the "net revenue from abroad". If the citizens of a country are earning more from abroad than the foreigners are earning in that country, GNP exceeds GDP. If the foreigners in the country are earning more than its citizens are earning abroad, GNP is less than GDP.

3. Net National Product (NNP): NNP is obtained by subtracting depreciation value (i.e. capital stock consumption) from GNP. In equation form: $\text{NNP} = \text{GNP} - \text{Depreciation}$.

In the process of producing goods and services (including capital goods), a part of total stock of capital is used up. 'Depreciation' is the term used to denote the worn-out or used-up capital. An estimated value of depreciation is deducted from the GNP to arrive at NNP.

The GNP explained above is based on **market prices** of produced goods which include indirect taxes and subsidies. NNP can be calculated in two ways:

- (i) at market prices of goods and services, and
- (ii) at factor cost.

When NNP is obtained at factor cost, it is known as national income. National Income is calculated by subtracting net indirect taxes (i.e. total indirect tax-subsidy) from NNP at market prices. The obtained value is known as NNP at factor

cost or national income.

In equation form:

NNP at factor cost or National Income = NNP at market price – (Indirect Taxes - Subsidy) = NNP_{Mp} – Indirect Tax + Subsidy.

Personal Income: Personal income is the income which is actually obtained by nationals. It is obtained by subtracting corporate taxes and payments made for social securities provisions from national income and adding to it government transfer payments, business transfer payments and net interest paid by the government.

In equation form:

Personal Income = National Income – undistributed profits of corporation – payments for social security provisions - corporate taxes + government transfer payments + business transfer payments + net interest paid by government.

It should always be kept in mind that personal income is a flow concept.

Personal Disposable Income: When personal direct taxes are subtracted from personal income, the obtained value is called **Disposable Personal Income (DPI)**.

In equation form:

[Disposable Personal Income] = [Personal Income] – [Direct Taxes]

Methods of Measuring National Income

According to **Simon Kuznets**, the national income of a country is calculated by the following mentioned three methods.

1. Product Method: S Kuznets gave a new name to this method, i.e. **product-service method**. In this method net value of final goods and services produced in a country during a year is obtained and the total obtained value is called **total final product**. This represents Gross Domestic Product (GDP). Net income earned in foreign boundaries by nationals is added and depreciation is subtracted from GDP.

2. Income Method: In this method, a total of net incomes earned by working people in different sectors and commercial enterprises is obtained. According to **Dr Bowley** and **Robertson**, incomes of both categories of people — those paying taxes and those not paying taxes — are added to obtain national income. For adopting this method, sometimes a group of people from various income groups is selected, and on the basis of their income, the national income of the country is estimated. In a broad sense, by income method national income is obtained by adding receipts as total rent, total wages, total interest and total profit.

Symbolically: National Income = Total Rent + Total Wages + Total Interest + Total Profit.

3. Consumption Method: It is also called **expenditure method**. Income is either spent on consumption or saved. Hence, national income is the addition of total consumption and total savings. For using this method, we need data related to income and savings of the consumers. Generally, reliable data of saving and consumption are not easily available. Therefore, expenditure method is generally not used for estimating national income.

In India, a combination of product method and income method is used for estimating national income.

India's per capita income crosses ` 50,000 level

The per capita income of Indians for the first time crossed the ` 50,000-mark in 2010-11, although using current prices as the barometer. It is estimated to have risen 16.9% to ` 53,331 compared to ` 46,117 in the previous year.

The \$1,000-average income of Indians is seen to be illusionary in economic circles as economists prefer to use factor cost to weed out the impact of inflation. Based on 2004-05 prices, per capita income saw a modest 6.4% increase and reached ` 35,993 in 2010-11, compared to ` 33,843 in the previous year.

Per Capita Income

Per capita income is computed by dividing net domestic product of a state with its population. So per capita income is a better criteria to measure regional imbalances.

Per Capita Income of Different States (At Current Prices) (Year 2009-10)

State (High Income States)	Per Capita Income (` p.a.)	State (Low Income States)	Per Capita Income (` p.a.)
Goa	1,32,719	Bihar	16,715
Haryana	78,781	Uttar Pradesh	23,395
Maharashtra	74,027	Jharkhand	27,132
Gujarat	63,961	Assam	27,197
Tamil Nadu	63,547	Madhya Pradesh	27,250
Punjab	60,746	Odisha	33,226

Planning in India

Five Year Plans

- 1 **Father of Indian Planning:** M. Visvesvaraya
- 1 The first attempt to initiate economic planning in India was made by Sir M. Visvesvaraya, a noted engineer and politician, in 1934 through his book, *Planned Economy for India*.
- 1 In 1944, '**Bombay Plan**' was presented by 8 leading industrialists of Bombay.
- 1 In 1945, 'People's Plan' was given by **MN Roy**.
- 1 In 1950, 'Sarvodaya Plan' was given by **JP Narayan**. A few points of this plan were accepted by the Government.
- 1 The concept of the planning is based on the Russian model initiated by **Joseph Stalin**.
- 1 The **Planning Commission** was set up in **1950** with Jawaharlal Nehru as its first Chairman.
 - The Planning Commission is only an advisory body according to the 39th article of the Constitution.
- 1 The **National Development Council (NDC)** was set up on August 6, 1952.
 - It gives final approval to plans in India. The Prime Minister is its chairman.
 - All the Chief Ministers of the States, Lt. Governors of Union Territories, all Union Cabinet Ministers and other Planning Commission members are its members.

The First Plan (1951-56)

- 1 It gave priority to **agricultural development**.
- 1 Community Development Programme (CDP) and Family Planning Programme (FPP) were launched in 1952.
- 1 National Extension Service (NES) was launched in 1953 during the First Five Year Plan period.
- 1 Important multipurpose projects in India like **Bhakra Nangal, Hirakud** and **Damodar Valley** projects were also launched during this Plan period.
- 1 The First Five Year Plan was a successful one.

The Second Plan (1956-61)

- 1 The second Five-year Plan functioned on the basis of **Mahalanobis model**. The Mahalanobis model was propounded by the famous Prasanta Chandra Mahalanobis.
- 1 It gave priority to **industrial development**.
- 1 The three important steel plants of India were built during this Plan period. They are **Durgapur** (West Bengal) with British help, **Bhilai** (Chhattisgarh) with **Russian** help and **Rourkela** (Orissa) with **German** help.

The Third Plan (1961-66)

- 1 It failed because of the Chinese aggression in 1962 and the conflict with Pakistan in 1965.
- 1 A plan holiday was declared during **1966-1969** due to the conflict with Pakistan.

The Fourth Plan (1969-74)

- 1 It also failed due to the Indo-Pak war of 1971.
- 1 Growth with stability was the objective of the plan.

The Fifth Plan (1974-79)

- 1 It is associated with Indira Gandhi's slogan of "**Garibi hatao**" (remove poverty).
- 1 Indira Gandhi launched the 20-point programmes during this Plan. Self-sufficiency in food-grains was the major achievement of this Plan.
- 1 The Plan was terminated in **1978** by the Janata Government, and they started the **Rolling Plan**.

The Sixth Plan (1980-85)

- 1 Elimination of unemployment and poverty was its objective.

The Seventh Plan (1985-90)

- It also aimed to eliminate poverty and increased employment opportunities and productivity within the framework of basic tenants of planning.
- 1 The 8th plan would not take off due to fast changing political situation at the centre. So the new government decide that the 8th plan would start in 1992.
- 1 During **1990-92, two Annual Plans were launched**.

Plan	Growth Target (per cent)	Actual (per cent)
First Plan (1951-56)	2.1	3.60
Second Plan (1956-61)	4.5	4.21
Third Plan (1961-66)	5.6	2.72
Fourth Plan (1969-74)	5.7	2.05
Fifth Plan (1974-79)	4.4	4.83
Sixth Plan (1980-85)	5.2	5.54
Seventh Plan (1985-90)	5.0	6.02
Eighth Plan (1992-97)	5.6	6.68
Ninth Plan (1997-2002)	6.5	5.5
Tenth Plan (2002-07)	8.0	7.7
Eleventh Plan (2007-12)	9.0	8.2*

* anticipated

The Eighth Plan (1992-97)

- 1 It proposed a growth rate of **5.6%** per annum and the energy sector was accorded top priority in the Plan allocation.

The Ninth Plan (1997-2002)

- 1 The slogan of this Plan was to achieve *growth with equity*.
- 1 It was developed in the context of four important dimensions: Quality of life, generation of productive employment, regional balance and self-reliance.

The Tenth Plan (2002-07)

- 1 The total outlay envisaged for the 10th Plan was ₹ 19,68,815 crore in 2001-02.
- 1 The strategy of this Plan was to make India one of the ten fastest growing nations. The main elements in the strategy of the Tenth Plan was to increase the rate of growth of national incomes and per capita income.

The Eleventh Plan (2007-12)

- 1 The theme of the Plan was 'towards faster and more inclusive growth'.
- 1 The main elements in the strategy of the Eleventh Plan are: (i) To achieve rapid growth and to bring general improvement in living conditions of the masses; (ii) To ensure that benefits of growth reach all sections of population, especially rural areas; (iii) Promoting foreign investment for achieving faster growth in the economy.

Twelfth Five-Year Plan

The Indian economy on the eve of the 12th plan was characterised by good performance in the Eleventh Plan period. Eleventh Plan had achieved annual growth rate of around 8.1 per cent in GDP, which was the highest growth rate achieved in any Plan period.

The duration of the twelfth Five-Year Plan is from 1st April 2012 to 31st March 2017. The slogan of the 12th Plan is '**Faster, Sustainable and More Inclusive Growth**'.

The priority areas of this Plan are: agriculture, irrigation, manufacturing, education, health, innovation and infrastructure.

Sectoral Growth Targets for Twelfth Plan

Sectors	9.0% target	9.5% target
1. Agriculture, Forestry & Fishing	4.0	4.2
2. Mining & Quarrying	8.0	8.5
3. Manufacturing	9.8	11.5
4. Electricity, Gas and Water Supply	8.5	9.0
5. Construction	10.0	11.0

Economic Census 2012

The year 2012 is scheduled for the 6th Economic Census. The last, i.e., the 5th Economic Census was done in the year 2005. The first Economic Census was done in 1977, followed by the second, third, fourth and fifth in the years 1980, 1990, 1998 and 2005 respectively.

Economic Census

Number	Year
1st	1977
2nd	1980
3rd	1990
4th	1998
5th	2005
6th	2012

Economic Census will cover and count all industrial units and with this exercise a **National Business Register (NBR)** will be made. The details of all industrial and commercial units will be included in this National Business Register. This Economic Census exercise will be done under the supervision of Ministry of Statistics and Programme Implementation. This National Business Register will be on the lines of **National Population Register** in which all details of Indian citizens are being registered.

The final results of Economic Census 2005 were released on 29th May, 2008. According to the results, there were 41.8 million establishments in the country employing 100.9 million persons.

The ministry proposed to conduct 6th Economic Census during 2012 in association with State/UT Directorates of Economics & Statistics.

Agriculture

Agriculture is the mainstay of the Indian Economy. Agriculture and allied sectors contribute nearly **14.4 per cent of Gross Domestic Product (GDP)** of India, while about 58.2 per cent of the population is dependent on agriculture for their livelihood. Agricultural output, however, is influenced by good

or bad monsoon conditions as nearly 55 per cent of total cropped areas is dependent on rainfall.

In 1950-51, the contribution of agricultural sector to the national income was 61 per cent. In the rich countries of the world, agriculture is sufficiently developed but its contribution

to the national income is very little. In America and England, agriculture contributes only 1 per cent of the national income. In underdeveloped countries, the share of agriculture in the national income is more as compared to the share of agriculture in developed countries.

Average growth rate of agricultural production

Plan	Average growth rate of Agriculture and Allied Services (per cent per annum)	
Seventh Plan (1985-1990)	3.2	
Annual Plans (1990-1992)	1.3	
Eighth Plan (1992-1997)	4.7	
Ninth Plan (1997-2002)	2.1	
Tenth Plan (2002-07)	2.5	
Eleventh Plan (2007-08)	4.5	
	(2008-09)	1.6
	(2009-10)	0.4
	(2010-11)	5.4
	(2011-12)	2.5

} 3.2 (Average Rate)

India's Ranking in the World in Agriculture

Criteria/Crop	India's Rank
Total irrigated Area	1
Pulses	1
Jute	1
Spices	1
Milk	1
Butter & Ghee	1
Cashew Nuts	1
Cultivable Land	2
Wheat	2
Rice	2
Sugar Cane	2
Fruits and Vegetables	2
Tobacco	2
Tea	2

S.No.	Agricultural Development Programme	Year of Beginning	Objective/Description
1	Intensive Agriculture Development Programme (IADP)	1960	To provide loans, seeds, fertiliser tools to the farmers.
2	Intensive Agriculture Area Programme (IAAP)	1964	To develop special harvest.
3	High Yielding Variety Programme (HYVP)	1966	To increase productivity of foodgrains by adopting latest varieties of inputs for crops.
4	Green Revolution	1966	To increase food-grains production.
5	Nationalisation of four banks	1969	To provide loans for agriculture, rural development and other priority sectors.
6	Marginal Farmer and Agriculture Labour Agency (MFALA)	1973	For technical and financial assistance to marginal and small farmers and agricultural labourers.
7	Small Farmer Development Agency (SFDA)	1974	For technical and financial assistance to small farmers.
8	Farmer Agriculture Service Centres (FASC)	1983	To popularise the use of improved agricultural instruments and tool kits.
9	Comprehensive Crop Insurance Scheme	1985	For insurance of agricultural crops.
10	Agricultural and Rural Debt Relief Scheme (ARDRS)	1990	To exempt bank loans upto ` 10,000 to rural artisans and weavers.
11	Intensive Cotton Development Programme (ICDP)	2000	To enhance the production per unit area through (a) technology transfer, (b) supply of quality seeds, (c) elevating IPM activities and (d) providing adequate and timely supply of inputs to the farmers.

12	Minikit Programme for Rice, Wheat and Coarse Cereals	1974	To increase the productivity by popularising the use of newly released hybrid/high-yielding varieties and spread the area of coverage under location-specific high-yielding varieties/hybrids.
13	Accelerated Maize Development Programme (AMDP)	1995	To increase maize production and productivity in the country from 10 million tonnes to 11.44 million tonnes and from 1.5 tonnes/hectare to 1.80 tonnes/hectare respectively upto the terminal year of 9th Plan i.e. 2001-2002 (revised).
14	National Pulses Development Project (NPDP)	1986	To increase the production of pulses in the country to achieve self-sufficiency.
15	Oil Palm Development Programme (OPDP)	1992	To promote oil-palm cultivation in the country.
16	National Oilseeds and Vegetable Oils Development Board (NOVOD)	1984	The main functions of the NOVOD Board are very comprehensive and cover the entire gamut of activities associated with the oil-seeds and vegetable oil industry, including production, marketing, trade, storage, processing, research and development, financing and advisory role to the formulation of integrated policy and programme of development of oil-seeds and vegetable oil.
17	Coconut Development Board	1981	To increase production and productivity of coconut; to bring additional area under coconut in potential non-traditional areas

New Agricultural Strategy Initiatives

Kisan Credit Card: The Kisan Credit Card (KCC) Scheme was introduced in August, 1998 with major share of crop loans being routed through it. Banks were advised that the credit card should normally be valid for 3 years subject to an annual review. The scheme was revised in October, 2004. The revised scheme aims at providing adequate and timely credit for the comprehensive credit requirements of farmers under single window, with flexible and simplified procedure, adopting whole-farm approach including the short-term credit needs, term loan and a reasonable component for consumption needs, through Kisan Credit Card. The banks may extend the validity of KCC from 3 years to 5 years in case of sanctioning of term-loan facility under KCC. So far 1,004 crore KCC's have been issued by the banking system in the country.

Rashtriya Krishi Vikas Yojana (RKVY)

Rashtriya Krishi Vikas Yojana came into force in August 2007. An amount of ₹ 18,550 crore was spent on RKVY during the 11th Plan against the target of ₹ 25,000 crore. RKVY helped in achieving growth rate of 3.2 per cent in agricultural production during the Eleventh Plan period against the target of 4 per cent annual growth. The main objectives of this scheme are:

(i) To increase public investment in agriculture.

- (ii) To prepare regional plans for agriculture depending upon climatic condition, natural resources, availability of technologies, etc.
- (iii) To focus attention on enhancing agricultural productivity.
- (iv) To maximise the return to the farmers.
- (v) To provide flexibility and autonomy to states in the process of planning and executing agriculture-related schemes.

National Food Security Mission (NFSM)

With a view to enhancing agricultural production of rice, wheat and pulses by 10 million tonnes, 8 million tonnes and 2 million tonnes respectively by the end of the Eleventh Plan, the Central Government had launched NFSM in the year 2007-08. NFSM aims to increase production through area expansion and productivity enhancement. NFSM is presently implemented in 480 identified districts. The mission has focused on the districts with productivity below the state average. A new programme called **Accelerated Pulses Production Programme (A3P)** has been launched in 2010-11 under NFSM. Through technological upgradation, significant impact has been made under NFSM on increase of agricultural production. In 2010-11, increase in agricultural production in comparison to pre-NFSM targets was 24.28 million tonnes. This achievement is more than the target of 20 million tonnes of NFSM.

New Economic Policy (NEP)

- 1 The New Economic Liberalisation Policy was launched in India in July 1991.
- 1 LPG, ie Liberalisation, Privatisation and Globalisation, are the three steps in NEP.

Need for New Economic Policy/Economic Reforms

The need for New Economic Policy was felt mainly because of the following reasons:

Fiscal Deficit: Prior to 1991, on account of continuous rise in non-developmental expenditure of the government, fiscal deficit went on rising. In the year 1981-82, it was **5.4 per cent** of gross domestic product (GDP) but in 1991-92, it rose to **8.4 per cent** of GDP. In order to meet the fiscal deficit, the government had to raise loans and pay interest thereon. In 1980-81, interest payments on public debt amounted to **10 per cent** of the total government expenditure. In 1991, the amount of interest payments rose to **36.4 per cent** of the total expenditure of the Central Government.

Increase in Unfavourable Balance of Payments: Deficit of balance of payments has been rising since 1980-81 in India. In the year 1980-81 the deficit of balance of payments on current account was 2,214 crore which in 1990-91 rose to 17,367 crore. So, to overcome the problem of unfavourable balance of payments, the need for new economic policy was realised.

Gulf Crisis: On account of the Gulf War in 1990-91, prices of petrol shot up. Thus, India had to make huge payments to the Gulf countries so as to import petrol. The Gulf crisis, thus, further worsened already adverse India's balance-of-payments position. This further increased balance-of-payments deficit.

Globalisation

- 1 The globalisation of Indian economy means that the Indian economy is having minimum possible restrictions on economic relations with other countries.

Measures Adopted for Globalisation

1. **Increase in Foreign Investment:** In many industries foreign direct investment to the extent of 100 per cent has been allowed without any restriction and red-tapism.
2. **Partial Convertibility of Indian Rupee:** Partial convertibility of Indian rupee was allowed. It was in conformity with economic reforms. Partial convertibility means to buy or sell foreign currencies like dollar and pound sterling for foreign transactions at a price determined by the market. This convertibility was valid

for the following transactions: (i) Import and export of goods and services; (ii) Payment of interest or dividend on investment; (iii) Remittances to meet family expenses. It is called partial convertibility because it does not cover capital transactions. Recently, government is seriously thinking of making rupee fully convertible into other currencies.

3. **Foreign Trade Policy:** In conformity with economic reforms, foreign trade policy was enforced for a long duration, viz., five years. *India's present foreign trade policy 2009-14 is a liberal policy.*

Sector-Specific Limits of Foreign Investment in India

Sector	FDI Cap/Equity
A. Agriculture	
1. Floriculture, Horticulture, Development of Seeds, Animal Husbandry, Pisciculture, Aquaculture, Cultivation of vegetables & mushrooms and services related to agro and allied sectors	100%
2. Tea sector, including plantation	100%
(FDI is not allowed in any other agricultural sector/ activity except the abovementioned sectors.)	
B. Industry	
1. Mining, covering exploration and mining of diamonds & precious stones, gold, silver and minerals	100%
2. Coal and lignite mining for captive consumption by power projects, and iron & steel, cement production	100%
3. Mining and mineral separation of titanium-bearing minerals	100%
C. Manufacturing	
1. Alcohol distillation & brewing	100%
2. Coffee & rubber processing & warehousing	100%
3. Defence production	26%
(Conditional 49%)	
4. Hazardous chemicals and isocyanates	100%
5. Industrial explosives	100%
6. Drugs and pharmaceuticals	100%
7. Power including generation (except atomic energy), transmission, distribution and trading	100%
(FDI is not permitted for generation, transmission & distribution of electricity produced in atomic power plant/atomic energy since private investment in this activity is prohibited and reserved for public sector.)	

D. Services

1. Civilisation (Greenfield projects and Existing projects) 100%
2. Asset Reconstruction companies 49%
(100% under FIPB)
3. Banking (private) sector 74% (FDI + FII,
FII not to exceed 49%)
4. **NBFCs:** Underwriting, portfolio-management services, investment advisory services, financial consultancy, stock broking, asset management, venture capital, custodian, factoring, leasing and finance, housing finance, forex broking, etc. 100%
5. Broadcasting
 - a. FM radio 20%
 - b. Cable network 49% (FDI+FII)
 - c. Direct to home 49% (FDI+FII)
 - d. Hardware facilities such as up-linking, HUB 49% (FDI+FII)
 - e. Up-linking news and current affairs TV Channel 100%
6. Commodity exchanges 49% (FDI+FII)
(FDI 26 %, FII 23%)
7. Insurance 49%
8. Petroleum and natural gas 49% (PSUs)
 - a. Refining 100% (Pvt. companies)
9. Print media
 - a. Publishing of newspapers and periodicals dealing with news and current affairs 26%
 - b. Publishing of scientific magazines / speciality journals/periodicals 100%
10. Telecommunications
 - a. Basic and cellular, unified access services, national/international long-distance, V-SAT, Public Mobile Radio Trunked Services (PMRTS), Global Mobile Personal Communication Services (GMPCS) and others 100%

Sectors where FDI is banned

1. Atomic Energy
2. Lottery Business, including government/private lotteries, online lotteries, etc
3. Gambling and betting, including casinos etc
4. Business of chit fund
5. Nidhi company
6. Trading in Transferable Development Rights (TDRs)
7. Activities/sectors not opened to private sectors investment
8. Agriculture (excluding Floriculture, Horticulture, Development of seeds, Animal Husbandry, Pisciculture

and cultivation of vegetables, mushrooms etc. under controlled conditions and services related to agro and allied sectors) and plantations (other than tea plantations)

9. Real estate business, or construction of farm houses; manufacturing of cigars, cheroots, cigarillos, cigarettes, tobacco and its substitutes.

FDI Policy: The International Experience

Foreign direct investment is treated as an important mechanism for channelising transfer of capital and technology and thus perceived to be a potent factor in promoting economic growth in the host countries. Moreover, multinational corporations consider FDI as an important means to reorganise their production activities across borders in accordance with their corporate strategies and the competitive advantage of host countries. These considerations have been the key motivating elements in the evolution and attitude of EMEs (Emerging Market Economies) towards investment flows from abroad in the past few decades, particularly since the Eighties.

Foreign Institutional Investors (FIIs)

On 14 September 1992, the Government of India, for the first time, permitted portfolio investments by Foreign Institutional Investors (FIIs) in the Indian capital market, and issued guidelines outlining the entry and investment norms for FIIs. FIIs were required to register with Securities and Exchange Board of India (SEBI) before making any investment in India. Since there were foreign exchange controls also in force, FIIs were required to seek Reserve Bank of India's (RBI) permission through SEBI. Thus FIIs were provided with a single window at SEBI for registration and foreign exchange permissions.

Subsequently, in 1995, the SEBI notified SEBI (FII) Regulations, 1995, which became the primary regulation regarding FII registration and investment norms. In December 2003, RBI gave general permission under the Foreign Exchange Management Act (FEMA) to SEBI-registered FIIs/sub-accounts. Thus the requirement of seeking separate approval from RBI at the time of FII registration was discontinued.

At present, the following acts / regulations / guidelines govern FIIs investments in India:

1. SEBI Act, 1992
2. SEBI (FII) Regulations, 1995
3. Foreign Exchange Management Act, 1999
4. Government of India Guidelines dated 14 September 1992
5. Various circulars/instructions issued by SEBI/RBI from time to time

As defined in the SEBI (FII) Regulations, an FII means an institution established or incorporated outside India which proposes to make investment in India in securities.

Eligibility

As per the SEBI (FII) Regulations, following entities/funds are eligible to get registered as FII:

1. Pension Funds
2. Mutual Funds
3. Investment Trusts
4. Insurance company/Reinsurance company
5. International or Multilateral Organisation or an agency thereof
6. Foreign Governmental Agency
7. Foreign Central Bank
8. Banks
9. Endowments
10. University Funds
11. Foundations
12. Charitable Trusts/Charitable Societies
13. Sovereign Wealth Fund
14. Broad Based Fund (only if it does not satisfy any other category)

Privatisation

Privatisation is the forecast of the removal of state interference in economic programme.

In the context of economic reforms, **privatisation means allowing the private sector to set up more and more of such industries as were previously reserved for public sector. Under it, existing enterprises of the public sector are either wholly or partially sold to private sector.** It enhances the importance of private sector because private sector comes to play a significant role in the economic development of the country. Thus, transferring of public sector industries to private sector is called privatisation.

Liberalisation

Liberalisation means free-market economy. It marks a change from a restrictionist regime to a free regime. It implies reducing, relaxing and dismantling of govt control and regulation in economic activities.

Measures Taken for Liberalisation

1. **Liberalisation of Industrial Licensing:** Under the New Economic Policy, **private sector has been freed**, to a large extent, from licences and other restrictions. As per amendment in the new economic policy in the year 2006, with the exception of 5 industries, industrial licensing has been abolished for all other industries. Industries for which licences are still necessary are: (i) liquor, (ii) cigarette, (iii) defence equipment, (iv) industrial explosives, (v) dangerous chemicals. The entrepreneur can float in any new company except in the above 5 industries without any restriction.

2. **Concessions from Monopolies Act:** According to the provisions of **Monopolies and Restrictive Trade Practices Act (MRTP Act)**, all those companies having assets worth more than `100 crore and used to be declared MRTP firms, were subjected to several restrictions. Now the concept of MRTP has been done away with. These firms are now no longer required to obtain prior approval of the government at the time of taking investment decisions. They are free to expand themselves. Large concessions have been granted to companies falling under MRTP Act. Capital investment limit, fixed earlier, has been removed. As a result, there would be no restriction on dominant companies and industrial houses for setting up new industries or expansion of industries, taking over and amalgamation. However, under this policy, more emphasis will be laid on checking unfair trade practices to safeguard the interest of the consumers. The newly empowered Monopoly Board will be authorised to investigate any matter *suo motu* (on its own) or on complaints received from individual consumers. In 2002, MRTP Act was abolished and in its place a much liberal **Competition Act, 2002** has been enacted.

3. **Replacing FERA with FEMA:** Earlier, for regulating foreign exchange transactions, government had enacted Foreign Exchange Regulation Act (FERA). This Act was very restrictive in nature. It involved various checks and controls on transactions involving foreign exchange. Following the economic liberalisation and the changed attitude of the government towards foreign capital, FERA was replaced with Foreign Exchange Management Act (FEMA) in the year 1999. The provisions of FEMA are liberal.

1. Devaluing the Indian Currency is considered a step towards liberalisation.
1. Under Liberalised Exchange Rate Management System (LERMS), 16% of the foreign exchange reserves could be converted in the market.

Disinvestment

Disinvestment is a process whereby the government withdraws a portion or the total of its equity in a public enterprise. In 1992, the government appointed a committee on disinvestment of shares in public sector enterprise under the chairmanship of **Dr. C. Rangarajan** to suggest measures with regard to disinvestment programmes. In order to expedite the process of disinvestment, the government established a new full-fledged ministry of disinvestment. The UPA government closed the ministry of disinvestment and converted it into a department under the Ministry of Finance.

Disinvestment Policy

The present disinvestment policy has been articulated in the recent President's addresses to Joint Sessions of the Parliament and the Finance Minister's recent parliament budget speeches.

The salient features of the policy are:

- (i) Citizens have every right to own part of the shares of public sector undertakings.
- (ii) Public sector undertakings are the wealth of the nation and this wealth should rest in the hands of the people.
- (iii) While pursuing disinvestment, government has to retain majority shareholding, i.e. at least 51% and management control of the public sector undertakings.

Balance of Payments (BoP)

In India's Balance of Payments (BoP), transactions are recorded in accordance with the guidelines given in the fifth edition of IMF's Balance of Payments Manual (1993), with minor modifications to adapt to the specifics of the Indian situation. The Manual defines BoP as a statistical statement that systematically summarises, for a specific time period, the economic transactions of an economy with the rest of the world. Transactions between residents and non-residents consist of those involving goods, services, and income; involving financial claims on and liabilities to the rest of the world; and those classified as transfers, involving offsetting entries to balance one-sided transactions.

The data are received from the banking system as part of the Foreign Exchange Management Act (FEMA), 1999. The data are received by the Reserve Bank of India mainly from the banking system (authorised dealers) as part of the Foreign Exchange Management Act (FEMA), 1999. The basic structure of the Balance of Payments (BOP) of India consists of:

- (i) **Current account:** Exports and imports of goods, services, income (both investment income and compensation of employees) and current transfers
- (ii) **Capital account:** Assets and liabilities covering direct investment, portfolio investment, loans, banking capital and other capital
- (iii) Statistical discrepancy
- (iv) International reserves and IMF transactions

Maharatnas

The status of Maharatna empowers mega Central Public Sector Enterprises (CPSEs) to expand their operations and

emerge as global giants. The policy of Maharatnas was started in 2010. It gives the mega CPSEs more financial and managerial autonomy. The Maharatnas include

1. Coal India Limited
2. Indian Oil Corporation Limited
3. NTPC Limited
4. Oil & Natural Gas Corporation Limited
5. Steel Authority of India Limited

Navaratnas

In 1997, the government identified nine leading, well-performing and high profit-making public enterprises as *Navaratnas* (Nine Precious Jewels). Later, in the same year, two more were added to the list. They were granted substantial enhanced autonomy and operational freedom in different fields (financial, commercial, managerial, organisational) to facilitate them becoming global players. The 16 public enterprises included in the category of Navaratnas at present are:

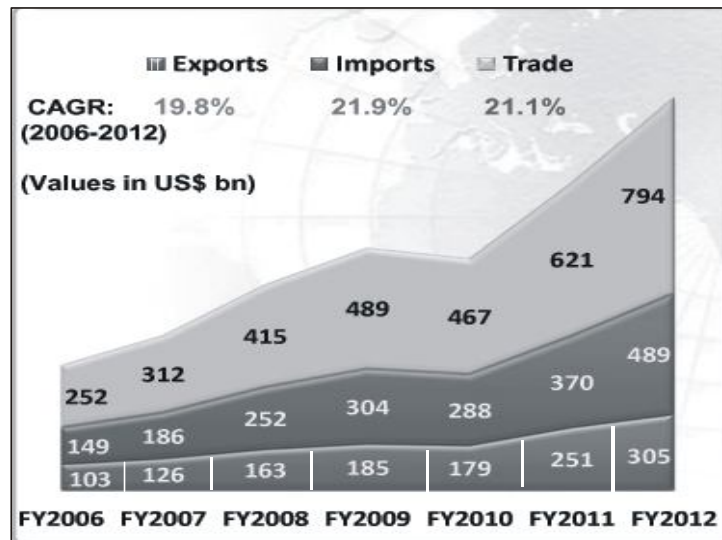
1. Bharat Electronics Limited
2. Bharat Heavy Electricals Limited
3. Bharat Petroleum Corporation Limited
4. GAIL (India) Limited
5. Hindustan Aeronautics Limited
6. Hindustan Petroleum Corporation Limited
7. Mahanagar Telephone Nigam Limited
8. National Aluminium Company Limited
9. NMDC Limited
10. Neyveli Lignite Corporation Limited
11. Oil India Limited
12. Power Finance Corporation Limited
13. Power Grid Corporation of India Limited
14. Rashtriya Ispat Nigam Limited
15. Rural Electrification Corporation Limited
16. Shipping Corporation of India Limited

Miniratnas

In 1997, the Government identified another 97 profit-making public enterprises as Miniratnas (Small Precious Jewels) and granted them financial, managerial and operational autonomy. But these declared mini-gems will be awarded full autonomy only when they are not credit defaulters of the government. In May 2001, the government approved a proposal for periodic review of the Navaratnas and the Miniratnas on the basis of their performance over three years.

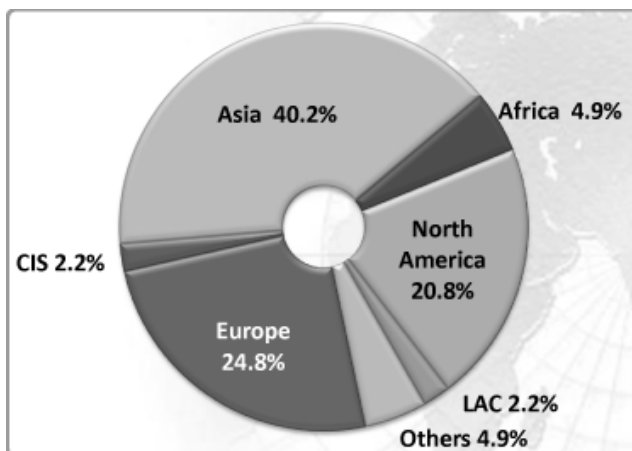
India's International Trade

Towards Increased Global Integration through Trade

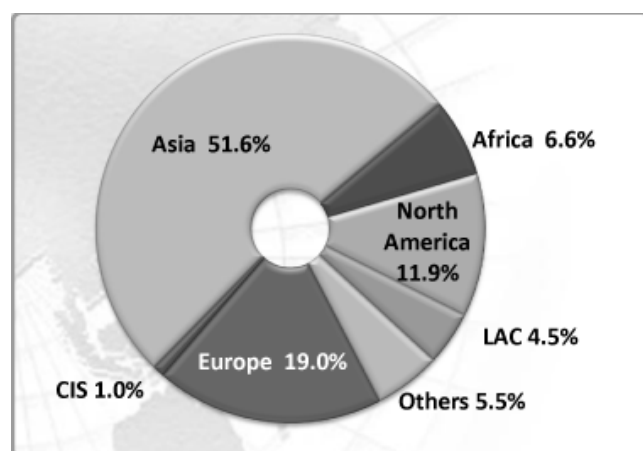


- 1 India's total merchandise trade increased over three-fold from US\$ 252 bn in FY 2006 to US\$ **794 bn** in FY 2012.
- 1 Both exports and imports have **trebled** during the period.
- 1 Trade-GDP ratio increased from 30.2% in FY 2006 to **42.9%** in FY 2012.
- 1 Exports-GDP ratio increased from 12.4% in FY 2006 to **16.5%** in FY 2012.
- 1 Share of India in world merchandise export: **1.67%** in 2011; Rank – 19 (up from 28th in 2006)

India's Export Destinations 2001-02 (US\$ 44 bn)



India's Export Destinations 2011-12 (US\$ 305 bn)



CIS - Common Wealth of Independent States

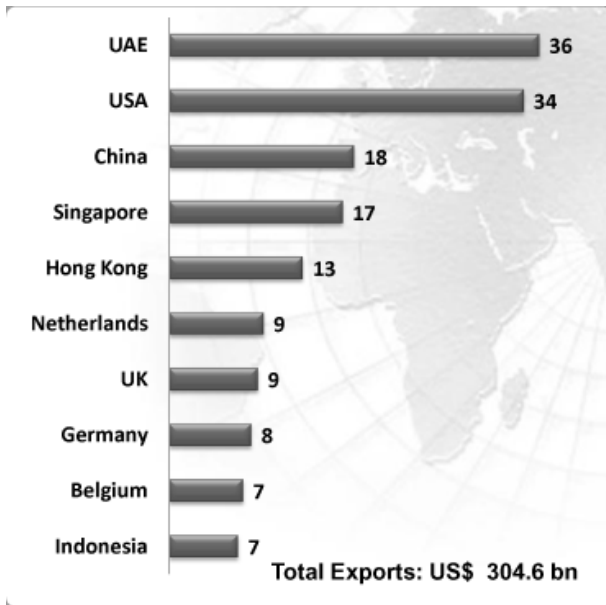
LAC – Latin America & Caribbean region

Source: Ministry of Commerce & Industry, Government of India

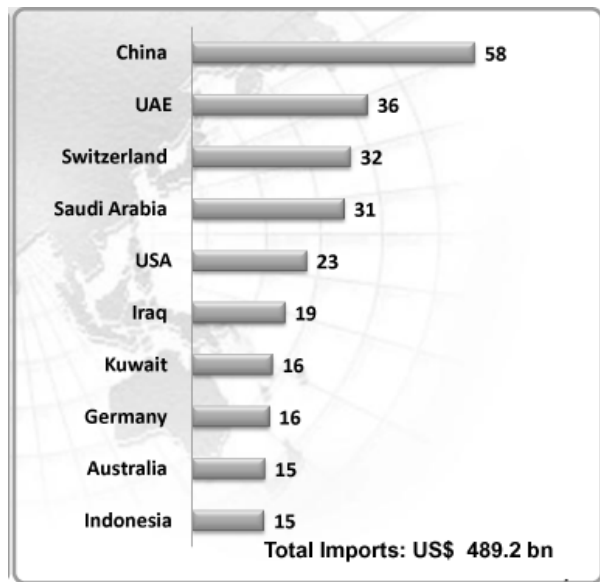
- 1 Direction of exports is moving towards the southern countries, particularly Asia and Africa region.
- 1 Share of Asia, Africa and LAC regions increased sharply from 47% in 2001-02 to **62.7%** in 2011-12. Of this, the share of Asia region rose from 40% to 52% during this period.
- 1 Future trade flows to be geared towards the developing nations (buttressed by GoI policies).

India's Major Trading Partners

Top Export Markets (FY 2012, US\$ bn)



Total Import Sources (FY 2012, US \$ bn)

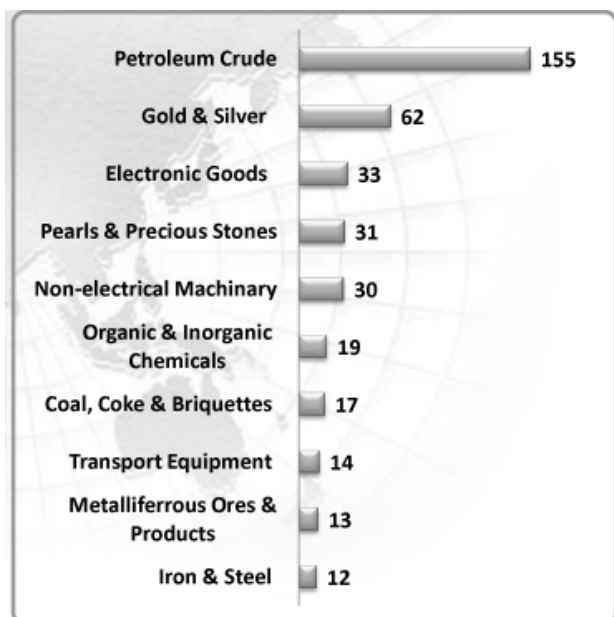


India's Trade Basket

Top Export Items (FY 2012, US\$ bn)



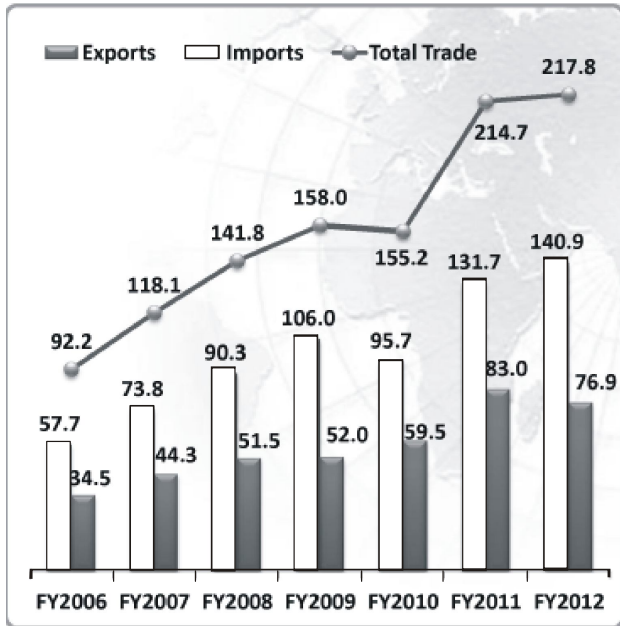
Top Import Items (FY 2012, US\$ bn)



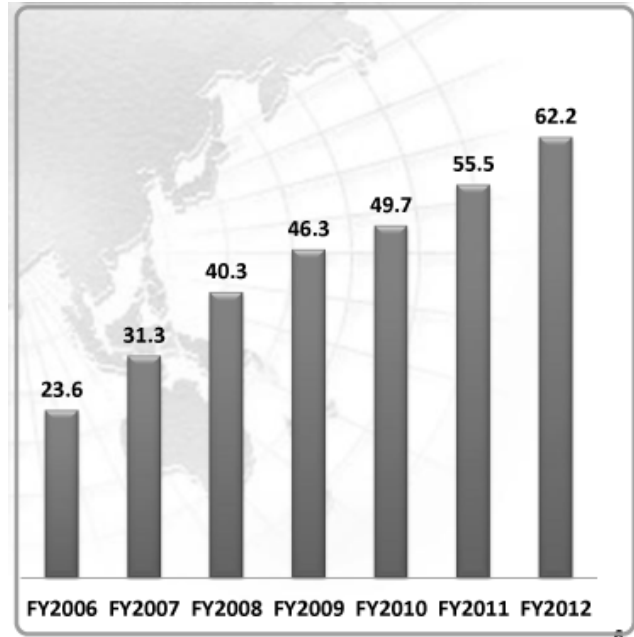
Source: Ministry of Commerce & Industry, Government of India.

India's Trade in Services

Total Trade in Services (US \$ bn)

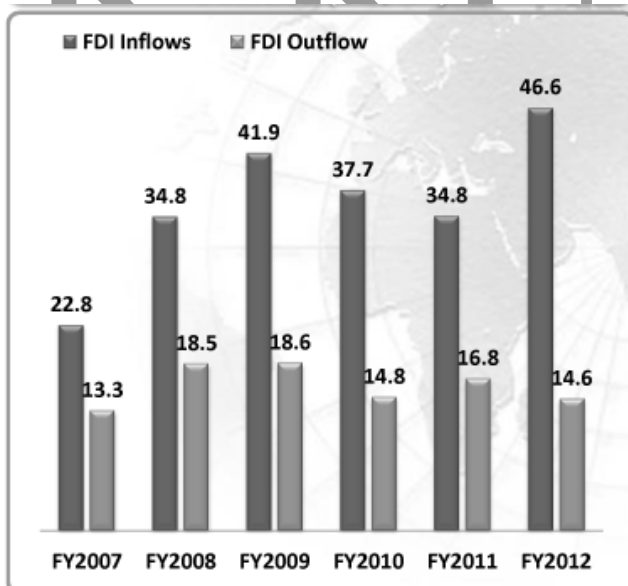


Software Exports (US\$ bn)

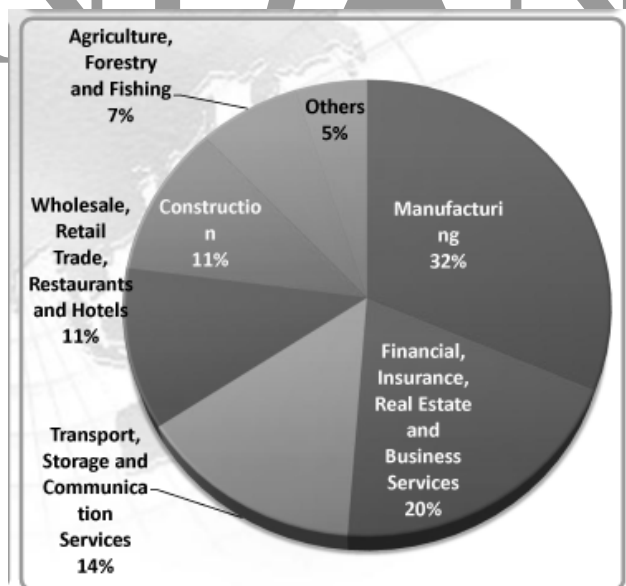


India's Direct Investment Flows

Foreign Direct Investment Inflows & Outflows (US\$ bn)



Sectorial pattern of Indian outward FDI (FY 2012)



* Mauritius was the largest destination of Indian Outward Direct Investment (ODI) in 2011-12, followed by Singapore.

Commerce

Special Economic Zones (SEZs)

India was one of the first in Asia to recognise the effectiveness of the Export Processing Zone (EPZ) model in promoting exports, with Asia's first EPZ set up in **Kandla** in 1965. Seven more zones were set up thereafter. However, the zones were not able to emerge as effective instruments for exports promotion on account of the multiplicity of controls and clearances, the absence of world-class infrastructure, and an unstable fiscal regime. While correcting the shortcomings of the EPZ model, some new features were incorporated in the Special Economic Zones (SEZs) which were announced in April 2000. This policy intended to make SEZs an engine for economic growth supported by quality infrastructure complemented by an attractive fiscal package, both at the Centre and the State level, with the minimum possible regulations. All the 8 Export Processing Zones (EPZs) located at **Kandla** and **Surat** (Gujarat), **Santa Cruz** (Maharashtra), **Cochin** (Kerala), **Chennai** (Tamil Nadu), **Vishakhapatnam** (Andhra Pradesh), **Falga** (West Bengal) and **Noida** (Uttar Pradesh) have been converted into Special Economic Zones.

In order to impart stability to the SEZ regime and to achieve generation of greater economic activity and employment through the establishment of SEZs, **Special Economic Zone Act, 2005** was formed in February 2006 supported by SEZ Rules, 2006.

The main objectives of the SEZ Act are:

- (a) generation of additional economic activity
- (b) promoting of exports of goods and services
- (c) promotion of investment from domestic and foreign sources
- (d) creation of employment opportunities
- (e) development of infrastructure facilities.

In a short span of about five years since SEZs Act and Rules were notified in February 2006, formal approvals have been granted for setting up of 584 SEZs, out of which 381 have been notified. Out of the total employment provided to 6,76,608 persons in SEZs as a whole, 5,41,904 persons in incremental employment were generated after February 2006 when the SEZ Act came into force. This is apart from the millions of days of employment created by the developers for infrastructure activities. Physical exports from the SEZs increased from ₹ 2,20,711.39 crore in 2009-10 to ₹ 3,15,867.85 crore in 2010-11, registering a growth of 43.11%.

A total of 133 SEZs are making exports. Out of this 76 are IT/ITES, 17 multi-product and 40 other sector specific SEZs. The total number of units in these SEZs is 3,290.

MMTC Limited

MMTC Limited is India's largest trading company with a present annual business turnover of about US \$ 15 billion. It is the largest exporter of minerals, from India, leading exporter/importer of agro commodities, single largest importer/supplier of bullion, a major player in the coal and hydrocarbons and non-ferrous metals imports by the country and one of India's largest buyers of finished fertilizers and fertiliser raw materials. The Company commands extensive market coverage in over 65 countries in Asia, Europe, Africa, Oceania and America. The domestic network of MMTC in India has spread across a number of offices, warehouses and retail outlets.

MMTC, currently holding the no. 1 rank amongst trading companies in India, had in 2000-10 further improved upon its already impressive performance by achieving record-level topline consecutively in the seventh year by registering its highest ever turnover of ₹ 68,687 crores.

As a strategy to diversify and add value to its trading operations, MMTC had earlier set up Neelachal Ispat Nigam Ltd. (NINL)—an Iron and Steel Plant of 1.1 million tonnes per annum capacity and 0.8 million tonne coke ovens and byproduct unit with captive power plants — jointly with the Government of Odisha at a total capital outlay of nearly 2000 crores. The construction of Phase II of the project with an estimated cost of ₹ 1,855 crores is under progress.

MMTC opened a new foreign office in Johannesburg, South Africa, in January 2011 to promote business in precious metals, semi-precious stones, coal etc. It has entered into clean power sector that is environment and eco-friendly by setting up and operating a 15-MW wind power farm in Karnataka since 2007.

STC LTD

The State Trading Corporation of India Ltd. (STC) is a premier international trading company of the Government of India with over five decades of experience in undertaking exports, imports and domestic marketing operations.

STC has an equity of ₹ 60 crore, of which, about 91% is held by the Govt. of India and the balance 9% by financial institutions/mutual funds/public. The Corporation has manpower strength of about 860. The Corporation owns tank farms, godowns and warehousing capacities at various locations in India.

Traditionally, STC had been undertaking export/import of agricultural commodities. Over the past decades, it has diversified into many non-agricultural items such as exports of steel raw materials, iron ore, gold jewellery and imports of bullion, hydrocarbons, minerals, metals fertilisers, petrochemicals, etc.

Money and Banking

Money

- 1 Money is that which is generally (legally) regarded as a means of payment in the settlement of all transactions including debt.

Money performs the following functions:

- (a) Medium of exchange
- (b) Unit of account
- (c) Standard of deferred payment
- (d) Store of value
- (e) Basis of credit creation
- (f) Basis of distribution of national income, etc.

Indian Currency

- 1 The Reserve Bank of India manages the currency of India while the responsibility of coinage vests with the Finance Ministry under the Government of India.
- 1 Presently Indian Currency system is based on the **Minimum Reserve System**.

New Monetary Aggregates

It was suggested by the working group constituted in December 1997 under the chairmanship of **Dr. Y.V. Reddy** in 1998.

$M = \text{Currency in circulation} + \text{Demand deposits with Banks} + \text{Other deposits with the RBI}$

$M = M + \text{Time liability portion of savings deposit with banks} + \text{Certificates of deposit issued by banks} + \text{Term deposits with banks maturing within one year (excluding FCNR(B) deposits)}$

$M_3 = M_2 + \text{Term deposits with banks (excluding FCNR}$

(B) of over-one-year maturity + Call/term borrowing of banks

M_4 : Abolished now

$M_0 = \text{Currency in circulation} + \text{Other deposits with RBI} + \text{Cash reserves of bank with the bank itself and with the RBI.}$

Important Nicknames

$M_0 = \text{Reserve Money of the government}$

$M_1 = \text{Narrow Money}$

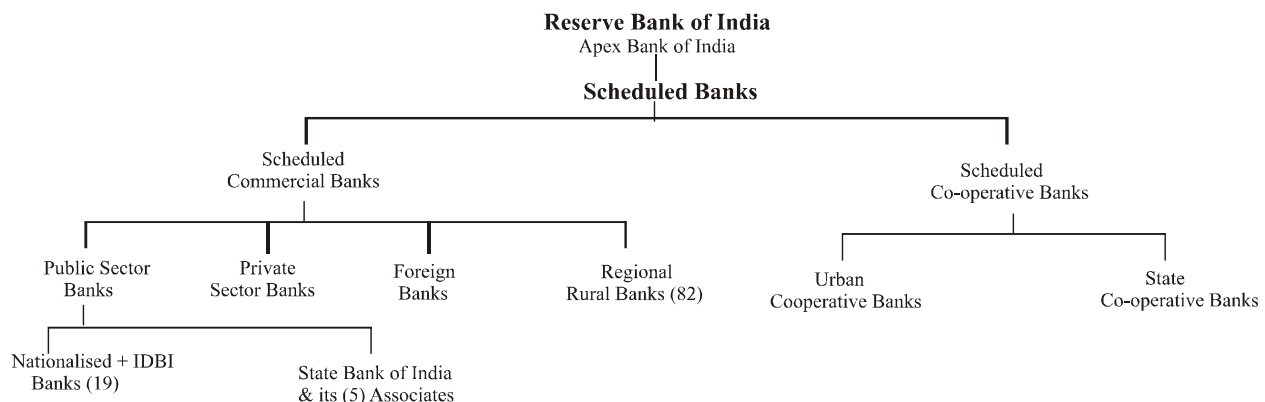
$M_3 = \text{Broad Money}$

$\frac{M_3}{M_0} = \text{Money Multiplier}$

Banking

- 1 The first commercial bank was established in 1770 by Alexander & Company. It was named *Hindustan Bank*. This venture was not successful.
- 1 The **Bank of Bengal** was established in 1806 in Calcutta, the **Bank of Madras** in 1843 at Madras and the **Bank of Bombay** in 1840. These three presidency banks were amalgamated on 27 January 1921 and **Imperial Bank of India** was established.
- 1 On July 1, 1955, the Imperial Bank of India was partially nationalised and it was named **State Bank of India**. At present State Bank of India is the **largest commercial bank of India**.
- 1 **Punjab National Bank** was established in 1894 and it is termed as the first truly Indian Bank as it was established by the Indians only.

Banking Structure in India



Reserve Bank of India

- 1 The Reserve Bank of India (RBI) is the **central bank** and supreme monetary authority of India.
- 1 RBI was established in **April 1935** with its central office at Calcutta under the RBI Act, 1934. Now it has its **headquarters** at **Mumbai** and four local boards at Kolkata, Delhi, Chennai and Mumbai.
- 1 RBI was established, with ` 5 crore as its capital, as a private shareholders' bank.
- 1 RBI was nationalised on **January 1, 1949**.

Functions of RBI

- 1 It acts as a central bank of India.
- 1 It acts as a banker to the central and state governments.
- 1 It announces the annual policy statement (earlier known as monetary and credit policy) to take care of monetary, credit, and other policy aspects of the economy.
- 1 It acts as an advisor to the government.
- 1 It acts as a banker's bank and supervisor.
- 1 It acts as the controller of money supply and credit.
- 1 It manages foreign exchanges.
- 1 It collects and publishes all monetary and banking data.
- 1 It promotes commercial banking, rural (agricultural) credit, industrial finance and export finance.
- 1 It issues currency.
- 1 It acts as *Central Clearing House* for inter-bank transactions.

Printing of Securities in India

- 1 **Indian Security Press, Nasik**
Postal & Judicial Stamps, Bonds, NSC, Kisan Vikas Patra etc.
- 2 **Security Paper Mill, Hoshangabad**
Paper for currency and other securities
- 3 **Bank Note Press, Devas (M.P.)**
Bank Notes
- 4 **Currency Note Press, Nasik**
Bank Notes
- 5 **Security Printing Press, Hyderabad**
Postal and Excise Duty Stamps
- 6 **Modernised Currency Notes Press**
Mysore (Karnataka) and Salboni (West Bengal)

Minting of Coins & Medals

- 1 **Coins Minting:** Mumbai, Kolkata, Hyderabad, Noida
- 2 **Govt. Medals Minting:** Kolkata, Noida

Control of Credit by RBI

The method of credit control used by the RBI can be divided into quantitative control and qualitative control.

Quantitative control

- Bank Rate
- Open Market Operations
- Cash Reserve Ratio

Qualitative control

- Moral Suasion
- Rationing of credit

- Statutory Liquidity Ratio
- Selective Credit Controls

Bank Rate

- 1 It is defined as the standard rate at which RBI is prepared to buy or rediscount bills of exchange or other commercial papers eligible for purchase under the RBI Act.

Cash Reserve Ratio (CRR)

- 1 Scheduled commercial banks are required to keep a certain percentage of their total deposits (Net Demand and Time Liability) in the form of cash reserves with the RBI.

Statutory Liquidity Ratio (SLR)

- 1 It is the ratio of the total deposits of a commercial bank which it has to keep with itself in the form of liquid assets. Liquid assets may consists of cash in hand, reserves with the RBI, excess reserves, government securities and other encumbered securities, gold etc.

Open Market Operations (OMO)

These involve the sale and purchase of government securities by the RBI.

Moral Suasion

Moral suasion is a combination of both 'persuasion' and 'pressure'. The central bank tries to persuade the commercial bank to follow its directive of monetary policy.

Rationing of credit

Rationing of credit refers to fixation of credit quota for different business activities.

Scheduled Banks

- 1 Scheduled Banks are those banks which are included in the second schedule of the RBI Act, 1934. These banks shall fulfil the following conditions:
 - (a) At least ` 5 lakh (now revised to ` 1000 crore as per Damodaran committee) as paid-up capital
 - (b) Any activity of the bank shall not be **derogatory** to the interest of the depositors.
- 1 Those banks which are not included in the second schedule are known as non-scheduled banks.

Liquidity Adjustment Facility (LAF) operating through Repo and Reverse Repo

- 1 **Repo rate** is the short-term interest rate at which banks can park their funds with the RBI.
- 1 **Reverse repo rate** is the rate of interest at which the RBI borrows funds from other banks in the short term.

Public Sector Banks

- 1 **State Bank of India (SBI)** was established after the nationalisation of the Imperial Bank of India in July 1955.

- 1 The **State Bank group** comprises of State Bank of India and its five associates, namely:
 1. State Bank of Bikaner and Jaipur
 2. State Bank of Hyderabad
 3. State Bank of Mysore
 4. State Bank of Patiala
 5. State Bank of Travancore

Nationalised Banks

- 1 The **first nationalisation** of banks took place on 19th July 1969. It included 14 large commercial banks which had reserves of more than ₹ 50 crore.
- 1 The **second nationalisation** took place on April 15, 1980 of those banks which were having reserves of more than ₹ 200 crores.

Presently there are 19 Nationalised Banks:

- | | |
|--------------------------|-------------------------------|
| 1. Allahabad Bank | 2. Andhra Bank |
| 3. Bank of Baroda | 4. Bank of India |
| 5. Bank of Maharashtra | 6. Canara Bank |
| 7. Central Bank of India | 8. Corporation Bank |
| 9. Dena Bank | 10. Indian Bank |
| 11. Indian Overseas Bank | 12. Oriental Bank of Commerce |
| 13. Punjab & Sind Bank | 14. Punjab National Bank |
| 15. Syndicate Bank | 16. UCO Bank |
| 17. Union Bank of India | 18. United Bank of India |
| 19. Vijaya Bank | |

Regional Rural Banks (RRBs)

- 1 The RRBs were set up under the RRB Act of 1976, as per the recommendation of the working group on Rural Banks chaired by **M. Narasimhan**.

Financial Market

Markets exist to facilitate the purchase and sale of goods and services. The financial market exists to facilitate sale and purchase of financial instruments and comprises two major markets, namely the **capital market** and the **money market**. The distinction between the capital market and the money market is that the capital market mainly deals in medium- and long-term investments (maturity more than a year) while the money market deals in short-term investments (maturity up to a year).

Money Market

- 1 RBI is the apex banking institution in the money market.
- 1 Indian money market is divided into organised sector and unorganised sector.
- 1 **Unorganised sector** includes unregulated non-bank financial intermediaries, indigenous bankers, money lenders etc.
- 1 **Organised sector** mainly comprises
 - (a) Call Money Market
 - (b) Treasury Bill Market
 - (c) Repo Market
 - (d) Commercial Bill Market
 - (e) Certificate of Deposit Market
 - (f) Commercial Paper Market
 - (g) Money Market Mutual Funds

Call Money Market

- 1 Call Money Market is a place where borrowing and lending transactions are carried out for one day only.

The call money market is also known as **Inter-Bank Call Money Market**.

Treasury Bills

- 1 In India treasury bills are the short-term liability of the central government.
- 1 It can be issued for a maturity period of **91 days, 182 days** or **364 days**.
- 1 It can have a minimum amount of face value of ₹ 1 lakh and thereafter in multiples of it.
- 1 The rate of interest is market-determined.

Commercial Paper (CP)

Commercial Paper (CP) is an unsecured money market instrument issued in the form of a promissory note.

- 1 It was introduced in India in **1990** with a view to enabling highly-rated corporate borrowers to diversify their sources of short-term borrowings and to provide an additional instrument to investors. Subsequently, primary dealers and all-India financial institutions were also permitted to issue CP to enable them to meet their short-term funding requirements for their operations.
- 1 Corporates, Primary Dealers (PDs) and the All-India Financial Institutions (FIs) are eligible to issue CP.
- 1 A corporate would be eligible to issue CP provided
 - a. The tangible net worth of the company, as per the latest audited balance sheet, is not less than ₹ 4 crore;
 - b. The company has been sanctioned working capital limit by bank(s) or all-India financial institution(s);

- c. The borrowal account of the company is classified as a Standard Asset by the financing banks/ institutions.
- 1 CP can be issued for maturities between a minimum of **7 days** and a maximum of up to **one year** from the date of issue. However, the maturity date of the CP should not go beyond the date upto which the credit rating of the issuer is valid.
 - 1 All eligible participants shall obtain the credit rating for issuance of Commercial Paper either from **Credit Rating Information Services of India Ltd. (CRISIL)** or the **Investment Information and Credit Rating Agency of India Ltd. (ICRA)** or the **Credit Analysis and Research Ltd. (CARE)** or the **FITCH Ratings India Pvt. Ltd.** or other such Credit Rating Agencies (CRAs) as may be specified by the Reserve Bank of India from time to time, for the purpose.

Certificate of Deposit (CD)

- 1 Certificate of Deposit (CD) is a negotiable money-market instrument and is issued in dematerialised form or as a Usance Promissory Note against funds deposited at a bank or other eligible financial institutions for a specified time period.
- 1 Guidelines for issue of CDs are presently governed by various directives issued by the Reserve Bank of India (RBI), as amended from time to time.
- 1 CDs can be issued by (i) Scheduled Commercial Banks (excluding Regional Rural Banks and Local Area Banks); and (ii) All-India Financial Institutions (FIs) that have been permitted by the RBI to raise short-term resources within the umbrella limit fixed by the RBI.
- 1 Banks have the freedom to issue CDs depending on their funding requirements.
- 1 Minimum amount of a CD should be ` 1 lakh, i.e., the minimum deposit that could be accepted from a single subscriber should not be less than ` 1 lakh, and in multiples of ` 1 lakh thereafter.
- 1 CDs can be issued to individuals, corporations, companies (including banks and PDs), trusts, funds, associations, etc. Non-Resident Indians (NRIs) may also subscribe to CDs, but only on non-repatriable basis, which should be clearly stated on the Certificate. Such CDs cannot be endorsed to another NRI in the secondary market.
- 1 The maturity period of CDs issued by banks should not be less than **7 days** and not more than **one year**, from the date of issue.
- 1 The FIs can issue CDs for a period not less than 1 year and not exceeding 3 years from the date of issue.

Capital Market

Capital market is important for raising funds for capital

formation and investments and forms a very vital link for economic development of any country. It provides a means for issuers to raise capital from investors (who have surplus money available from saving for investment). Thus, the savings normally flow from household sector to business or government sector, which normally invest more than they save. A vibrant and efficient capital market is the most important parameter for evaluating health of any economy.

The Indian capital market has two groups – **organised capital market** and **unorganised capital market**. Unorganised capital market comprises long-term borrowing and lending of funds from moneylenders and others. Organised capital market is broadly divided into the **stock exchange operations** and **long-term lending of funds** from the financial intermediaries, banks and non-banks financial intermediaries.

Functions of capital market

The major objectives of the capital market are:

- 1 To mobilise resources for investments.
- 1 To facilitate buying and selling of securities.
- 1 To facilitate the process of efficient price discovery.
- 1 To facilitate settlement of transactions in accordance with the schedules.

Security Market

The security market has two interdependent and inseparable segments, namely, the new issues (primary) market and the stock (secondary) market. The **primary market** provides the channel for the creation and sale of new securities, while the **secondary market** deals in the securities that were issued previously. The securities issued in the primary market are issued by public limited companies or by government agencies. The resources in this kind of market are mobilised either through a public issue or through a private-placement route. If *anybody* can subscribe to the issue, it is a **public issue**; if the issue is made available only to a select group of people, it is known as **private placement**. There are two major types of issuers of securities — **corporate entities**, who issue mainly debt and equity instruments, and the **government** (central as well as state), which issues debt securities (dated securities and treasury bills).

The secondary market enables participants who hold securities to adjust their holdings in response to changes in their assessment of risks and returns. Once new securities are issued in the primary market, they are traded in the stock (secondary) market. The secondary market operates through two mediums, namely, the **over-the-counter (OTC) market** and the **exchange-traded market**. The OTC markets are informal markets where trades are negotiated. Most of the trades in government securities take place in the OTC market. All the spot trades where securities are traded for immediate delivery and payment occur in the OTC market. The other

option is to trade, using the infrastructure provided by the stock exchanges. The exchanges in India follow a systematic settlement period. All the trades taking place over a trading cycle (day = T) are settled together after a certain time (**T + 2 days**). The trades executed on exchanges are cleared and settled by a **clearing corporation**. The clearing corporation acts as a counter party and guarantees settlement. A variant of the secondary market is the **forward market**, where securities are traded for future delivery and payment. A variant of the forward market is the **Futures and Options market**. Presently, only two exchanges in India — the **National Stock Exchange of India Ltd. (NSE)** and the **Bombay Stock Exchange (BSE)** — provide trading in Futures and Options.

Bombay Stock Exchange

BSE Ltd, the first-ever stock exchange in Asia established in **1875** and the first in the country to be granted permanent recognition under the **Securities Contract Regulation Act, 1956**, has had an interesting rise to prominence over the past 138 years.

BSE is a corporatised and demutualised entity with a broad shareholder base which includes two leading global exchanges, **Deutsche Bourse** and **Singapore Exchange** as strategic partners.

BSE provides an efficient and transparent market for trading in equity, debt instruments, derivatives, mutual funds. It also has a platform for trading in equities of Small-and-Medium Enterprises (SMEs).

Around 5000 companies are listed on BSE, making it world's No. 1 exchange in terms of listed members.

BSE Ltd is world's fifth most active exchange in terms of number of transactions handled through its electronic trading system. It is also one of the world's leading exchanges (5th largest) for index options trading.

BSE also provides a host of other services to capital-market participants, including risk management, clearing, settlement, market data services and education. It has a global reach with customers around the world and a nationwide presence. BSE systems and processes are designed to safeguard market integrity, drive the growth of the Indian capital market and stimulate innovation and competition across all market segments.

BSE is the first exchange in India and second in the world to obtain an ISO 9001:2000 certification. It is also the first exchange in the country and second in the world to receive Information Security Management System Standard BS 7799-2-2002 certification for its on-line trading system (BOLT).

It operates one of the most respected capital market educational institutes in the country (the BSE Institute Ltd.). BSE also provides depository services through its Central Depository Services Ltd. (CDSL) arm.

Bombay Stock Exchange has now adopted only its initials BSE as its new name, positioning itself as a national multi-asset financial-infrastructure institution. BSE's strategic shift in approach, attitude and business focus is reflected in its new tagline "**Experience the New**".

BSE's popular equity index — the **SENSEX** — is India's most widely-tracked stock market benchmark index. It is traded internationally on the EUREX as well as leading exchanges of the BRCS nations (Brazil, Russia, China and South Africa).

National Stock Exchange (NSE)

The National Stock Exchange (NSE) is India's leading stock exchange covering various cities and towns across the country. NSE was set up by leading institutions to provide a modern, fully automated screen-based trading system with national reach. The Exchange has brought about unparalleled transparency, speed and efficiency, safety and market integrity. It has set up facilities that serve as a model for the securities industry in terms of systems, practices and procedures.

On its recognition as a stock exchange under the Securities Contracts (Regulations) Act, 1956 in April 1993, NSE commenced operations in the Wholesale Debt Market (WDM) segment in June 1994. NSE started trading in the equities segment (Capital Market Segment) on November 3, 1994 and within a short span of one year became the largest exchange in India in terms of volumes transacted. NSE commenced operations in derivatives segment in June 2000 with the launch of index future. The figure contracts are based on the popular benchmark S&P CNX, Nifty Index. The Exchange introduced trading in Index Options (also based on Nifty) on June 4, 2001. NSE also became the first exchange to launch trading in options on individual securities from July 2, 2001.

Securities and Exchange Board of India (SEBI)

The Securities and Exchange Board of India was established on **April 12, 1992** in accordance with the provisions of the **Securities and Exchange Board of India Act, 1992** for dealing with all matters relating to development and regulation of security market and investor protection.

Mutual Fund

A mutual fund is an investment vehicle that is made up of a pool of funds collected from many investors for the purpose of investing in securities such as stocks, bonds, money-market instruments and similar assets. One of the main advantages of mutual funds is that they give small investors access to professionally managed, diversified portfolios of equities, bonds and other securities, which would be quite difficult (if not impossible) to create with a small amount of capital.

All mutual fund schemes are governed by SEBI regulations.

Stock Market Indices	Country
1 BSE Sensex	India
1 Hang Seng Index	Hong Kong
1 Nikkei 225	Japan
1 Kospi Index	South Korea
1 Kuala Lumpur Composite Index	Malaysia
1 TSEC Weighted Index	Taiwan
1 SSE Composite Index	China
1 Dow Jones	USA
1 NASDAQ Composite Index	USA
1 FTSE Index	UK
1 Jakarta Composite Index	Indonesia

Gilt-Edged market

It refers to the market for government and semi-government securities, backed by the RBI. The securities traded in this market are stable in value and are much sought after by banks and other institutions.

Establishment Year of Important Financial Institutions of India

1 Industrial Finance Corporation of India	1948
1 UTI (Unit Trust of India)	1964
1 IDBI (Industrial Development Bank of India)	1964
1 NABARD (National Bank for Agriculture and Rural Development)	1982
1 SIDBI (Small Industries Development Bank India)	1990
1 EXIM Bank (Export-Import Bank of India)	1982
1 NHB (National Housing Bank)	1988
1 LIC (Life Insurance Corporation)	1956
1 GIC (General Insurance Corporation)	1972

1 RRBs (Regional Rural Banks)	1975
1 HDFC (Housing & Development Finance Corporation Ltd.)	1977

Important Committees

Committees	Appointed for
1 Ghosh Committee	Bank Frauds
1 Goiporia Committee	Bank Customer Services
1 Goswami Committee	Industrial Sickness and Corporate Re-structuring
1 Jilani Committee	Loan System
1 Janakiraman Committee	Securities Transactions of the Banks and Financial Institutions
1 Malhotra Committee	Insurance Sector Reforms
1 Dr. Mehta Committee	Integrated Rural Development Programmes
1 Nadkarni Committee	To evolve an improved procedure for conducting transactions in public sector bonds and mutual funds
1 Ist Narasimham Committee	Banking Sector Reforms
1 IInd Narasimham Committee	Banking Sector Reforms

Devaluation of Indian Currency: Lowering of the value of domestic currency in terms of foreign currencies is called devaluation. A country resorts to devaluation when its exports fall short of imports. As a result of devaluation, imports become dearer and exports cheaper. India devalued its rupee in the years 1949, 1966 and twice in the year 1991. But now this measure is not used, as the exchange rate of rupee with other currencies of the world is determined by market forces of demand and supply and not by the government.

Inflation

Inflation is generally understood as an economic process which denotes a substantial and rapid general increase in the level of prices and consequent deterioration in the value of money over a period of time. Thus, inflation is a sustained rise in price level over a period of time. It can be measured in terms of percentage increase in the price index as a rate per cent per unit of time, say a month or a year.

What is inflation?

- 1 “Inflation is a state in which the value of money is falling or prices are rising.” — **Crowther**
- 1 “The obvious definition of inflation is that inflation is a rising price-level.” — **Edward Shapiro**

- 1 “Inflation is a self-perpetuating and irreversible upward movement of prices caused by excess of demand over capacity of supply.” — **Emile James**
- 1 “Inflation consists of a process of rising prices.” — **A.C.L. Day**
- 1 “Inflation is a general and continuing increase in prices. This does not imply that all prices are increasing, some prices may even be falling, the general trend must be upward. The rise in prices must also be continuing; once and for all price increases are excluded.” — **Michael R. Edmond**

Features of Inflation

Some of the characteristics of inflation are as follows:

- (i) Inflation is associated with a sustained rise in prices. It is different from a temporary price rise.
- (ii) Price rise is persistent and immediately irreversible.
- (iii) Inflation is an economic phenomenon, i.e., the result of economic forces.
- (iv) Inflation is also a monetary phenomenon. Excess supply of money may cause inflation.
- (v) The real value of money shows a falling trend.

Inflation occurs under the following circumstances:

- (i) The quantity of money is increasing but the volume of production is static or is even declining.
- (ii) The quantity of money is stable but the volume of production is declining.
- (iii) The quantity of money as well as the volume of production is increasing but the rate of increase in volume of production is lesser than the rate of increase in the quantity of money.
- (iv) The quantity of money is declining and the volume of production is also declining, but decline in production is higher than the decline in the quantity of money.
- (v) The quantity of money, i.e., supply is in excess of demand or requirements.

As a post-full employment phenomenon

Some economists including **Pigou and Keynes** regard inflation as a phenomenon of full employment. According to Keynes, rising prices in all situations can't be termed inflation. In a situation of underemployment, when an increase in money supply and rising prices are accompanied by an expansion of output and employment, inflation does not occur. But, sometimes, due to bottlenecks in the economy, an increase in money supply may cause costs and prices to rise more than the expansion of output and employment. This is known as **semi-inflation** or **bottleneck-inflation**. However, once a level of full employment is reached, the entire increase in money supply is reflected by rising prices. This, according to Keynesian view, is a case of true inflation.

Causes of inflation in India

- (i) Increase in government expenditure
- (ii) Expansion of money supply
- (iii) Deficit financing
- (iv) Bank credit
- (v) Black money
- (vi) Population growth
- (vii) Over-dependence on agriculture
- (viii) Natural calamities
- (ix) Dependence on imports
- (x) Miscellaneous factors

Types of inflation

Demand-Pull Inflation: It occurs when excessive demand for commodities pulls up their prices. This is the conventional inflationary situation of 'too much money chasing too few goods'.

Cost-Push Inflation: It occurs when wages and other costs rise and the producers are successful in passing on the higher costs to the consumers in the shape of higher prices.

Hyperinflation: It refers to a situation of runaway inflation reaching even up to 100 per cent per annum. It also refers to rapid inflation in which prices increase so fast that money loses its importance as a medium of exchange.

Changes in price level are measured by the following:

- 1 Wholesale Price Index (WPI)
- 1 Consumer Price Index (CPI)
- 1 Gross Domestic Product (GDP) Deflator

GDP deflator, which distinguishes between physical growth in output and price rise, gives an accurate picture of the overall price level. Theoretically, the growth in physical output in an economy has to be matched by a corresponding growth in monetary flows. Any mismatch between the two gets reflected in the growth-rate and price changes. Monetary policy aims at managing the balance between growth in real flows and growth in monetary flows.

WPI, CPI and GDP Deflator

The new series of **Wholesale Price Index (WPI)** with **2004-05** as the base year has a weighted average of indices covering **676 commodities**, which are traded in primary, manufacturing, and fuel and power sectors. WPI is thus a measure of inflation of an economy on a wider scale. **Services** do not figure in this, as there is usually no wholesale price for services. The weightage for **primary articles** is only **20.11 per cent**, reflecting the structural changes in the economy.

Consumer Price Index (CPI) is the retail price average of a **basket of goods** and **services** directly consumed by the people. It is, therefore, a more accurate benchmark for measuring inflation than WPI. At present, CPI uses **2001** as the **base year** measure. It is computed separately by the Labour Bureau, Government of India for the following three groups: (i) CPI for **Industrial workers**, (ii) CPI for **Rural labourers** and (iii) CPI for **Agricultural labourers**.

The **GDP Deflator** is arrived at by dividing GDP at current prices by GDP at constant prices in terms of base-year prices. This indicates as to how much of the growth in GDP in a year is due to price rise and how much due to increase in output. GDP deflator is now available only annually with a gap of one year.

Base years: One of the problems in the history of price rise in post-independent India is that the government of India has been changing the **base year** every 10 years. WPI (**1950-**

51=10) was given up in mid-60s and a new series with **1960-61** as base was introduced. Subsequently, it was shifted to **1970-71** and later to **1981-82**. This was revised to **1993-94** and finally to **2004-05**. Such shifts in the base year are necessary to reflect the fast structural changes in India's economy as shown in the relative importance of agriculture and industry and by changes in production and consumption pattern of certain commodities.

Measures to control inflation

Inflation has to be controlled in the beginning itself, otherwise it will take the shape of hyper-inflation, which might ruin the economy. The methods used to control inflation are generally known as anti-inflationary measures. Their main attempt is to reduce the aggregate demand for goods and services on the assumption that inflation is due to demand pull. The following are the anti-inflationary measures:

(i) Monetary Policy: It is the policy of the central bank of the country to use methods such as bank rate, open market operations, the reserve ratio and selective controls in order to control the credit-creation operation of the commercial banks and thus restrict the amount of bank credit in the country. This is called **tight money policy**.

(ii) Fiscal Policy: It is the policy of the government with regard to taxation, expenditure and public borrowing. The government will introduce new taxes and raise the rate of existing taxes with the purpose to reduce the purchasing power in the hands of the public. Also, the government expenditure should be reduced so that the demand for goods and services is further reduced. Lastly, public debt (i.e., the debt of the government) may be managed in such a way that the supply of money in the country is controlled.

(iii) Control over Investment: Controlling investments is considered necessary because, due to the multiplier effect, the initial investment leads to large increase in income and expenditure and the demand for both the consumer and the capital goods goes up speedily. Therefore it is necessary that the resources of the community should be employed for investment which does not have the effect of increasing inflation.

(iv) Price Control and Rationing: Price control implies the fixing of the upper limits beyond which prices of particular goods should not rise. The purpose of rationing is to distribute the goods in short supply in an equitable manner among all the people. This is generally the most effective method during war when monetary and fiscal policies do not yield any significant result.

(v) Increased Production: Another important measure to combat inflation is to increase the supply of goods through either increased production or increased imports.

(vi) Compulsory Savings: Schemes of compulsory savings may be introduced by the government to take from

each person certain portion of his earnings. Its main object is to check inflation and provide for future security.

Deflation

Deflation denotes the economic phenomenon when prices are falling and fall in prices is accompanied by a decreasing level of employment, output and income. While inflation implies excess demand over the available supply, deflation implies deficiency of demand to lift what is supply. When the supply of goods is more than its demand, there is their fall in prices. Thus, deflation arises when the total expenditure of the community is less than the value of output at existing prices. As a result, the value of money goes up and the prices fall.

It should be noted that merely falling prices cannot be called deflation. When the inflationary trend in prices is reversed by the government measures without creating unemployment and fall in output, the phenomenon is known as **disinflation**. Deflation, on the other hand, is an under-employment phenomenon as it means falling prices accompanied by a decreasing level of employment, output and income.

Effects of Deflation

Deflation is considered undesirable for an economy because of the following reasons:

(i) Effects on Production: Deflation has got an adverse effect on the levels of production, employment, income and investment climate. Since prices fall rapidly without a corresponding fall in the cost of production during deflation, producers incur heavy losses and so have to curtail investment and employment. Some firms even have to go into liquidation because of huge losses. Thus, there is a general fall in production, employment, investment and income. Business pessimism emerges and, gradually, a state of depression develops in the economy.

(ii) Effects on Distribution: Deflation has an adverse effect on the distribution of wealth and income too. The share of profit earners in the total national income decreases and that of fixed wage group increases. Thus, deflation favours the consumer class as the value of money increases. Investors in fixed interest-bearing securities, renters and fixed income earners stand to gain. Creditors also tend to gain at the expense of debtors. The debtors do not have adequate means to repay their loans and thus may have to go into liquidation.

Control of Deflation

Deflation can be controlled by taking the following measures:

(i) The monetary authorities should follow cheap-money policy to avoid depression. They should use bank rate policy and open market operations to raise the volume of credit by the banks. It is felt that with the increase in

- the level of credit, there will be an increase in the levels of investment, production and employment.
- (ii) The government should attempt to reduce the level of taxation so as to leave a larger amount of purchasing power with the public. The government should also resort to deficit financing (i.e., expenditure in excess of revenues). It should increase its expenditure on public works programmes to increase the level of employment. There will, thus, be more income with the people who will spend money on consumer items leading to a stimulation to increase production by the businessmen.
 - (iii) The government may resort to price support programme, under which the government may fix the prices below which the goods will not be sold and will also undertake to buy the surplus stocks from the producers.
 - (iv) The government may give subsidies to poor and unemployed people so that they survive the depressionary trend and continue to demand the essential items of consumption.

Inflation vs Deflation

Generally, it is believed, that deflation is exact opposite of inflation. But this is not so because inflation is rise in prices unaccompanied by increase in employment and output while deflation is fall in prices accompanied by decreasing employment and output. The other points of difference between inflation and deflation are discussed below:

1. **Impact on Income:** Inflation does not reduce the income of the community; it only distorts the distribution of income among various classes. Deflation, on the other hand, reduces national income through contraction of production.
2. **Impact on Society:** Inflation is always demoralising for the society as it introduces the spirit of gambling. It is unjust as it promotes speculation and hoarding and diverts business skill and efficiency from productive purposes to speculative purposes. On the other hand, deflation is inexpedient since it increases the level of unemployment in the economy because of contraction of production. Thus, the whole society suffers in case of deflation.

3. **Erosion of Savings:** Inflation erodes real savings of the people by reducing the value of money, but during depression there is lack of purchasing power because of fall in employment level and in investment activities.
4. **Control:** Inflation can be controlled by adoption of various monetary and fiscal measures in a co-ordinated manner, but it is very difficult to control deflation. Once the deflationary trend starts, it injects pessimism into businessmen, who stop further investment, which ultimately leads to depression. It is very difficult for the monetary authority to control deflation.

The above discussion clearly shows that *inflation is unjust and deflation is inexpedient*. Keynes showed a preference for inflation because it is the lesser of the two evils. Inflation is a post-full employment phenomenon whereas deflation is an under-employment phenomenon which aggravates the problem of unemployment which no country wants to face.

In case of developing economies, a mild inflation can stimulate economic development leading to increase in employment and production. Nonetheless, the dangers of inflation should always be kept in mind because once it goes out of control, it will give rise to hyperinflation which no economy can withstand.

Stagflation

It is not at all necessary that inflation is accompanied by a growth in employment. In the recent years, many countries of the world have been experiencing a situation in which price levels have been rising continuously, and simultaneously there has been a rise in the rate of unemployment and stagnation in the rate of growth. Such a situation has been termed *stagflation* by Samuelson. "Stagflation involves inflationary rise in prices and wages at the same time so that people are unable to find jobs, and firms are unable to find customers for what their plants can produce." Thus, when inflation is accompanied by recession in an economy, stagflation is said to exist.

Indian Taxation System

1. Proper taxation system is of great significance for the economic development of the country.
1. Taxes are mainly of two kinds:
 - (1) Direct Tax
 - (2) Indirect Tax

Economists distinguish between the impact and the incidence of a tax. The **impact** refers to the levying of the tax; the person who pays the tax to the government. The **incidence** refers to who bears the burden of the tax. According to the traditional school, impact of tax is the point at which (or upon

whom) a tax is imposed whereas incidence of tax means the eventual distribution of burden of tax. For example: The impact of sales tax is upon a shopkeeper or on a seller because sales tax is imposed upon sellers. In the course, every seller may shift the burden of that tax to the buyer by increasing the price. Thus the burden of tax eventually falls upon the buyer. This is the incidence of a tax. In other words, the impact point of sales tax is the seller and its incidence point is the buyer. A fee is charged ("levied") by government on products, income, or activity. If the tax is levied directly on personal or corporate income, then it is a direct tax. If the tax is levied on the prices of goods and services, then it is called indirect tax.

The purpose of taxation is to finance govt expenditure. One of the most important uses of taxes is to finance public goods and services, such as street-lighting and street-clearing.

Direct taxation is the tax which is collected directly from the individual who earns an income. Examples of direct tax are corporate taxes, income taxes etc.

Indirect taxation is the tax which is collected indirectly.

1. Income tax was imposed for the first time in 1860 by Sir **James Wilson**.

Direct and Indirect Taxes in India

Direct Tax	Indirect Tax
Personal Income Tax	Excise Duty
Corporation Tax	Customs Duty
Wealth Tax	Value Added Tax
Gift Tax	Service Tax
Land Revenue	Central Sales Tax
Profession Tax	Passenger Tax
Stamp Duty and Registration Charges	Entertainment Tax
Securities Transaction Tax	Electricity Duty
	Motor Vehicles Tax

Suggestions for Improvement

With a view to reforming the Indian taxation system the government had appointed many committees such as:

- (1) John Mathai Taxation Inquiry Commission – 1953
- (2) Kaldor Report – 1956
- (3) Direct Tax Enquiry Committee – 1970
- (4) Mahavir Tyagi Report – 1958
- (5) Bhoothalingam Committee – 1957
- (6) Wanchoo Committee – 1977
- (7) Raj Committee – 1972
- (8) Jha Committee – 1977
- (9) Choksi Committee – 1977
- (10) Raja J. Chelliah Committee – 1992
- (11) Kelkar Committee – 2002

Government Efforts to Improve Taxation System

It is only in the post-independence era that government made efforts to reform the taxation system in India. In this respect, the government has accepted and implemented the recommendations of the following commissions, committees and reports.

Voluntary Disclosure of Black Money

Although **Wanchoo Committee** was not in favour of voluntary disclosure scheme regarding black money, yet the government provided this facility and succeeded in unearthing black money to some extent. In 1997-98, through voluntary disclosure of income scheme, total disclosures amounted to ` 33,000 crore and the total taxes earned by the government on this scheme amounted to ` 10,500 crore.

Raja J. Chelliah Committee

The Committee submitted its report to the government in February 1992. The following are its main recommendations:

- (i) The tax system and its burden must be acceptable to the tax-payers. The maximum rate of income tax should not exceed 40 per cent of the total income.
- (ii) The tax system should be more income-elastic.
- (iii) Many concessions should be provided to Special Economic Zones (SEZs).

Tax Reform Measures in Budget 2012-13

1. The basic exemption limit for personal income tax was increased in general to 2 lakh; for senior citizens to 2.50 lakh and for very senior citizens (age 80 years or more), basic exemption limit is ` 5 lakh. In 2011-12, the age for ability of senior citizens was reduced from 65 years to 60 years.
1. The personal income tax rates for individuals and Hindu Undivided Family (HUF) were modified as under:
 - (a) 10 per cent for income between ` 2 lakh and ` 5 lakh.
 - (b) 20 per cent for income between ` 5 lakh and ` 10 lakh.
 - (c) 30 per cent for income above ` 10 lakh.
1. The tax rate on foreign companies was reduced from 65 per cent to **40 per cent**.
1. Education cess on income tax and surcharge was raised from 2 per cent to **3 per cent**.
1. A new category of assessee 'very senior citizens' was introduced in budget 2011-12. People in the age limit of 80 years and above were classified as very senior citizens. The exemption limit for very senior citizens was kept at ` 5,00,000.
1. New 'Direct Tax Code' is proposed to be effective very soon.

Reforms in Custom Duties

- 1 Customs duty on specified raw materials and on machinery used in leather, footwear industry, sports goods, textile industry, biotech sector, power generation, construction of national highways was fully exempted.
- 1 SEZ units were exempted from payment of customs duty on all imported inputs.

Reforms in Excise Duties

For the last many years the government has been making persistent efforts to reform excise tax structure, e.g. lowering of the tax rates, discontinuing of exemptions, adopting ad valorem duty rates, etc. It has enabled the domestic industry to compete in the international market. The major reforms in excise duty structure are:

Modified Value Added Tax (MODVAT) was started in 1986 for improving excise tax system. This scheme continued till

2000-01. In year 2001-02, the government adopted **Central Value Added Tax (CENVAT)** in place of MODVAT. VAT is charged on value additions in each stage of production or distribution. For example, when raw materials are changed into work in process, some value addition takes place. Similarly when work in process is converted into finished goods, again some value addition takes place. In VAT, tax is charged on each stage of value addition. In 2008-09, the general CENVAT rate on all goods was reduced from 16 per cent to 14 per cent. In 2009-10, excise duty was reduced to 8 per cent to boost the economy to come out of economic recession. In 2011-12, excise duty was enhanced to 10 per cent. In 2012-13 general excise duty was further raised to 12 per cent.

Reforms in Service Tax

For the year 2012-13, the rate of service tax was increased from 10 per cent to 12 per cent.

Socio-Economic Indicators

Poverty

Poverty is a social phenomenon wherein a section of society is unable to fulfil even its basic necessities of life. The UN Human Rights Council has defined poverty as “a human condition characterised by the sustained or chronic deprivation of the resources, capabilities, choices, security and power necessary for the enjoyment of an adequate standard of living and other civil, cultural, economic, political and social rights.”

Types of Poverty

Poverty has two aspects: (1) Absolute poverty (2) Relative poverty.

1. Absolute Poverty: It is a situation in which the consumption or income level of people is less than some minimum level necessary to meet the basic needs as per the national standards. It is expressed in terms of a poverty line.

2. Relative Poverty: It is expressed in the form of comparison of the levels of income, nutrition or consumption, or expenditure of the poor strata vis-a-vis the rich strata of the society. It shows the extent of inequality.

Measurement of poverty in India

In India, poverty is estimated by the Planning Commission on the basis of the data collected by the National Sample Survey Organisation (NSSO). NSSO conducts large sample surveys after an interval of every five years. It conducted a

large sample survey in 2004-05 as the 61st round of survey.

The Planning Commission estimates the incidence of poverty at the national and the state level, using the methodology recommended by the Expert Group on Estimation of Proportion and Number of Poor (**Lakdawala Committee**).

The Planning Commission has defined the poverty line on the basis of the minimum recommended (by Indian Council for Medical Research) nutritional requirement of **2400 calories per person per day** in rural areas and **2100 calories per person per day** in urban areas. On this basis poverty line is estimated at the monthly per capital expenditure level of ` 328 for rural areas and ` 454 for urban areas at 1999-2000 prices.

NC Saxena Committee

The Committee, constituted by the Ministry of Rural Development for suggesting a methodology for estimation of BPL households in rural areas, observed that the national poverty line at ` 356 per capita per month in rural areas and ` 539 per capita per month in urban areas at 2004-05 prices permitted both rural and urban people to consume about 1,820 calories as against the desired norm of 2,400/2,100 calories. Hence, a large number of the rural poor got left out of the BPL status benefits as in order to consume the desired norm of 2,400/2,100 calories, the cut-off line for determining BPL status should have been around ` 700 in rural areas and ` 1,000 in urban. The Committee therefore recommended that the percentage of people entitled to BPL status should be

revised upwards to at least 50 per cent though the calories norm of 2,400 would require this to be 80 per cent.

Tendulkar Committee

The Committee was set up by the Planning Commission for the estimation of the poverty ratio in the country. The Committee *inter alia* suggested to base the estimation of future poverty lines on the basis of urban poverty line based on Mixed Reference Period (MRP) and to give up the calories norm for estimating poverty. Based on this methodology, according to the Committee, the percentage of BPL in 2004-05 was 37.2 per cent and the rural poverty stood at 41.8 per cent.

Population Below Poverty Line (BPL): In India, inequality of income is also determined by the number of people living below the poverty line. As per Tendulkar Committee methodology (accepted by the Planning Commission) in the year 2009-10, the persons whose monthly expenditure is less than ` 860 in urban areas and ` 673 in rural areas at 2009-10 prices are treated as persons living below the poverty line.

Poverty in India (Tendulkar methodology)

Area	2004-05		2009-10	
	No. of People	Percentage Below Poverty Line	No. of People	Percentage Below Poverty Line
Rural	32.58 crore	45.0%	27.82 crore	33.8%
Urban	8.14 crore	25.5%	7.65 crore	20.9%
Combined	40.72 cr	37.2%	35.47 cr	29.5%

SR Hashim Committee

In light of no uniform methodology followed by the States/UTs to identify the urban poor, the Planning Commission set up an expert group under the chairmanship of Professor S.R. Hashim to recommend the methodology for identification of BPL families in urban areas.

Human Development Report (HDR)

1. **HDR** is brought up by the United Nations Development Programme (UNDP) in every calendar year, whereas the **World Development Report** is brought by the World Bank in every financial year.
1. HDR is based on the Human Development Index, which was for the first time given by **Mahbub-ul-Haq** of Pakistan in 1990, in partnership with the Indian economist, **Amartya Sen**. The first HDR was published in 1990.
1. HDR brings various indices:
 1. HDI (Human Development Index) – introduced in HDR 1990

2. GDI (Gender-Related Development Index) – introduced in HDR 1995
3. GEM (Gender Empowerment Measures) – introduced in HDR 1995
4. HPI (Human Poverty Index) – introduced in 1997
5. TAI (Technology Achievement Index) – introduced in 2001

Note: HPI-I: Measures Human Poverty in developing countries.

HPI-II: Measures Human poverty in developed countries.

Human Development Index

HDI is prepared on the basis of three indicators.

1. Life Expectancy at birth (Longevity)
2. Education Level Attained (Literacy) with 2/3rd weightage to adult literacy and 1/3rd weightage to combined enrolment ratio
3. Standard of living (Per Capita Income)

Unemployment

Unemployment simply means a situation when able and willing people are not getting jobs as per their own capabilities. Unemployment in India is structural in nature, i.e. productive capacity is inadequate to create a sufficient number of jobs. This is a chronic phenomenon.

Rural Unemployment

In Indian villages more than 80% of the labourers are engaged in agricultural activities.

In the rural areas of India, the main problem is that of disguised unemployment and seasonal unemployment.

(i) **Disguised Unemployment:** Disguised unemployment is a situation wherein the number of workers engaged in a job is much more than actually required to accomplish it. If some of them are withdrawn from that job, the total production will not fall. Thus such employees will be treated as disguisedly unemployed. The marginal productivity of such unemployed persons is zero.

(ii) **Seasonal Unemployment:** It is another kind of rural unemployment. It occurs simply because agriculture is a seasonal occupation. Crops are grown according to their respective seasons. During off-season, the farm workers are usually rendered idle.

The volume of seasonal unemployment depends upon the condition and methods of cultivation in different states. It is estimated that a farmer who grows one crop in a year usually remains unemployed for 5 to 7 months.

Urban Unemployment

Unemployment problem in the urban sector can be divided into two parts:

Industrial Unemployment: It includes those illiterate

persons who are willing to work in industries, mining, transport, trade and construction activities etc.

Many industries in India are resorting to labour-saving devices as in Western countries. This has emerged as yet another sector contributing to the value of industrial unemployment.

Educated Unemployment: In India the problem of unemployment among the educated class is also quite grave. This type of unemployment is a great danger to the stability and security of the country.

Common Types of Unemployment

In India, following types of unemployment are found in urban and rural areas:

- (i) **Open Unemployment:** Open unemployment refers to a treated situation wherein there is the necessary ability to work, yet the person does not get work. This type of unemployment is usually found among agricultural labourers, educated persons and those who come from villages to urban areas in search of job but fail to get any work.
- (ii) **Structural Unemployment:** It occurs due to structural changes in the economy. Structural changes are broadly of two types:
 - a) Changes in technology, as a result of which old technocrats are no longer needed; they are rendered unemployed.
 - b) Change in the pattern of demand, because of which certain industries are closed down and the workers are thrown out.

India presently suffers mainly from structural unemployment, which exists in open and disguised forms.

- (iii) **Under-employment:** Under-employment is a situation in which a worker gets work for less time than the time he can work. In other words, he remains unemployed for some months in a year or some hours everyday.

According to National Sample Survey statistics, if a person works for **28 hours** in a week he will be called extremely under-employed. According to International Conference of Labour Statistics, the condition of under-employment is found, when

- a) persons engaged in part-time work are prepared to do more work than they are actually doing.
 - b) the productivity and the income of the persons increase if shifted from their existing occupation to another occupation.
- (iv) **Frictional Unemployment:** Some people quit their job and look for something better. At any time some workers will be between job transitions. Some of them will be voluntarily moving from one job to another, while some might have been fired and will be hunting for some other job. Unemployment of this sort is called frictional unemployment. Frictional unemployment is inevitable, since people find it desirable to change jobs, and such job changes often involve a period of temporary unemployment.

Development/Welfare Programmes

National Social Assistance Programme (NSAP)

Coming into effect from 15th August, 1995, this programme represents a significant step towards the fulfilment of the Directive Principles in **Article 41** of the Constitution. The programme introduced a National Policy for Social Assistance for the poor and aims at ensuring minimum national standard for social assistance in addition to the benefits that states are currently providing or might provide in future.

Presently NSAP comprises the following **five schemes**:

- (i) **Indira Gandhi National Old Age Pension Scheme (IGNOAPS):** Under the scheme, BPL persons aged 60 years or above are entitled to a monthly pension of ` 200 up to 79 years of age and ` 500 thereafter.

- (ii) **Indira Gandhi National Widow Pension Scheme (IGNWPS):** BPL widows aged 40-79 years are entitled to a monthly pension of ` 300.
- (iii) **Indira Gandhi National Disability Pension Scheme (IGNDPS):** BPL persons aged 18-79 years with severe and multiple disabilities are entitled to a monthly pension of ` 300.
- (iv) **National Family Benefit Scheme (NFBS):** Under the scheme, a BPL household is entitled to a lumpsum amount of money on the death of the primary breadwinner aged between 18 and 59 years. The amount of assistance is ` 20,000.
- (v) **Annappurna:** Under the scheme, 10 kg of foodgrains per month is provided free of cost to those senior citizens who, though eligible, have remained uncovered under IGNOAPS.

National Pension System (NPS)

The National Pension System is an attempt towards providing adequate retirement income to every citizen of India. NPS aims at ensuring financial security to every citizen by encouraging them to start contributing towards old-age saving. It has been designed to enable the subscribers to make optimum decisions regarding their future through systematic savings during their employment. NPS seeks to inculcate the habit of saving for retirement amongst the citizens.

Initially launched for Central Government employees, it was later offered to employees of various state governments, corporate, and individuals belonging to unorganised sectors and economically disadvantaged sections (NPS-Lite).

In order to promote NPS and extend NPS benefits to maximum possible target beneficiaries, the Government of India has recently launched “Swavalamban” scheme.

Swavalamban Scheme

Following the announcement in the Union Budget 2010, then Union Finance Minister Shri Pranab Mukherjee inaugurated “Swavalamban”, a pension scheme for the unorganised sector, on 26th September, 2010 at **Raghunathganj** under the Jangipur Sub-Division of Murshidabad District and distributed **PRAN (Permanent Retirement Account Number) Cards** to a few beneficiaries.

The Swavalamban Scheme is a co-contributory pension scheme whereby the Central Government would contribute a sum of ₹ 1,000 per annum in each NPS account opened having a saving of ₹ 1,000 to ₹ 12,000 per annum. The Swavalamban Scheme is targeted to benefit anganwadi workers, construction workers, occupational classes like weaver, fishermen, farmers, dairy workers, etc.

The scheme is applicable to all citizens in the unorganised sector who join the New Pension System (NPS) administered by the interim Pension Fund Regulatory and Development Authority (PFRDA).

The Union Cabinet approved in April 2012 the extension of funding support for implementing the Swavalamban Scheme under the New Pension System (NPS) from the present three years to five years for all subscribers who were enrolled during 2010-11, 2011-12 and 2012-13. The exit norms of the Scheme have been relaxed to enable subscribers under Swavalamban to exit at the age of 50 years instead of 60 years, or a minimum tenure of 20 years, whichever is later.

This will benefit 70 lakh workers of the unorganised sector till **2016-17**.

Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA), 2005

- 1 Every household in rural areas living below poverty line has right to at least **100 days** of guaranteed employment to at least one adult member of the family in each year.
- 1 Wages in this scheme are paid at statutory minimum wage rate of the state. For example, for the year 2012-13 this wage rate is ₹ 191 per day in Haryana, ₹ 166 per day in Punjab, ₹ 157 per day in Himachal Pradesh, ₹ 133 per day in Rajasthan, ₹ 125 per day in Uttar Pradesh, etc. The wage disbursement in MGNREGA is through workers’ accounts which are to be opened in banks or post offices.
- 1 Employment is provided for generating productive assets in rural areas like constructing roads, irrigation projects, etc.
- 1 Work is provided within **15 days** of demand.
- 1 If work is not provided within the prescribed 15 days time then unemployment allowance is paid, which is equal to 1/3 of the statutory minimum wages.
- 1 Workers working under this scheme are covered under **Employees’ Compensation Act**.
- 1 For administrative support, the government has recommended for the recruitment of one **Gram Rozgar Sewak Sahayak** in each panchayat and one **Programme Officer** in each block.
- 1 The Gram Panchayat will monitor the work under this scheme in its village.
- 1 90 per cent expenses of this scheme (which are expected to be 1 per cent of GDP) are borne by the Central Government. This programme is implemented in three phases. By the year 2008-09, it had covered the whole of India.
- 1 In MGNREGA, at least **33 per cent** of the total beneficiaries have to be women.

Indira Awaas Yojana (IAY)

Indira Awaas Yojana (IAY) was launched during 1985-86 as a sub-scheme of Rural Landless Employment Guarantee Programme (RLEGP) and continued as a sub-scheme of Jawahar Rozgar Yojana (JRY) since its launching in April 1989. It has been delinked from the JRY and has been made an independent scheme with effect from January 1, 1996.

Objective

The objective of IAY is primarily to provide grant for construction of houses to members of Scheduled Castes/Scheduled Tribes, freed bonded labourers and also to non-SC/ST rural poor below the poverty line.

The target group for houses under IAY will be people below poverty line living in rural areas belonging to Scheduled

Castes/Scheduled Tribes, freed bonded labourers and non-SC/ST subject to the condition that the benefits to non-SC/ST should not exceed 40% of total IAY allocation during a financial year.

From 1995-96, the IAY benefits have been extended to ex-servicemen, widows or next of kin of defence personnel and para-military forces killed in action irrespective of the income criteria subject to the condition that (i) they reside in rural areas; (ii) they have not been covered under any other scheme of shelter rehabilitation; and (iii) they are houseless or in need of shelter or shelter upgradation.

Bharat Nirman

The programme for building infrastructure and providing six basic amenities to rural areas, including **rural housing, irrigation, drinking water, rural roads, electrification and communication**, was launched on 16 December 2005.

PURA

Provision of Urban Amenities to Rural Areas (PURA) is a strategy for rural development in India. The concept was given by former president Dr. A.P.J. Abdul Kalam.

The scope of the scheme is to select private partners to develop livelihood opportunities, urban amenities and infrastructure facilities to prescribed service levels and to be responsible for maintenance of the same for a period of ten years in select Panchayats/cluster of Panchayats. Private sector entities having experience in development and management of community-oriented infrastructure projects shall be selected through an open competitive bidding process based on rigorous qualifications and evaluation criteria. The selected private partners would be required to provide amenities like water supply and sewerage, roads, drainage, solid waste management, street lighting and power distribution and undertake some economic and skill development activities as part of the PURA project. The private partners may also provide add-on revenue-earning facilities such as village-linked tourism, integrated rural hub, rural market, agri-common services centre, warehousing etc. in addition to the abovementioned amenities. Where the PURA project spans several Panchayats in a cluster, the private partner would propose sub-projects with the PURA elements for each of the Panchayats.

The leveraging of public funds with private capital and management expertise for creation and maintenance of rural infrastructure is the essence of the PURA scheme, which is envisioned to act as the catalyst not only for convergence between different infrastructure development schemes but also for the new model for the management of urbanisation of rural areas.

Self-Help Groups

Self-Help Group is a homogeneous group of micro entrepreneurs with affinity among themselves, voluntarily formed to save whatever amount they can conveniently save out of their earnings and mutually agree to contribute to a common fund of the group from which small loans are given to the members for meeting their productive and emergent credit needs at such rate of interest, period of loan and other terms as the group may decide.

Objectives

- 1 To meet the credit needs of the poor by combining flexibility, sensitivity and responsiveness of the informal credit system with the strength of technical and administrative capabilities and financial resources of the formal credit institutions.
- 1 To build mutual trust and confidence between the bankers and the rural poor.
- 1 To encourage banking activity both on thrift and credit side in a segment of the population that formal financial institutions usually find difficult to cover.

Antyodaya Anna Yojana

In this scheme foodgrains at subsidised rates of **2 per kg for wheat** and **3 per kg for rice** are provided to the poorest of poor families. Subsidised foodgrains weighing 35 kg per family per month are distributed through public distribution system to the poorest of poor families from amongst the below poverty line families. The coverage of this Yojana has increased to 2.43 crore families in the year 2009-10.

Aam Admi Bima Yojana (AABY)

In the year 2007, AABY was framed by the government for rural landless households in the age group of **18 to 59 years** for life insurance. In this Yojana, the head of family or one earning member of the family is insured. The Central Government bears 50 per cent of the premium of ₹ 200 per person per year and the remaining 50 per cent premium is borne by the state government. In case of natural death ₹ 30,000 and in case of accidental death ₹ 75,000 are provided.

CAPART

The **Council for Advancement of People's Action and Rural Technology (CAPART)** was set up in September 1986 by the amalgamation of the People's Action for Development India (PADI) and Council for Advancement of Rural Technology (CART). It is a society registered under the Societies' Registration Act 1980 and operates as an autonomous body under the aegis of the **Ministry of Rural Development**, Government of India, with headquarters at New Delhi. Today,

this agency is a major promoter of rural development in India, assisting over 12,000 voluntary organisations across the country in implementing a wide range of development initiatives.

Aadhaar Card

Aadhaar (formerly called **UID Numbers**) is a 12-digit unique number which the **Unique Identification Authority of India (UIDAI)** issues for all the residents of the country.

Aadhaar is the most complex data management system the world has ever known. A **12-digit unique number** is to be issued to all residents — a number that will mean a lot. When fully operational, the system will cover 1200 million people.

UIDAI was constituted in January 2009. **Nandan M Nilekani** (who co-founded infosys and was its co-chairman) joined as the Chairman of the Authority in July 2009.

The first Aadhaar number was allotted to a lady **Ranjana Sonawane**, who lives in a tribal village in Maharashtra in September 2010.

Women and Child Development Programmes

A separate ministry of Women and Child Development came into existence from **30th January 2006** with the prime intention of addressing gaps in state action for women and children.

Indira Gandhi Matritva Sahyog Yojana (IGMSY): It is a conditional cash transfer scheme under which cash incentive of 4000 is provided in 3 instalments to pregnant women of 19 years and above.

STEP: With a view to ensuring employment and income generation of marginalised women through training and skill upgradation for self-employment, the scheme **Support to Training and Employment Programme for Women (STEP)** was launched as a Central sector scheme in 1986-87. The scheme seeks to provide updated skills and new knowledge to poor and assetless women in 10 traditional sectors, i.e., Agriculture, Animal Husbandry, Dairying, Fisheries, Handlooms, Handicrafts, Khadi and Village Industries, Sericulture, Waste Land Development and Social Forestry for enhancing their productivity and income generation.

Rajiv Gandhi Scheme for Empowerment of Adolescent Girls (RGSEAG) — SABLA: It will be implemented initially in 200

districts selected across the country, using the platform of Integrated Child Development Services (ICDS). The Government of India had launched a programme called **Kishori Shakti Yojana (KSY)** in 2000 to improve the nutrition and health status of adolescent girls (**aged 11 to 18**), to equip them to improve and upgrade their home-based and vocational skills, and to promote their overall development, including awareness about their health, personal hygiene, nutrition and family welfare and management.

Subsequently, another programme called the **National Programme for Adolescent Girls (NPAG)** was initiated as a pilot programme in 51 identified districts to address the problem of under-nutrition among adolescent girls by providing 6 kilograms of free foodgrains per month per beneficiary. However, on evaluation, it was found that both the schemes had more or less similar objectives and addressed the same target groups. It was, therefore, decided to merge the two schemes into the new comprehensive scheme, called **Rajiv Gandhi Scheme for Empowerment of Adolescent Girls — SABLA**. Apart from the 200 districts where SABLA will be tried out, the old schemes of KSY and NPAG will continue as before in all the other districts.

Swadhar

The Swadhar Scheme was launched by the ministry during the year 2001-02 as a central sector scheme for providing holistic and integrated services to women in difficult circumstances such as destitute widows, deserted by their families in religious places like Vrindavan and Kashi, women prisoners released from jails and without family support, women survivors of natural disasters who have been rendered homeless and are without any social and economic support, trafficked women/girls rescued or runaway from brothels, women victims of terrorist violence who are without any family support and without any economic means for survival, mentally challenged women who are without any support of family or relatives and women with HIV/AIDS deserted by their families and without social/economic support etc.

Ujjawala

Ujjawala is a comprehensive scheme for prevention of trafficking, with five specific components – Prevention, Rescue, Rehabilitation, Reintegration and Repatriation of victims of trafficking. It was launched on 4th December, 2007.

Various Development Programmes at a Glance

S. No.	Employment Generation Programme	Year of Beginning	Objective/Description
1	Employment Guarantee Scheme of Maharashtra	1972	To assist the economically weaker sections of the rural society
2	Crash Scheme for Rural Employment (CSRE)	1972	For rural employment
3	Training Rural Youth for Self-Employment (TRYSEM)	1979	Programme for training rural youth for self-employment
4	Integrated Rural Development Programme (IRDP)	1980	All-round development of the rural poor through a programme of asset endowment for self-employment
5	National Rural Employment Programme (NREP)	1980	To provide profitable employment opportunities to the rural poor
6	Rural Landless Employment Guarantee Programme (RLEGP) 1983		For providing employment to landless farmers and labourers
7	Self-Employment to the Educated Unemployed Youth (SEEUY)	1983	To provide financial and technical assistance for self-employment
8	Self-Employment Programme for Urban Poor (SEPUP)	1986	To provide self-employment to the urban poor through provision of subsidy and bank credit
9	Jawahar Rozgar Yojana	1989	For providing employment to the rural unemployed
10	Nehru Rozgar Yojana	1989	For providing employment to urban unemployed
11	Scheme of Urban Wage Employment (SUWE)	1990	To provide wages employment after arranging the basic facilities for the poor people in the urban areas where population is less than one lakh
12	Employment Assurance Scheme (EAS)	1993	To provide employment of at least 100 days in a year in village
13	Swarna Jayanti Shahari Rozgar Yojana (SJSRY)	1997	To provide gainful employment to the urban unemployed and under-employed poor through self-employment or wages employment
14	Swarnajayanti Gram Swarozgar Yojana (SGSY)	1999	For eliminating rural poverty and unemployment and promoting self-employment Note: The Swarnajayanti Gram Swarozgar Yojana (SGSY) has now been restructured as National Rural Livelihood Mission.
15	Jai Prakash Narayan Rozgar Guarantee Yojana (JPNRGY)	Proposed in 2002-03 budget	Employment guarantee in most poor districts
16	National Rural Employment Guarantee Scheme	2006	To provide at least 100 days' wages employment in rural areas
17	Sampoorna Grameen Rozgar Yojana	2001	To provide wages employment and food security in rural areas and also to create durable economic and social assets

18	Food for Work Programme	2001	To give food through wages employment in the drought-affected areas in eight states. Wages are paid by the state governments partly in cash and partly in foodgrains.
19	Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA)	2005	To create a right-based framework for wage employment programmes and make the government legally bound to provide employment to those who seek it
20	Prime Minister's Employment Generation Programme (PMEGP)	2008	To generate employment opportunities in rural as well as urban areas through setting up of new self-employment ventures/projects/micro enterprises

Other Development Programmes

S. No.	Other Development Programmes	Year of Beginning	Objective/Description
1	Housing and Urban Development Corporation	1970	Loans for the development of housing and provision of resources for technical assistance
2	Members of Parliament Local Area Development Scheme (MPLADS)	1993	To sanction ` 1 crore per year to every member of the Parliament for various development works in their respective areas through the district magistrates
3	Scheme for Infrastructural Development in Mega Cities (SIDMC)	1993	To provide capital through special institutions for water supply, sewage, drainage
4	Scheme of Integrated Development of Small and Medium Towns	Sixth Five Year Plan	To provide resources and create employment in small and medium towns for prohibiting the migration of population from rural areas to big cities
5	District Rural Development Agency (DRDA)	1993	To provide financial assistance for rural development
6	National Slum Development Programme	1996	Development of urban slums
7	Integrated Rural Development Programme (IRDP)	1980	All-round development of the rural poor through a programme of asset endowment for self-employment
8	Development of Women and Children in Rural Areas (DWCRA)	1982	To provide suitable opportunities of self-employment to the women belonging to the rural families who are living below the poverty line

Rural Development Programmes

S.No.	Rural Development Programme	Year of Beginning	Objective/Description
1	Community Development Programme (CDP)	1952	Overall development of rural areas with people's participation

2	Rural Electrification Corporation	1969	Electrification in rural areas
3	Accelerated Rural Water Supply Programme (ARWSP)	1972-73	For providing drinking water in villages
4	Crash Scheme for Rural Employment	1972-73	For rural employment
5	National Institution for Rural Development	1977	Training, investigation and advisory organisation for rural development
6	National Rural Employment Programme (NREP)	1980	To provide profitable employment opportunities to the rural poor
7	Development of Women and Children in Rural Areas (DWCRA)	1982	To provide suitable opportunities of self-employment to the women belonging to the rural families who are living below the poverty line
8	Rural Landless Employment Guarantee Programme (RLEGP)	1983	For providing employment to landless farmers and labourers
9	National Fund for Rural Development (NFRD)	1984	To grant 100% tax rebate to donors and also to provide financial assistance for rural development projects
10	Council for Advancement of People's Actions and Rural Technology (CAPART)	1986	To provide assistance for rural prosperity
11	Service Area Account (SAA)	1988	A new credit policy for rural areas
12	Jawahar Rozgar Yojana	1989	For providing employment to rural unemployed
13	Agriculture and Rural Debt Relief Scheme (ARDRS)	1990	To exempt bank loans up to ₹ 10,000 of rural artisans and weavers
14	Supply of Improved Toolkits to Rural Artisans	1992	To supply modern toolkits to the rural craftsmen except the weavers, tailors, embroiderers and tobacco labourers who are living below the poverty line
15	District Rural Development Agency (DRDA)	1993	To provide financial assistance for rural development
16	Mahila Samridhi Yojana	1993	To encourage rural women to deposit in post office savings account
17	Swarna Jayanti Gram Swarozgar Yojana	1999	For eliminating rural poverty and unemployment and promoting self-employment
18	Pradhan Mantri Gramodaya Yojana	2000	To fulfil the basic requirements in rural areas
19	Pradhan Mantri Gram Sadak Yojana (PMGSY)	2000	To line all villages with pucca roads
20	Bharat Nirman	2005	Development of rural infrastructure including six components : irrigation, water supply, housing, road, telephone and electricity
21	National Rural Employment Guarantee Scheme (NREGS)	2006	To provide at least 100 days' wage employment in the rural areas
22	Indira Awaas Yojana	1999	To help construction of new dwelling units as well as conversion of unserviceable kutcha houses into pucca/semi-pucca by the members of

			SC/STs, freed bonded labourers and also non-SC/ST rural poor below the poverty line by extending them grant-in-aid
23	National Rural Livelihood Mission	2011	To reduce poverty among the rural BPL by promoting diversified and gainful self-employment and wage employment opportunities which would lead to an appreciable increase in income on a sustainable basis
24	Pradhan Mantri Adarsh Gram Yojana (PMAGY)	2010	Integrated development of scheduled castes-dominated villages in the country
25	Sampoorna Gramin Rozgar Yojana	2001	To provide additional wage employment in the rural areas as also food security, along with the creation of durable community, social and economic infrastructure in rural areas
26	Twenty Point Program	1975	Poverty eradication and raising the standard of living
27	Drought Prone Areas Programme (DPAP)	1973-74	To minimise the adverse effects of drought on production of crops and livestock and productivity of land, water and human resources, ultimately leading to drought-proofing of the affected areas
28	Annapurna Scheme	2000	To ensure food security for all, create a hunger-free India in the next five years and to reform and improve the public distribution system so as to serve the poorest of the poor in rural and urban areas

Child Welfare Programmes

S.No.	Child Welfare Programmes	Year of Beginning	Objective/Description
1	Integrated Child Development Services (ICDS)	1975	It is aimed at enhancing the health, nutrition and learning opportunities of infants, young children (0-6 years) and their mothers.
2	Creche Scheme for the children of working mothers	2006	Overall development of children, childhood protection, complete immunisation, awareness generation among parents on malnutrition, health and education.
3	Reproductive and Child Health Programme	1951	To provide quality integrated and sustainable primary healthcare services to the women in the reproductive age group and young children and special focus on family planning and immunisation.

4	Pulse Polio Immunisation Programme	1995	To eradicate poliomyelitis (polio) in India by vaccinating all children under the age of five against polio virus
5	Sarva Shiksha Abhiyan	2001	All children in school, Education Guarantee Centre, Alternate School, 'Back-to-School' camp by 2003; all children complete five years of primary schooling by 2007; all children complete eight years of elementary schooling by 2010; focus on elementary education of satisfactory quality with emphasises on education for life; bridge all gender and social category gaps at primary stage by 2007 and at elementary education level by 2010; universal retention by 2010
6	Kasturba Gandhi Balika Vidyalaya	2004	To ensure access and quality education to the girls of disadvantaged groups of society by setting up residential schools with boarding facilities at elementary level
7	Mid-day Meal Scheme	1995	Improving the nutritional status of children in classes I–VIII in Government, Local Body and Government-aided schools, and EGS and AIE centres; encouraging poor children belonging to disadvantaged sections, to attend school more regularly and help them concentrate on classroom activities. Providing nutritional support to children of primary stage in drought-affected areas during summer vacation.
8	Integrated Programme for Street Children	1993	Provisions for shelter, nutrition, healthcare, sanitation and hygiene, safe drinking water, education and recreational facilities and protection against abuse and exploitation of destitute and neglected street children.
9	The National Rural Health Mission	2005	Reduction in child and maternal mortality, universal access to public services for food and nutrition, sanitation and hygiene and universal access to public healthcare services with emphasis on services addressing women's and children's health universal immunisation, etc.