Basic Concepts of Economy

Economics as a word comes from the Greek language where "Oikos" means family, household or estate and nomos" means management .Thus household management or management of scarce resources is the essential meaning of economics.Economics includes production, distribution, trade & consumption of goods and services. Economics is the study of how societies use scarce resources to produce valuable products and distribute them among different people.

1.Branches of economics

a)Micro Economics (Detailed study in depth about individual entity):-
It examines economic behaviour of individuals such as consumers, households etc to understand how decisions are made in the face of scarcity and what effects they will have on the larger economy.eg studying an automobile firm(TVS showroom in chandni chowk Delhi) or studying about a farmer.

1.1 Macroeconomics is a branch of economics dealing with the performance, structure, behavior, and decision-making of an economy as a whole. This includes regional, national, and global economies. **It is a** study of aggregated indicators such as GDP, unemployment rates, national income, price indices, and the interrelations among the different sectors of the economy to better understand how the whole economy functions. Eg: *The economy is in recession.*

2. Economics and Economy

Production, tradethe**Economy** is, "the relationship between production, trade and the supply of money in a particular country or region". It is dynamic and deals with applied part of economics.eg: Indian Economy and U.S. Economy etc.
Economics is a science that studies economies and develops possible models for their functioning. It also includes theoretical part also . eg: *He studied economics at the LSE (London School of Economics).*

3. Types of Economies :

3.1 Capitalist Economy

Existence of private enterprise in the main sphere of production is the main parameter for capitalism. Private Enterprise means a system of production based on private ownership of capital.
Capital can be physical assets like land, factories , machines or it can be money. There is existence of concept of supply and demand by which buyers and sellers determine which goods and services will be bought and sold in the market ,in what quantities and at what prices.
Focus is always on profit maximization and not on the welfare of people.

Capitalist economies are the type of economies in which business is largely controlled and owned by, the private sector. Thus, there is virtual absence or only little presence of the public sector in economic activity. In these economies, the state plays the role of the regulator only. The private sector plays the role of investor. In these economies, prices of goods as well as services are determined by market forces of demand and supply.

Advantages

1. There is sufficient incentive in the form of increase in wealth for private individuals to work hard. Thus, there is overall efficiency in the economy leading to lower cost of production of various reserved commodities.
2. There are many private players producing the same output. Thus, there is a very high competition in these economies. High competition and economic incentives encourage innovation in these economies.

3. Prices are determined by markets and not by governments. Thus, prices reflect the actual value at which customers are willing to buy and sellers are willing to sell.

Disadvantages

1. In a capitalist economy, prices of even essential commodities are determined by market forces. Thus, the prices of essential commodities may escalate to such a level where these commodities are unaffordable for a larger section of population.

2. The private sector is the main employer. The approach of the private sector is to use minimal workforce to produce maximum output. Machines are preferred over human beings to carry out work. Thus, these economies may have large unemployment rate despite high levels of economic growth.

3. The income levels are grossly unequal. A large section of the population owns little wealth, and a tiny section of the population owns large wealth.

4. Common man's interest at times likely to be jeopardized, in the interest of Investor.

*** Capitalist economies are also liberalized, privatized, as well as globalized economies. This is because in these economies there are a few restrictions, there is high presence of the private sector, and these economies are more inter-related to other economies of the world.

On the other hand, socialist economies are less liberalized, have no (or less) presence of the private sector and have no (or less) trade with other economies of the world.

3.2 Socialist Economy

Existence of public enterprise i.e., there is state ownership of capital in all important spheres of productive activity. There is centralized planning for production & distribution. Government decides what to produce according to the needs of the people. It is assumed that the Government knows what is good for the people of the country.

The means of production are owned by the government .It produces everything and decides how goods are produced and distributed.

Even in socialist economy, Private enterprises are allowed but only for consumption and for small level of production activities.

In socialist economies, business is largely controlled and owned by the state. Thus, there is virtual absence or only, little presence of private-sector investment. In these economies, the state plays the role of both investor and regulator. In these economies, prices of goods and services are determined the state.

Advantages

1. In a socialist economy, prices of essential commodities are deliberately kept low to enable access to everyone.

2. The government is the main employer. It attempts to provide employment to a maximum number of people.

3. Profits on investments will accrue to the Government which can be used for development and public welfare.

4. The income levels of large population are similar and the Primary Objective of socialist economy is to achieve equality in the society.

Disadvantages

1. Economic activity is under government control. Government undertakings are usually inefficient Moreover; there is a lack of economic incentive for private individuals other than fixed salary. Thus, there is overall inefficiency in the economy leading to higher cost of production of various commodities.
2. The whole economic output of these economies is produced by large government undertakings that have monopoly in their respective fields. Thus, there is virtual no competition in these economies. Lack of competition and absence of economic incentives discourage innovation in these economies.

3. Inefficiency in production causes shortage of various commodities. Consequently, black markets develop for various commodities.

4. Bureaucratic rule and Government regulations will be impediments in efficient functioning and system tends to be more corrupt owing to lack of transparency.

3.3 Mixed Economy

Factors of production are owned by both private and public enterprises. Some firms engaged in production are owned by government & some by private owners. Though the private enterprises are owned by individual owners, they are still subject to government control.

The government can regulate the working of private enterprises in India to safe guard public interest through different provisions of law.eg.treatment of industrial waste before discharging it into river bodies. Apart from publicly owned & privately owned firms, there are also firms which are owned joint by private shareholders and government. These firms are neither wholly in public sector nor in private sector category and can be said to be in the joint sector

3.4 Keynesian Economics

During great Depression of USA, an economist John Keynes said that if USA wanted to get over recession, it should follow expansionist policies i.e., the Government to come into play and start spending. Earlier Laissez Faire prevailed in USA and the government did not interfere in the market. According to him, State can stimulate economic growth and restore stability in the economy by expansionary policies.eg.By decreasing the tax rate, providing loans at cheaper rates of interest, by increased public spending on infrastructure.

This theory is very important because it suggests ways as to how to come out of a financial crisis.

Eg. Quantitative Easing done by US Federal Reserve and EU Central Bank, stimulus packages provided by Indian government between 2008 to 2010, by the United States of America to overcome the sub-prime crisis , and by China pumping stimulus investing in creating massive infrastructure after economic slowdown in 2007.

The Depression of 1929 showed that market wasn't perfect. Even market could fail. The intervention by the state is done in the down time of economic cycle. In the normal times, the market drives the growth.
The only drawback of Keynesian economics is that it leads to increased fiscal deficit(The government keeps spending and gets no returns).(Fiscal deficit will be discussed in the chapter fiscal policy) And increased money in market which ultimately leads to inflation.

Keynes also suggested the capitalist economies to adopt some of the features of socialist economy. Government should provide the basic facilities. Keynes suggested the capitalist order to assimilate the goals and some features of socialist economics.

In a capitalist economy, everything was provided by private enterprises via the market (i.e. regulated according to demand).It resulted in the capitalist getting richer & labourers getting poorer. It affected the purchasing power of labourers & hence decreased the demand of goods. The ultimate result was the great depression of 1929-1935.

Due to his advice, the governments started supplying some basic goods and services called public goods to people for free or at subsidesed prices.eg.healthcare, sanitation, education etc.
Prof. Lange in 1950s advised the socialist economics to adopt some features of capitalist economics and move towards market socialism but the communist political system were stubborn and rejected the advice.
It ultimately led to the breakdown of USSR in 1991,but China adopted open door policy in 1978 and today it is the largest economy of the world in PPP terms.

Laissez faire

It is the more extended form of free market economy. It means "allow to do" or "Let do".
There is no government intervention such as regulation, privileges, tariffs and subsidies, beyond what is necessary to maintain individual security and liberty. The role of state is to protect private property.

4. Three Sectors of the economy

The three sector hypothesis is an economic theory which divides economies into 3 sectors of activity.

According to the theory, as an economy progresses ,its main focus shifts from the primary to secondary and finally to the tertiary sector. If the economy follows this transition there is increase in employment and hence quality of life.

Countries in early state of development have low income. The main part of their national income is achieved through production in the primary sector. Countries in a more advanced state of development with a medium national income generate their income mostly in the secondary sector. In highly developed countries with high income, the tertiary sector dominates the total output of the countries.
The sectors of economy are :

4.1 Primary Sector:- It involves changing natural resources into primary products. Most products from this sector are considered raw material for other industries. It includes agriculture, fishing, forestry, mining, Quarrying .It is a larger sector in developing countries.
4.2 Secondary Sector :- It includes those economic sectors which create finished, usable products. It includes manufacturing & construction. It takes the output of primary sector & manufactures finished goods.
4.3 Tertiary Sector :- It is the exclusion of other two sectors. It is also called service sector. (the economic activities not mentioned in the above two sectors).The tertiary sector involves provision of services to business as well as to final consumers.Transport, banking, insurance, retail, tourism,IT,BPO, etc.

5. National Income

The income of a nation has no relevance to its geographical area or the size of the population. India occupies 2 per cent of the world's surface area making it eight times as larger as Germany or Japan and in population is the second largest in the world, with 17 per cent of world's population. Had these parameters been considered for defining the the national income, India should rank among the world's most developed countries. Many African countries richly endowed with material resources are quite poor.

People meet their material needs through their command over their range of goods and services like food and comforts. These goods and services are not directly available in the nature. They must be produced with the involvement of human efforts. Because individual can supply only a small fraction of their daily needs, they are invariably dependent on the whole community for supply of their other needs. All of the society within or outside, is involved in producing them for us.

Thus the national income is the total value in Rupees or currency of goods and services society produces in a year to meet the requirement of the material needs. However all the goods produced in a given tear do not count as society's income. Production takes two sets of inputs i.e. input materials and labour. Both kinds of inputs are required. To obtain ant set of material outputs. For example to raise crops of Rice, we require rice seeds, fertilizer and farm equipment in addition to labour. Sometimes the material inputs themselves are the result of production like the seeds of last year's crop , organic manure is produced by farmer or there are industries that produce fertiluizer and farm machinery.

Fig: Process of Production

Some inputs like seed, Fertilizer etc. are exhausted in the same year and needs replacement in the next year. Some others like farm machinery etc need to be replaced after a gap of few years. This means a part of material outputs produced annually must be devoted to replace inputs regularly, The production would not be viable, unless the society can maintain its production at existing level.

5.1 Gross National Income (GNI) is defined as GDP (Gross Domestic Product; income generated by production activities on economic territory of that country) plus the net receipts from wages, salaries, property income taxes, and subsidies of the country's citizens abroad minus the income earned in the domestic economy by nonresidents.

Final goods and intermediate goods

Final goods are the goods that are consumed by the customer. They are not used in the production of another goods.Eg.1kg Tomato bought & consumed by making it into a type of chutney.Here tomato is a final good.

Intermediate goods are those goods which are used to make final goods. Eg. 1kg tomato bought by Kissan Sauce Co. The company makes sauce out of it and sells the sauce in the market.Here tomato is an intermediate good and sauce is final good.

Only final goods are included while measuring national income. If intermediate goods were also included, this would lead to double counting.

5.2 Factors of production and factor Incomes

Land labour capital and entrepreneur are the factors of production and rent,wages,interest and profit are the corresponding factor incomes.

5.3 Four sectors of the economy

From the economic point of view, a mixed economy can be divided into four sectors:

1. Private sector: All the enterprises owned by the private individuals or group of individuals belong to the private sector. The private sector consists of companies/firms/enterprises in India which are not owned by the government.

2. Government sector: This sector includes public administration, police, defense, framing of laws and enforcing them. Apart from imposing taxes and spending money on various infrastructure and healthcare services and education etc., government also undertakes production activity through its companies like coal India limited(CIL),Steel Authority of India limited(SAIL) etc. So all the companies owned by the central or State governments i.e. Public Sector undertakings (PSUs) also belong to the government sector.

3. Household Sector: A household is a single individual who takes decisions relating to his own consumption, or a group of individuals for whom decisions relating to consumption are jointly determined. So if a single individual is living alone then he will be considered as one household. And if a person is living with his wife and two children then all the four will constitute one household as the decisions relating to consumption of food and other items are decided jointly. We should always remember that households consist of people. These people work in firms as workers and earn wages. They are the ones who work in the government departments and earn salaries and they are the owners of firms and earn profits. So all the human beings (population) belong to the household sector.

4. External Sector: This sector consists of the exports and imports of goods and services flowing into the country or out of the country. It also includes the financial flows from and into the domestic country.

6. GDP (Gross Domestic Product)

It is defined as the market value of all final goods & services produced by the factors of production located within the boundary of a country during a period of 1 year.In India GDP is calculated by CSO(Central Statistical Organization),which comes under the ministry of Statistics and Programme Implementation.

How to measure GDP

Three different ways are used :-

- Output Approach
- Income Approach
- Expenditure Approach

Concept and measurement of “Value Added”

It is defined as the difference between the value of output of a firm and value of inputs bought from other firms. It is thus the vaue which the firm concerned has added by its process of production (Basically the profit margin). Most goods pass through many stages of production.

The value of the final good will be equal to the sum of the value added at each stage of production.

Sum of value added = 1 + 0.5 + 0.5 + 0.5 = 2.5
= Value of Final Good
GDP contribution = 2.5(1+.5+.5+.5)
GDP is sum of value addition at each stage of production
and not 1 + 0.5 + 2 + 2.5 = 7

It will not be the sum total of values of outputs at each stage.We wont add the value of the intermediate goods in the GDP but we will add the value addition at each stage.If we add the value of intermediate goods ,we will be counting the value of one good many times(also called double counting of goods).

Income Approach

Here GDP is sum of all factor incomes generated in the production of a good.It is the addition of all factor incomes generation in the production of goods and services.
It includes :-
1.Wages

2.Profit to the owners of the firm

3.Rent earned by owners of the land

4.Interest earned by the person providing capital

In the above example, while producing wheat,flour,cake and giving services at Mc.Donalds,factor incomes are generated at each stage.eg.the miller purchases the wheat at Rs.1, converts it into flour and sells it for Rs.1.5.But for doing it,he needs a piece of land , for which he pays a rent(10 paise),he employs a labourer and he gives wages(15 paise) to him ,he has taken a loan from a bank,for which he has to give interest(10paise) and then whatever is left after paying rent,interest and wages,he gets it as his profit(15 paise).All this is repeated at every stage.So when we add factor incomes generated at each stage, we get GDP by Income Approach.

Expenditure Approach

Here GDP is considered as sum of Expenditure .There are three different types of expenditures :

1.Private Consumption Expenditure

It is the monetary value of goods & services purchased by households or individuals or non profit institutions like gurudwaras. During a time period. It is divided in 3 sub categories:

a.Consumer services. Eg. Banking,transport,education etc.
b.Consumer non durable goods. Eg. Food, Clothes Etc.These goods are used in very short span of time.
c.Consumer durable goods. Eg. Fridge, T.V. etc. They are used for longer period of time.But durability doesn't imply a state of permanence. Durable goods also have a limited period of use value after which they are discarded.
Private consumption expenditure adds up the expenditure of all the 3 categories above.

2.Investment

It includes four categories:
a.Business fixed investment:- Amount spent by business units on purchase of new machinery.
b.Inventory investment:- Net change in inventories of final goods awaiting sale. These must be included since they represent currently produced output but are not included in the current sale of final output. The difference between goods produced and goods sold in a year is called inventory.
c.Residential construction investment:- Amount spent on building housing units.
d.Public investment:- It includes all capital formation carried by government for the construction of roads hospitals etc.
Total investment will be sum total of al the above investment.

3.Goverment purchase of goods & services

It includes the goverment spending on goods & services. Eg salaries.

At the same time government makes payments to certain categories of people to compensate them.Eg. Pension, scholarships etc. food coupons, direct benefit transfers.They are called transfer payments or Government transfers. They aren't counted in the GDP because there is no production of goods or services.Money is just getting transferred from government account to the beneficiary account.

4.**Net Exports** = Exports (X) – Imports (M)

GDP = C + I + G + (X – M)

C = Private consumption
I = Investment
G = Government purchases
X – M = Net exports

A stimulus' is an attempt by policymakers to kickstart a sluggish economy through a package of measures.

A monetary stimulus will see the central bank expanding money supply or reducing interest rates to encourage consumer spending.

A fiscal stimulus is one in which the government spends more from its own pocket or slashes tax rates or gives loan waivers.

Stimulus package puts more money in the hands of consumers and spending goes up – thereby encouraging demand & growth.

So the package will involve decrease in tax rates,loan waiver,decrease in interest rates and increased government spending especially on infrastructure creation.

7. Stimulus package 2008

After the 2008 Sub-prime crisis India, like many other countries provided a fiscal stimulus package. It included excise duty cuts, infrastructure financing, government employee pay revision and big ticket government purchases.

Consequently growth revived from 6.7% in FY09 to 8.9% in FY11.

But at the same time, fiscal deficit(will be discussed in fiscal policy chapter) of the government for FY09 rose to nearly 8% of GDP, from the projected 2.5%.

Recently, India's GDP growth in the Q1 2017-18, slumped to 5.7%. So, there were demands for unleashing a fiscal stimulus to revive economy.

8. GNP (Gross National Product)

It is the value of output produced by the nationals of a country both within the geographical boundary and outside.

Income is calculated as part of GNP on the basis who owns the factors of production rather than where the production takes places.

The difference between GDP and GNP is that GNP includes net factor income from abroad. Therefore if we have to get GDP from GNP, we should subtract net factor income from abroad (NFIA) from GNP.Or to calculate GNP,we add the income of Indians from abroad and subtract the contribution of foreigners in India's GDP.

GNP = GDP + (Factor income earned by the domestic factors of production employed in the rest of the world) minus (Factor income earned by the factors of production of the rest of the world employed in the domestic economy .

GNP = GDP + NFIA (net factor income abroad

The items counted in income from abroad are:

1.Net exports

It is (exports minus imports). In India's case, it is negative because we import more than what we export .

2.Interest of external loans :

India takes more loans than it provides to other countries. Therefore,India gives more interest on external loans takes as compared to the interest what it earns on the loans given to other countries.So, the interest is overall negative in India's case.

Net interest = interest taken – interest given

= –ve (India gives more interest)

3.Income from entrepreneurship and returns on investments (FDIs/FIIs) like dividends and interest:

Negative in case of India. There are more foreign companies investing in India as compared to Indian companies investing abroad. Moreover the amount invested by foreign companies is greater

compared to what Indian companies invest abroad. Therefore, the returns on investments of foreign companies is larger.
Net income is equal to Indian companies getting return on investment from abroad minus foreign companies getting return on investment made in India = –ve.

4.Private remittances:

It is that net outcome (result) of money which inflows and outflows on account of pvt. transfers by Indians working outside (sending money to India) and foreign nationals working in India (sending money to their homeland).

In India's case, it is always positive due to large remittances (India is the largest receiver of remittances in the world) sent by Indians especially from Gulf region, US, EU etc.
In India, the Balance of above four points comes out to be negative and hence NFIA in India is negative.

GNP = GDP + NFIA

$GNP_{(India)} = GDP_{(India)} – NFIA$

$GDP_{(India)} > GNP_{(India)}$

GNP is the national income according to which IMF ranks the nations of the world.

5. GDP at Market price and GDP at factor cost:

Market price refers to the actual transacted price and it includes indirect taxees like excise duty and custom duty.
Factor cost are the actual production cost at which goods and services are procduced by an industry in an economy. They are really the cost of all the factors of production (Land, Labour, Capital, Entreprenuer).

Market price = factor cost + indirect taxes – subsidies
Net Indirect Taxes = Indirect taxes – subsidies

@ M.P means at market prices
@ F.C means at factor cost

GDP (market Price)	=	GDP + (factor cost)	Indirect Taxes	–	subsides

GDP@M.P = GDP@F.C + indirect taxes – subsidies

GDP @M.P = GDP @F.C + Net Indirect Taxes

6. What is 'Gross Domestic Product (GDP)?

Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period. Though GDP is usually calculated on an annual basis, it can be calculated on a quarterly basis as well (in the United States, for example, the government releases an annualized GDP estimate for each quarter and also for an entire year).

GDP includes all private and public consumption, government outlays, investments, private inventories, paid-in construction costs and the foreign balance of trade (exports are added, imports are subtracted). Put simply, GDP is a broad measurement of a nation's overall economic activity – the godfather of the indicator world.

GDP is commonly used as an indicator of the economic health of a country, as well as a gauge of a country's standard of living. Since the mode of measuring GDP is uniform from country to country, GDP can be used to compare the productivity of various countries with a high degree of accuracy. Adjusting for inflation from year to year allows for the seamless comparison of current GDP measurements with measurements from previous years or quarters. In this way, a nation's GDP from any period can be measured as a percentage relative to previous periods. An important statistic that indicates whether an economy is expanding or contracting, GDP can be tracked over long spans of time and used in measuring a nation's economic growth or decline, as well as in determining if an economy is in recession

6.1.Nominal GDP: GDP is evaluated at current market prices. Therefore nominal GDP will include all of the changes in market prices that have occurred during the current year due to inflation or deflation. It is also called GDP at current prices.

6.2 In **Real GDP**: In real value of goods and services, has been adjusted to inflation, enabling comparison of quantities, as if prices had not been changed. This means the real value of GDP excludes the effect of inflation.

Constant prices adjust for the effects of inflation. Using constant prices enables us to measure the actual change in output (and not just an increase due to the effects of inflation.

6.3 Advantages of Real GDP

It is useful in finding out the effect of increased production of goods & services on the real development capacity of the economy.

It helps to make a year to year comparison of changes in the growth of output of goods and services.

Real GDP is often used in making international comparisons of economic performance across the countries.
The purpose of using constant prices is to eliminate the effect of price changes.Therefore we express the value of current year's GDP (Nominal GDP) in terms of prices prevailing during a reference year in the past, called the base year. That means the account of the value of current year's GNP as if the price level is same as that of the base year.

National Income = Real NNP@ market price

7. GDP deflator

It is a comprehensive measure of inflation implicitly derived from National accounts data as the ratio of nominal GDP to real GDP.
It's positive side is that it isn't limited to a basket goods as in WPI(wholesale price index) or CPI(Consumer price index)(explained in Inflation chapter) but encompasses all the goods produced

in the country. But its negative aspect is that it is available on annual/quarterly basis ,while WPI or CPI based inflation data comes out monthly.

GDP deflator = $\frac{Nominal\ GDP}{Real\ GDP} \times 100$

Eg. A price deflator of 200 means that the current year price is twice its base year's price.
That means GDP deflator is a measure of inflation.

8. Per Capita Income

It measures the average income earned per person in a given country in a specified year.It is calculated by dividing the country's total income by its total population.

Per capita income = $\frac{\text{Net National Product at factor cost}}{\text{Population}}$

Limitations of GDP as a measure of welfare

- It doesn't value intangibles like leisure, quality of life etc.
- Impact of growth can be harmful for the environment.It can also cause lifestyle diseases. Eg. Obesity
- It only gives average figures that causes stratification (it makes layers). Economic inequality is not revealed by GNP figure.
- Condition of poor is not indicated
- Doesn't show gender disparity
- Doesn't measure sustainability of growth

9. Green GNP: GNP (or GDP) does not take into consideration the cost in terms of (i) environmental pollution and (ii) depletion of natural resources caused by production of output. Mere increase in GNP will not reflect improvement in quality of life if it increases environmental pollution or reduces available resources for future generations. That is why the concept of Green GNP has been introduced.

Green GNP is defined as "GDP which is an indicator of a sustainable use of natural environment and equitable distribution of benefits of development." This concept denotes the following characteristics, (i) Sustainable economic development, i.e., development which should not cause environmental degradation (pollution) and depletion of resources, (ii) Equitable distribution of benefits of development, (iii) Promote economic welfare for a long period of time.

10. New method (CSO 2015 reforms)

UN, WB, IMF, OECD (Organisations of economically developed countries) and European Commision have collaborated to give System of National accounts (SNA) and have adviced the countries to keep their national accounts in this format.In this method , we calculate GVA and then GDP.

Earlier in income method :

Total income = Wages + Profit + Rent + Interest

But under the new method, we will add,
compensation to employees + Mixed income / operating surplus(earlier profit) + consumption of fixed capital

Compensation to employees

It includes wages plus any social security benefit given by the employer like Provident fund contribution or insurance premium paid by the employer.

11. Consumption of fixed capital

It is the decline in the current value of the stock of fixed assets owned and used by a producer as a result of physical deterioration. The plant and machinery fall under the category of capital assets. It undergoes wear and tear in the manufacturing process. It is a sort of consumption. It is called consumption of fixed capital.

GVA @F.C = Compensation to employees + Consumption of fixed capital + (Mixed Income/Operating Surplus)

GVA@basic price = GVA @F.C + production taxes – production subsidies

12. Production Tax and Production Subsidies

They are paid to the government or received by the people or firms with relation to production and are independent of volume of actual production.Production taxes are given even if the products are not produced. Eg of production taxes are stamp duty, land revenue,registration fees ,professional tax etc.Production subsidies include subsidies on irrigation,free electricity to farmers etc.

GDP = GVA @basic price + Product tax – Product subsidy

GDP = GVA @ F.C + production taxes + product taxes – production subsidies – product subsidies
Which is same as GDP @M.P

Therefore, India's current GDP is Real GDP @M.P and GDP before 2015 reforms,it was Real GDP @F.C

Product tax are dependent on volume of production.Eg.excise tax,VAT.

Product subsidy are dependent on volume of production.
Eg.food subsidy,petroleum subsidy.
Before 2015,CSO was not using market prices to calculate GDP,rather it was using factor cost.But now as per global best practices ,India's GDP will be calculated at market prices.So now Real GDP at market prices is our GDP,while earlier it was Real GDP at factor cost.

13. Purchasing Power Parity

Purchasing Power parity is defined as the number of units of a country's currency required to buy the same basket of goods and services in the domestic market as one dollar would buy in the US.
PPP is an attempt to work out how much currency will be needed to buy the same basket of goods and services in different countries.It reflects the underlying exchange rate between the two different countries for buying goods and services,and a more

14. Peculiar case of India's Growth story: Services led growth

India's economic growth is mainly on account of growth in the services sector. It has bypassed the stage of growth in the secondary sector. India has witnessed high growth in the services sector due to the following reasons:

1. Low cost of workers
2. Availability of skilled personnel

3. People who can speak English and, thus, provide services abroad

4. Information technology facilitating delivery of services from India to anywhere across the world

On the other hand, India has not witnessed much growth in the secondary sector due to the following, reasons:

1. Late entry of the private sector in the economy due to delayed liberalization.
2. Competition from Chinese goods, which are available at cheap prices and are available in wide range,
3. Poor quality of infrastructure, which enhances the cost of doing business and hampers the pace of business operations. For instance, electricity produced by diesel can cost twice as much as the energy produced from coal or hydropower based systems. High energy costs combined other infrastructure deficits, such as rail and road problems, have lowered the productivity rates of manufacturing industries in India.
4. Excessive rules and regulations in India (or red tapism). For example, securing numerous clearances before setting up a business enhances the cost of functioning of business. The high cost functioning makes survival difficult for the business in the highly competitive environment. Difficulty in starting a business dissuades people from entering into business activity.

Previous years' Prelims questions

2018

1. If a commodity is provided free to the public , by the Government, then

(a) the opportunity cost is zero.
(b) the opportunity cost is ignored.
(c) the opportunity cost is transferred from the consumers of the product to the tax-paying public.
(d) the opportunity cost is transferred from the consumers of the. product to the Government.

Ans c

2. Increase in absolute and per capita real GNP ***do not*** connote a higher level of economic development, if

(a) industrial output fails to keep pace with agricultural output.
(b) agricultural output fails to keep pace with industrial output.
(c) poverty and unemployme crease.
(d) imports grow faster than exports.

Ans c

3. Consider the following statements :
Human capital formation as a concept is better explained in terms of a process which enables

1. individuals of a country to accumulate more capital.
2. increasing the knowledge, skill levels and capacities the people of the country.
3. accumulation of tangible wealth.
4. accumulation of intangible wealth.

Which of the statements given above is/are correct?

(a) 1 and 2 (b)2 only (c) 2 and 4 (d) 1, 3 and 4

Ans c

4. Despite being a high saving economy, capital formation may ***not*** result in significant increase in output due to

(a) weak administrative machinery
(b) illiteracy
(c) high population density
(d) high capital-outputs ratio

Ans d

2017

5. Which of the following gives 'Global Gender Gap Index' ranking to the countries of the world?

(a) World Economic Forum
(b) UN Human Rights Council
(c) UN Women
(d) World Health Organization

Solution: A

2016

6. Which of the following is/are the indicator/indicators used by IFPRI to compute the Global Hunger Index Report?

1. Undernourishment
2. Child stunting
3. Child mortality

Select the correct answer using the code given below.

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

Solution: C

2015

7. With reference to India economy, consider the following statements:

1. The rate of growth of real Gross Domestic Product has steadily increased in the last decade.
2. The Gross Domestic Product at market prices (in rupees) has steadily increased in the last decade

Which of the statement given above is/are correct?
a)1 only b) 2 only c) Both 1 and 2 d) Neither 1 nor 2

Solution: b

2013

8. Economic growth in country X will necessarily have to occur if

(a) there is technical progress in the world Economy
(b) there is population growth in X
(c) there is capital formation in X
(d) the volume of trade grows in the world Economy

Solution c

9. The national income of a country for a given period is equal to the

(a) Total value of goods and services produced by the nationals.
(b) Sum of total consumption and investment expenditure.
(c) Sum of personal income of all individuals.
(d) Money value of final goods and services produced.

Solution d

2012

10. The Multi-dimensional Poverty Index developed by Oxford Poverty and Human Development Initiative with UNDP support covers which of the following?

1. Deprivation of education, health, assets and services at household level
2. Purchasing power parity at national level
3. Extent of budget deficit and GDP growth rate at national level

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

Solution a

2011

11. In the context of Indian economy, consider the following statements :

1. The growth rate of GDP has steadily increased in the last five years.
2. The growth rate in per capita income has steadily increased in the last five years.

Which of the statements given above is/are correct?
(a) 1 only (b) 2 only (c) Both 1 and 2 (d) Neither 1 nor 2

Solution b

12. Which of the following can aid in furthering the Government's objective of inclusive growth?

1. Promoting Self-Help Groups
2. Promoting Micro, Small and Medium Enterprises
3. Implementing the Right to Education Act

Select the correct answer using the codes given below:

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

Solution d

13. Economic growth is usually coupled with

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

Solution b

Previous years' Mains questions

1. 1.Among several factors for India's potential growth, the savings rate is the most effective one. Do you agree? What are the other factors available for growth potential? (150 words, 10 marks) (2017).

2. What are the salient features of 'inclusive growth'? Has India been experiencing such a growth process? Analyze and suggest measures for inclusive growth. (250 words, 15 marks)(2017)

3. Comment on the challenges for inclusive growth which include careless and useless manpower in the Indian context. Suggest measures to be taken for facing these challenges. (200 words, 12.5 marks)(2016)

4. Capitalism has guided the world economy to unprecedented prosperity. However, it often encourages short-sightedness and contributes to wide disparities between the rich and the poor. In this light, would it be correct to believe and adopt capitalism for bringing inclusive growth in India? Discuss. (200 words, 12.5 marks)(2014)

5. Normally countries shift from agriculture to industry and then later to services, but India shifted directly from agriculture to services. What are the reasons for the huge growth-services vis-a-vis industry in the country? Can India become a developed country without a strong industrial base? (200 words, 12.5 marks)(2014)