Quick Discussion On Basics of Economics

- By :DeshRaj Yadav

The Word Economics

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

<u>What is Economics?</u>

Economics is a study of rationing systems

Definitions

- Economics is the study of human behavior that seeks to analyze and describe the allocation of scarce resources into unlimited wants.
- Economics can be summarized into three following activity :- Production, Distribution and Consumption

Understanding the Want?

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¾NEEDS: is a state of mind in which you felt deprived of something e.g.

- ¾ WANTS: are the desire that people have
- Need+ Power + ability

Types of Goods

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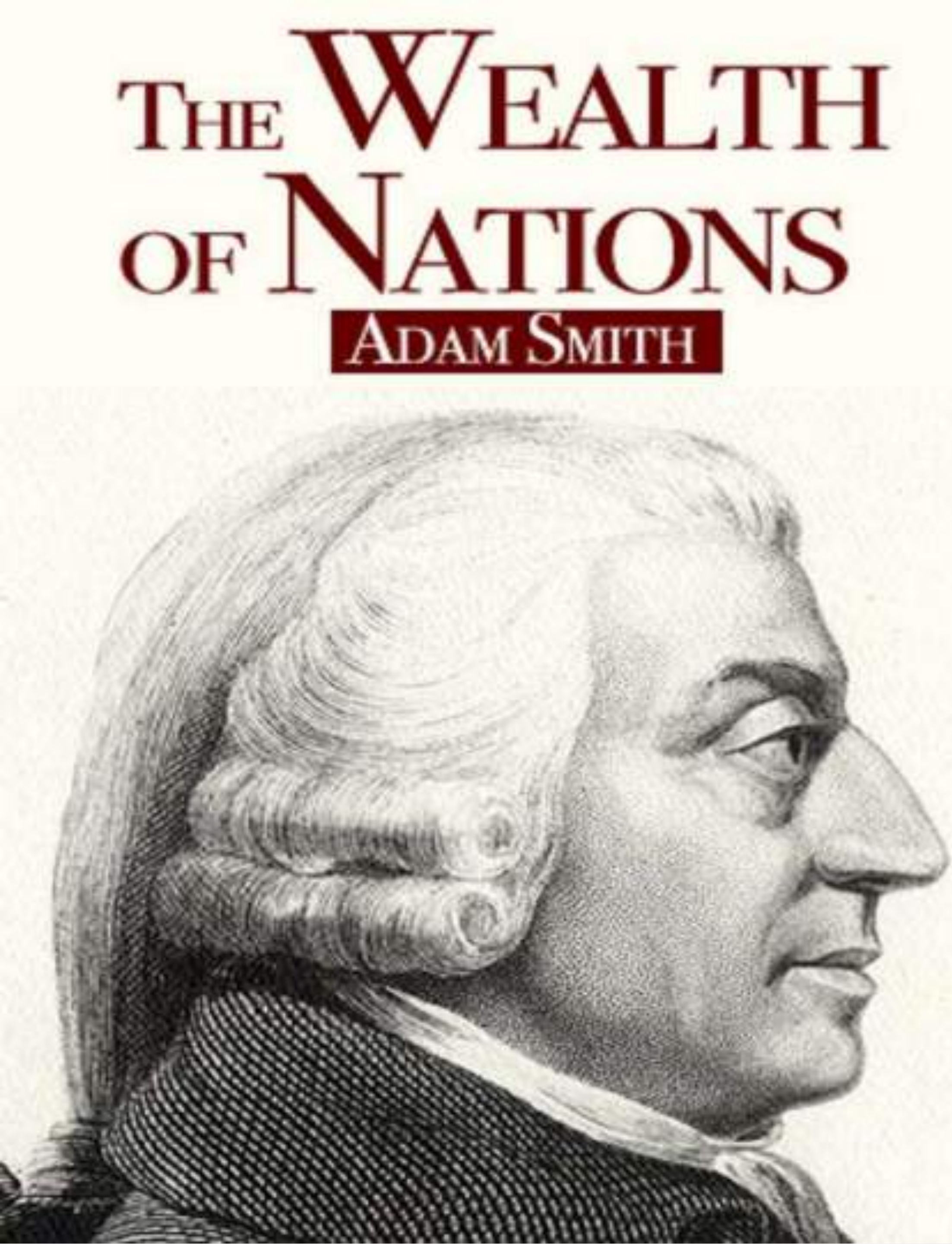
- On the basis of Needs

Nature of wants

- Wants are recurring
- Wants are unlimited
- Wants are complementary
- Any Particular want is Satiable

- **Which of the following is core problem of economics?**

1) Limited resources
2) Unlimited wants
3) Allocation of resources
4) Human behaviour



- **Adam Smith** defined economics “as the study of the nature and causes of the generation of wealth of a nation”.

Macro v/s Micro

- The subject matter of economics has been divided into two parts: Microeconomics and Macroeconomics
- These terms were first coined and used by **Ragnar Frisch**

Ragnar Frisch

Professor Ragnar Frisch

Examples

- **Microeconomics**
- Production/output in individual industries and businesses and
- consumer and behaviour
- How much steel
- How much office space
- How many cars
- Consumer behaviour

- **Macroeconomics**
  - National production/output
  - Gross domestic product
  - Employment
  - Poverty
- Inflation
- BOP

Economy

- Application of economics into a particular area is known as Economy.

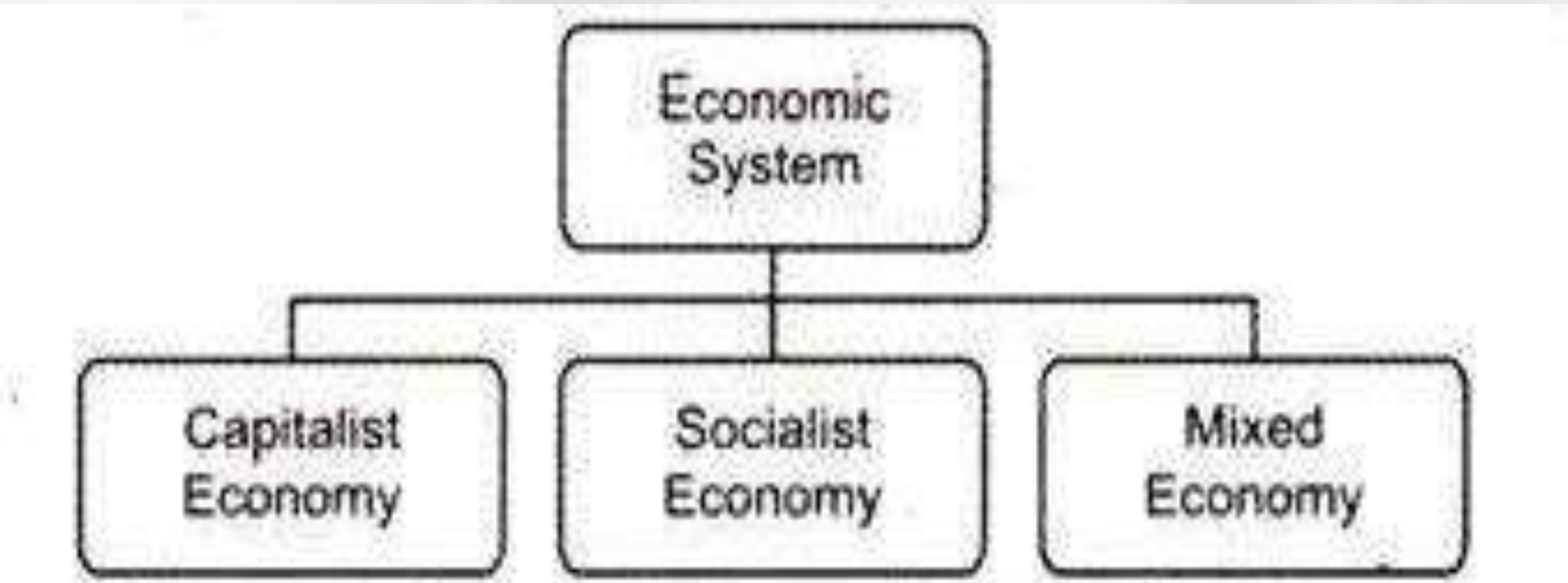
- If economics is theory , practical is economy

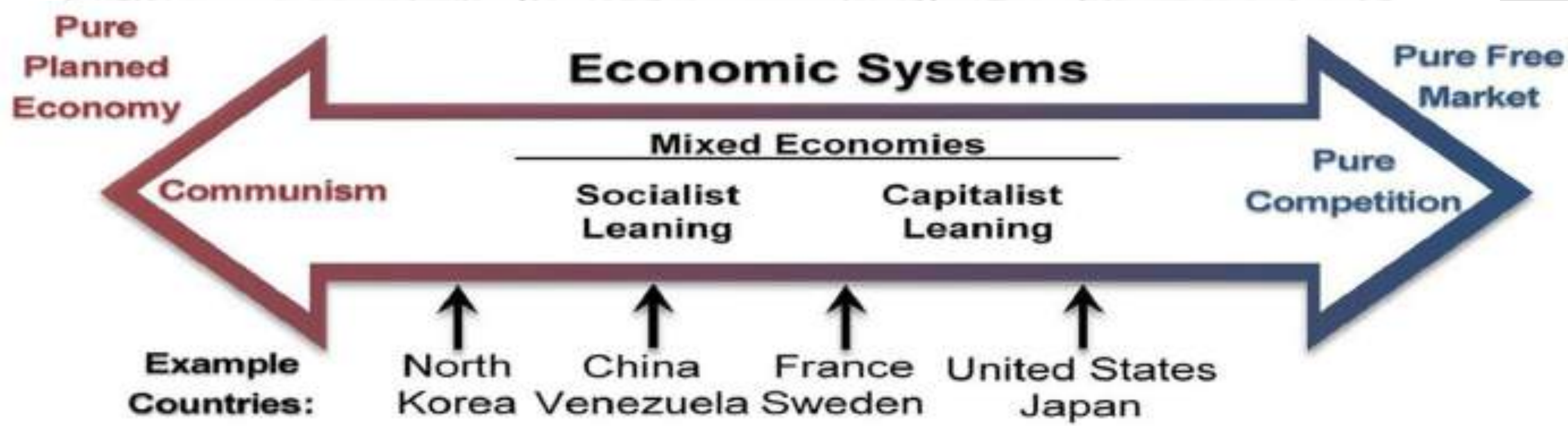
TYPES OF Economy

- On the basis on ***INTERNATIONAL TRADE***

Open Economy

Closed Economy


Economic System
Capitalist Economy
Socialist Economy
Mixed Economy


Pure Planned Economy
Economic Systems
Pure Free Market
Mixed Economies
Communism
Socialist Leaning
Capitalist Leaning
Pure Competition
Example Countries:
North Korea
China Venezuela
France Sweden
United States Japan

Economics v/s Economy

Types of Economy

- On the Basis Of International Trade

- International Trade means ?


INTERNATIONAL TRADE
IMPORTS
EXPORTS
IMPORT
EXPORT
IMPORT
IMPORT
EXPORT

Open Economy

Closed Economy

Closed Economy	Open Economy
Does not have economic relations with the rest of the world.	An open economy has economic relations with other countries.
Activities taking place outside the territory do not affect the economic activities.	Economic activities of such an economy are affected by international fluctuations.
There is no difference between national income and domestic income.	The size of national income may be greater or smaller than the domestic income.
It is an imaginary economy.	It is a realistic economy.

Advantages of an **open economy**	Disadvantages of a **closed economy**
Countries can import raw materials and energy	A country has high average costs of production (especially made worse is the population size is small)
A wider ranges of products can be available --> wider consumer choice	No economies of scale or long production runs
In theory, a country can produce a wide range of goods because it can import goods that they need to increase their exports. (However in practice, the country only produces a proportion because most good and services are imported)	
Economies of scale and long production runs	**Long production runs:** variable factors of production

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India before 1991

- Balance of Payment crisis 1991
- Reasons:-

- Disintegration of USSR
- Gulf Crisis


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INDIAN EXPRESS

SCREEN

RV influenced Punjab poll postponement

Sharp depreciation of rupee

Top officials among 14 kidnapped in Assam

LPG Reforms

- This LPG phenomenon was first initiated in the Indian Economy in 1990 when the Indian Economy experienced a severe crisis. There was decline in the country’s export earnings, national income and industrial output. The government had to seek aid from IMF to resolve it’s debt problem.

Liberalization

- Liberalization means elimination of state control over economic activities. It implies greater autonomy to the business enterprises in decision-making and removal of government interference.
- It was believed that market forces of demand and supply would automatically operate to bring out greater efficiency and the economy would recover

Privatization

- Privatization is the transfer of control of ownership of economic resources from the public sector to the private sector. It means a decline in the role of the public sector as there is a shift in the property rights from the state to private ownership.

Globalization

- According to IMF 'the growing economic interdependence of countries worldwide through increasing volume and variety of cross border transactions in goods and services and of international capital flows and also through the more rapid and widespread diffusion of technology.'

- **When there is affect on economic activity of an specific country due to import and export, then such economy are called-**
  - Closed economy
  - Open economy
  - Agricultural economy
  - Industrial economy

- **The Removal of prohibitions and hindrance by government is called.**
  - Globalisation
  - Privatisation
  - Liberalisation
  - Bilateral understanding

Economic System

- An economic system refers to those norms and rules or institutions which direct an economy.
- Types of Economies on the Basis of Ownership of Resources

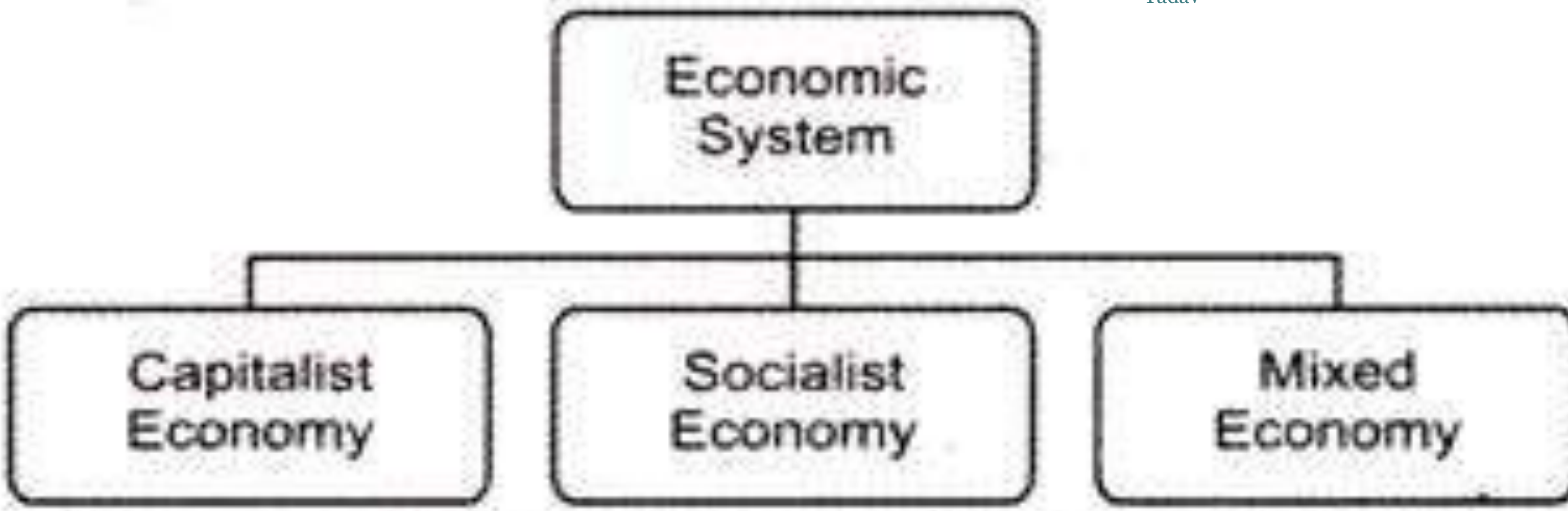
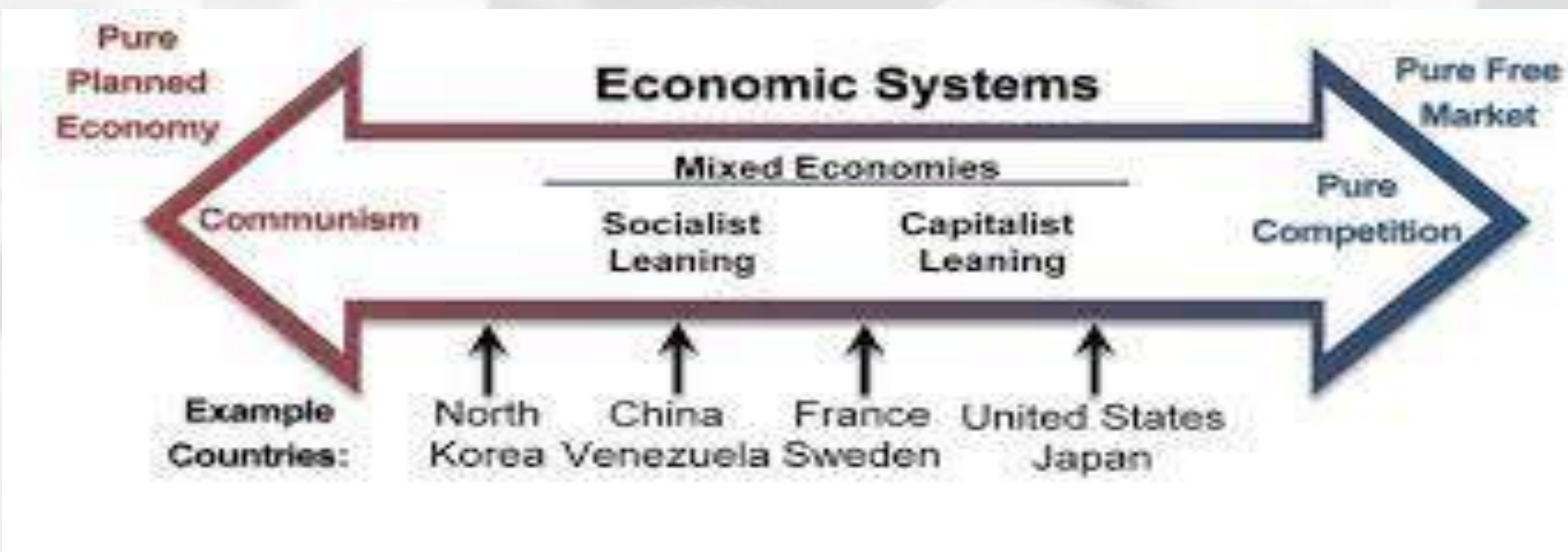
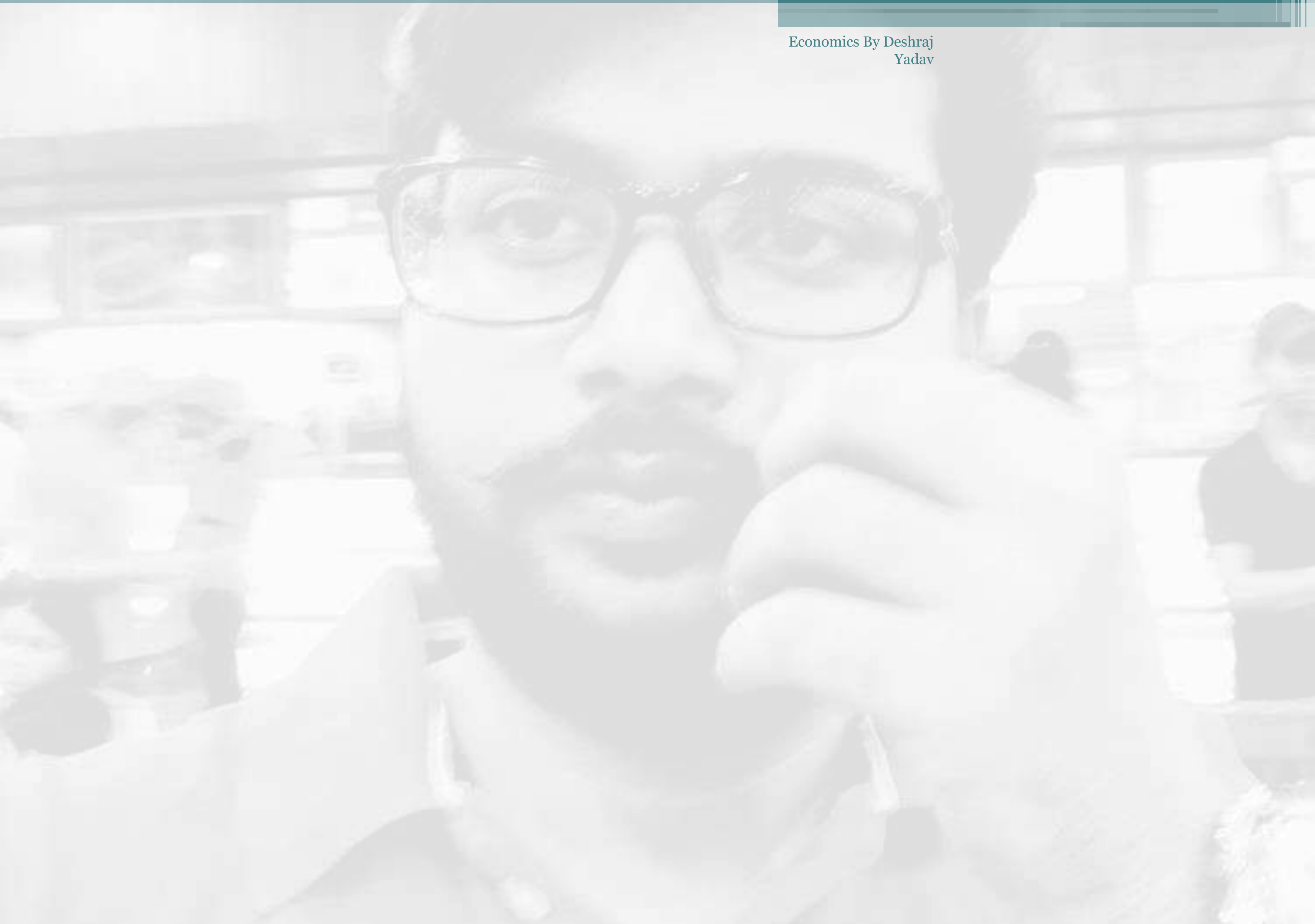


Figure-1: Different Types of Economic System





Capitalistic or Market Economy

- Based on Capitalism
- 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'.

Features of Capitalistic Economy

- Profit Motive
- Private Property
- Self-interest
- Price Mechanism
- Labour as a Commodity
- Freedom of Enterprise
- Competition and Cooperation
- Sovereignty of the Consumer
- Lassiez Fair

The main feature of a capitalist economy is–

(a)Administered Prices

(b) Public Ownership

(c)Economic Planning

(d) Private Ownership

Socialistic or Command Economies

- Based on Socialism
- In Socialism 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.

Features of Command Economies

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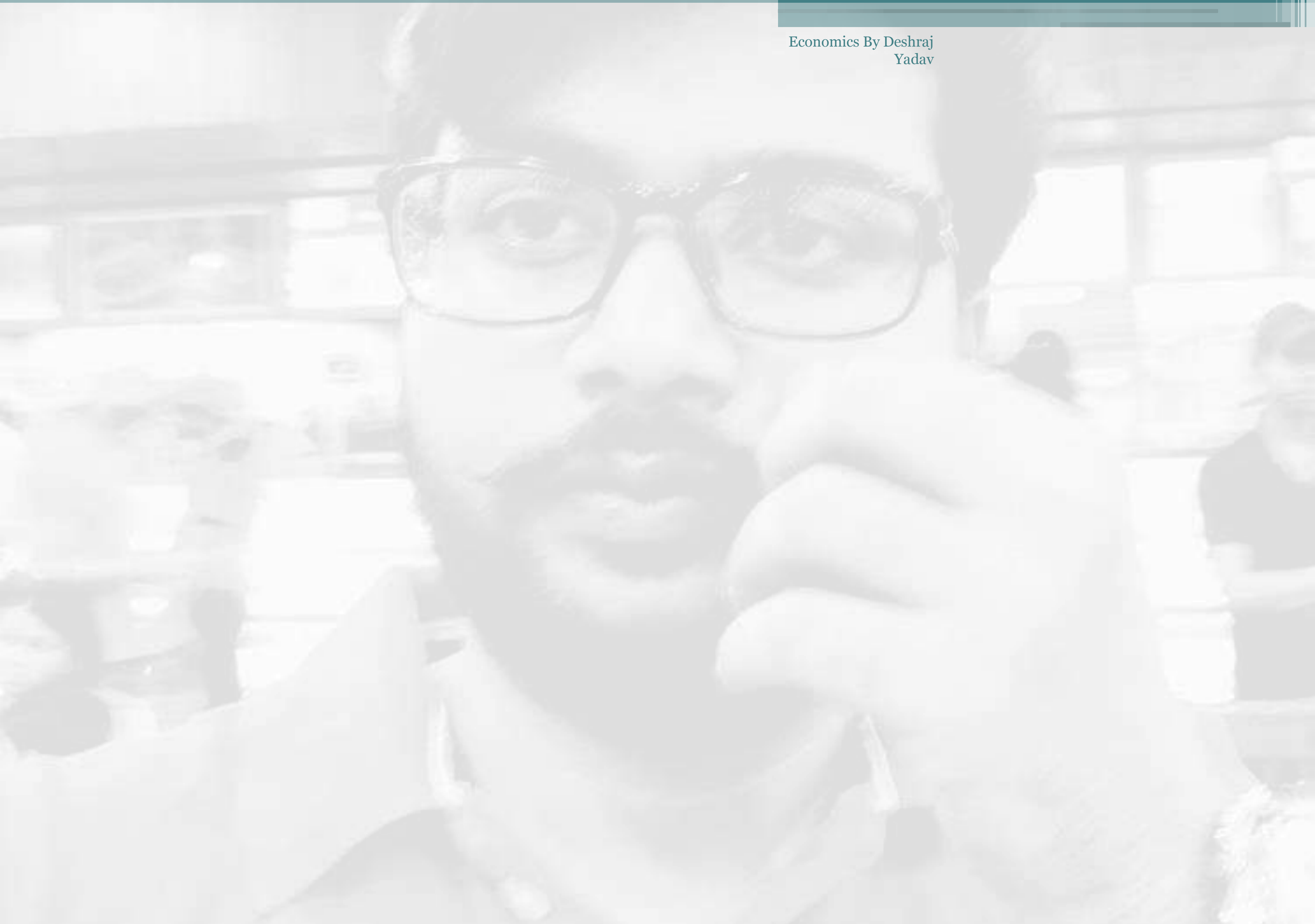
- Social or Collective Ownership
- Central Planning Authority
- Set Objectives
- Economic Planning
- Government Control
- Lack of Competition
- No or limited Private Sector



Mixed Economy

- 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

Features of Mixed Economies

- Co-existence of the Private and the Public Sectors
- Directive Planning and Government Control
- Private Property and Economic Equality
- Regulated Price Mechanism
- Profit Motive and Social Welfare

FEATURES	MARKET ECONOMY	COMMAND ECONOMY	MIXED ECONOMY
Ownership of property:	Private ownership	Government ownership	Private + Public (govt.) ownership
Motive or objective:	Profit maximization	Collective welfare social	Private Sector Profit maximsation Public Sector Collective Welfare
Allocative mechanism:	**Price mechanism** (demand and supply)	**Rationing mechanism** (central planning & quota's)	Private Sector Price mechanism Public sector Rationing mechanism
Freedom of choice: (In Production & Consumption)	Freedom of choice	No freedom of choice	Private Sector yes Public sector no
Competition:	Yes	No	Private Sector yes Public sector no
Role of government: (In allocation of resources i.e.)	Minimum role of govt. in economic affairs. Only limited to maintain law & order in the country.	All economic & non-economic affairs are in the hands of govt.	Govt. limit its role to the provision of necessary goods & services & regulate private sector for social welfare…
Variety of goods & services:	Yes	No	Private Sector yes Public sector no
Quality of goods & services:	High quality	Poor quality usually	Private sector High quality Public sector Poor quality usually
Response to changes in demand: Consumer sovereignty	Quick response to changes in consumers preferences.	Slow or no response	Private Sector Quick response Public sector Slow response
Efficiency: Producing most desirables goods (allocative efficiency) with least cost methods (productive efficiency)	*efficient allocation of resources usually because of existence of profit motive *Sometime inefficient. e.g. private Monopolies.	Inefficient allocation of resources because of absence of profit motive.	Inefficiency of private sector is minimized by govt. policies.
Shortages & surpluses: (Shortage = Demand > Supply) (Surplus = > Supply > Demand)	Price mechanism clears markets and there are no shortages & surpluses.	Central planning is unable to guess exact quantities demanded . Shortages & surpluses are present.	Private sector No shortages & surpluses Public sector Shortages & surpluses are present.
Merit goods: e.g. Healthcare, education etc.	Underproduction & under consumption.	Socially optimum	*Private sector underprovision *Missing markets of merit goods will be supplied by govt. provision.

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ECONOMIC SYSTEMS AROUND THE WORLD

Economic systems across the world are the product of many factors: political structures, resources, culture, social systems, technology and even geography. The economic systems of most countries embody one of three major economic structures: **free enterprise economies, command economies, or mixed economies**, which are a combination of both.

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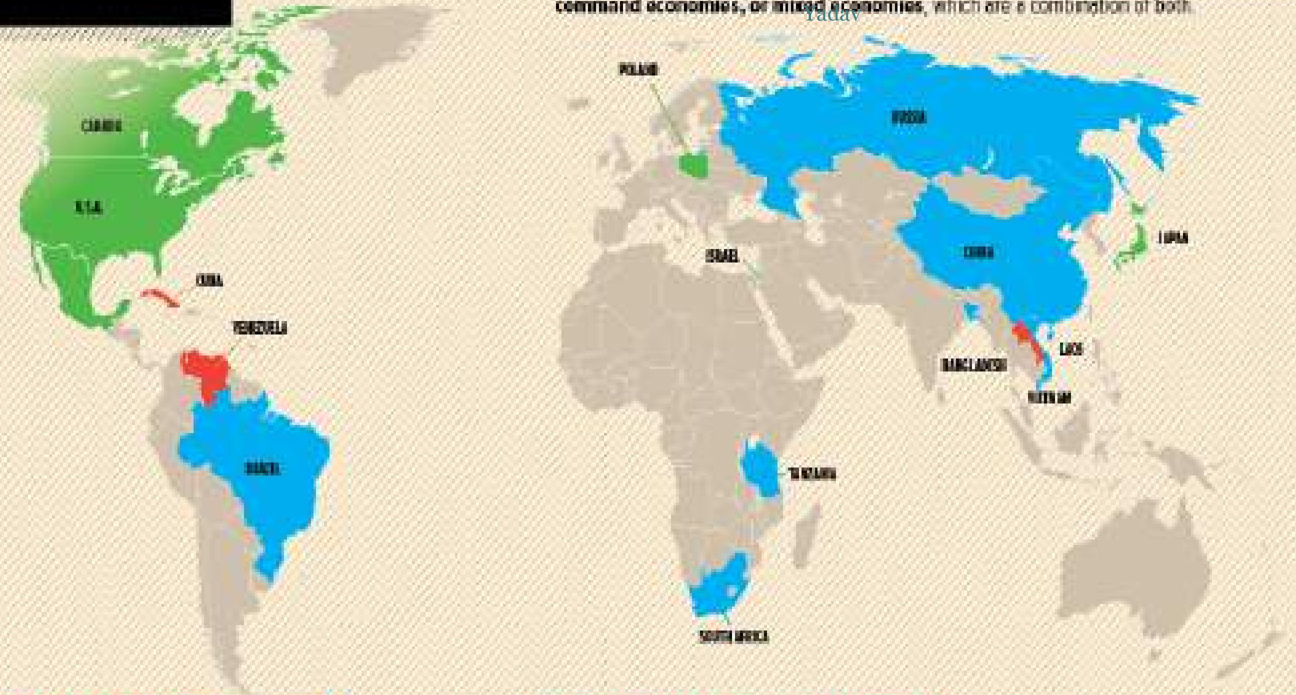
The economic systems of most countries typically reflect one of three predominant economic structures.

- FREE ENTERPRISE
- MIXED SYSTEM
- COMMAND ECONOMY



FREE ENTERPRISE

Private citizens own and use the factors of production to generate profits. But even these countries do not have a purely free-enterprise system as the government also plays some role in regulating production and profits.

MIXED ECONOMY

Mixed economies have characteristics of the other two systems. For example, South Africa has a stock exchange and strong private sector, both typical of free enterprise. However, the national electric service is government controlled, which is typical of command economies.

COMMAND ECONOMY

The government owns all of the factors of production and determines how these factors are combined to produce goods and services within the economy. This type of system is increasingly rare in the twenty-first century.

THINK ABOUT IT!

How is the role of government different in a free enterprise economy, a mixed economy, and a command economy?

How is government regulation likely to influence the cost of bringing goods to market? Provide two examples.

Sectors of Economy

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- Primary Sector
- Secondary Sector
- Tertiary Sector

Primary Sector

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- The primary sector of the economy extracts or harvests products from the earth. The primary sector includes the production of raw material and basic foods.

- Examples include agriculture mining, forestry, farming, grazing, hunting and gathering, fishing, and quarrying.

Secondary Sector

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- The secondary sector of the economy manufactures finished goods. All of manufacturing, processing, and construction lies within the secondary sector.

- Examples include metal working, automobile production, textile production, chemical industries , aerospace manufacturing, breweries, construction, and shipbuilding

Tertiary Sector

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- The tertiary sector of the economy is the service industry. This sector provides services to the general population and to businesses.
- Examples include retail and wholesale sales, transportation and distribution, entertainment

Practice Paper

Quaternary Sector

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- The quaternary sector of the economy consists of intellectual activities.
- Examples include government, culture, libraries, scientific research, education, and information technology

Quinary Sector

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- Quinary activities are services that focus on the creation, re-arrangement and interpretation of new and existing ideas; data interpretation and the use and evaluation of new technologies. 'Gold collar Job Workers'

Share of Employment & Share in GDP

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Sectors	Employment	Share in GDP (%)
Primary	63%	17%
Secondary	14%	28%
Tertiary	23%	55%

History of Planning In India

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- The first attempt to initiate economic planning in India was made by Sir M. Visvesvaraya.
- In 1934 through his book, Planned Economy for India.

PLANNED ECONOMY
FOR INDIA

BY

SIR M. VISVESVARAYA

BANGALORE CITY:

National Planning Committee

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- In Year 1938
- Haripura
- Congress conference
- President :- S.C. Bose
- Advisor:- Meghnad Shah
- NPC Chairman:- J.L.Nehru

Bombay Plan

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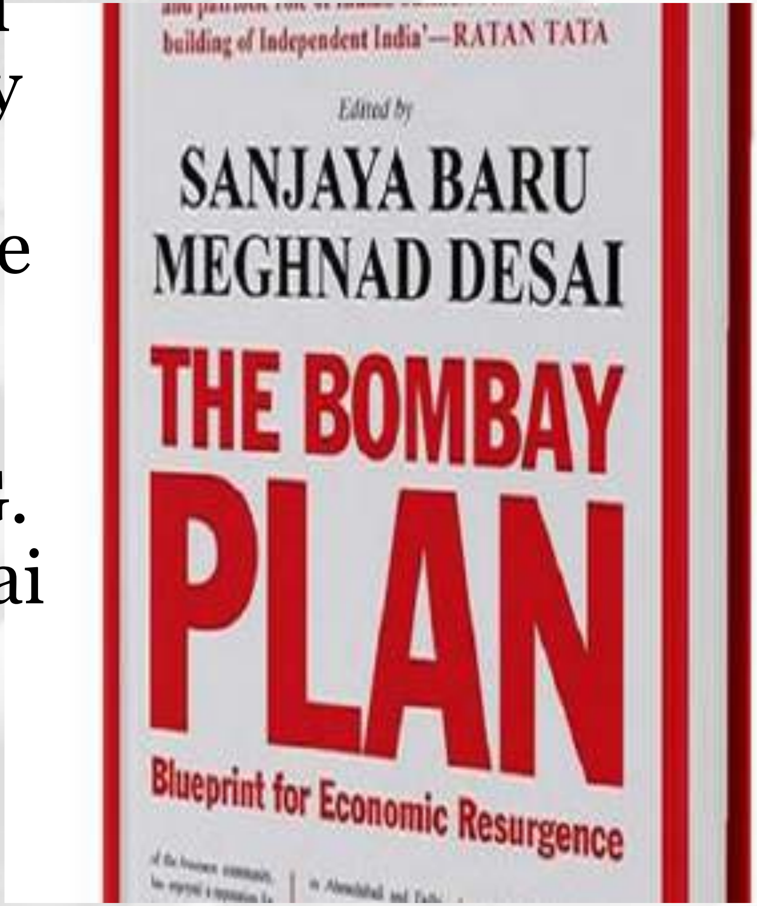
- A small group of influential business leaders in Bombay drew up and published in January 1944, a plan for the economic development of India.
- Mr. J. R. D. Tata and Mr. G. D. P. Thakurdas, Kasturbhai Lalbhai and Sir Shri Ram, Ardeshir Dalal, Mr. A. D. Shroff and Dr. John Matthai.



Gandhian Plan

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- By S.N Agarwal
- Based on Idea of Trusteeship

- In 1945, 'People's Plan' was given by MN Roy.
- In 1950, 'Sarvodaya Plan' was given by JP Narayan.
- 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

National Development Council

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- 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.

Table 6.1: Timing of the Five Year Plans

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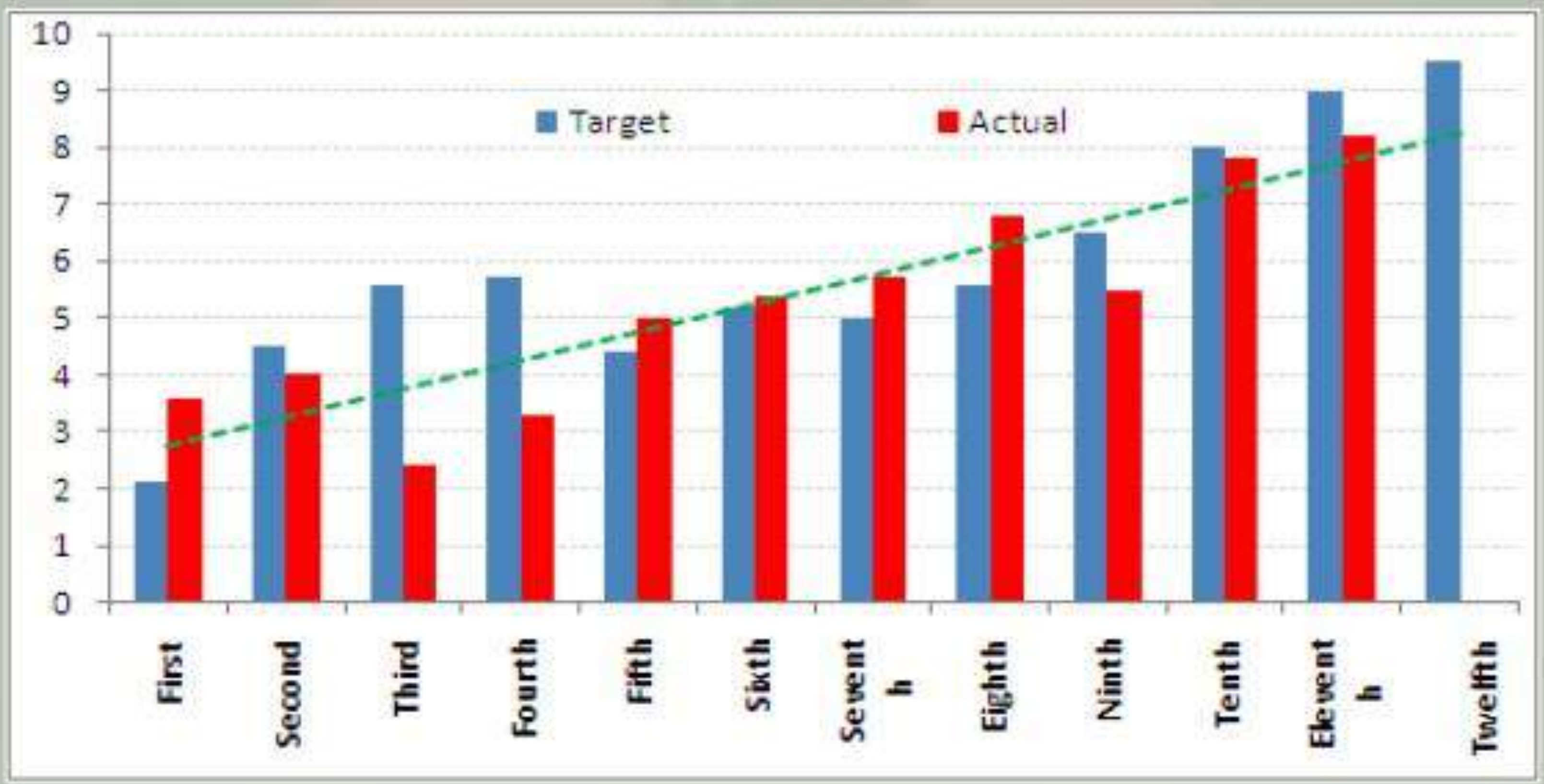
First Plan	1951-56
Second Plan	1956-61
Third Plan	1961-66
Three Annual plans	1966-69
Fourth Plan	1969-74
Fifth Plan	1974-78*
Annual Plan	1979-80
Sixth Plan	1980-85
Seventh Plan	1985-90
Annual Plan	1990-92
Eighth Plan	1992-97
Ninth Plan	1997-2002
Tenth Plan	2002-2007
Eleventh Plan	2007-2112

Growth Rate (in %)



The First Plan (1951-56)

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Based on Harrod Domar Model

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

The Second Plan (1956-61)

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Based on Mahalanobis model.

- It gave priority to industrial development.
- 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.
- Panchayati Raj
- Economic constitution of India

Third Plan (1961-66)

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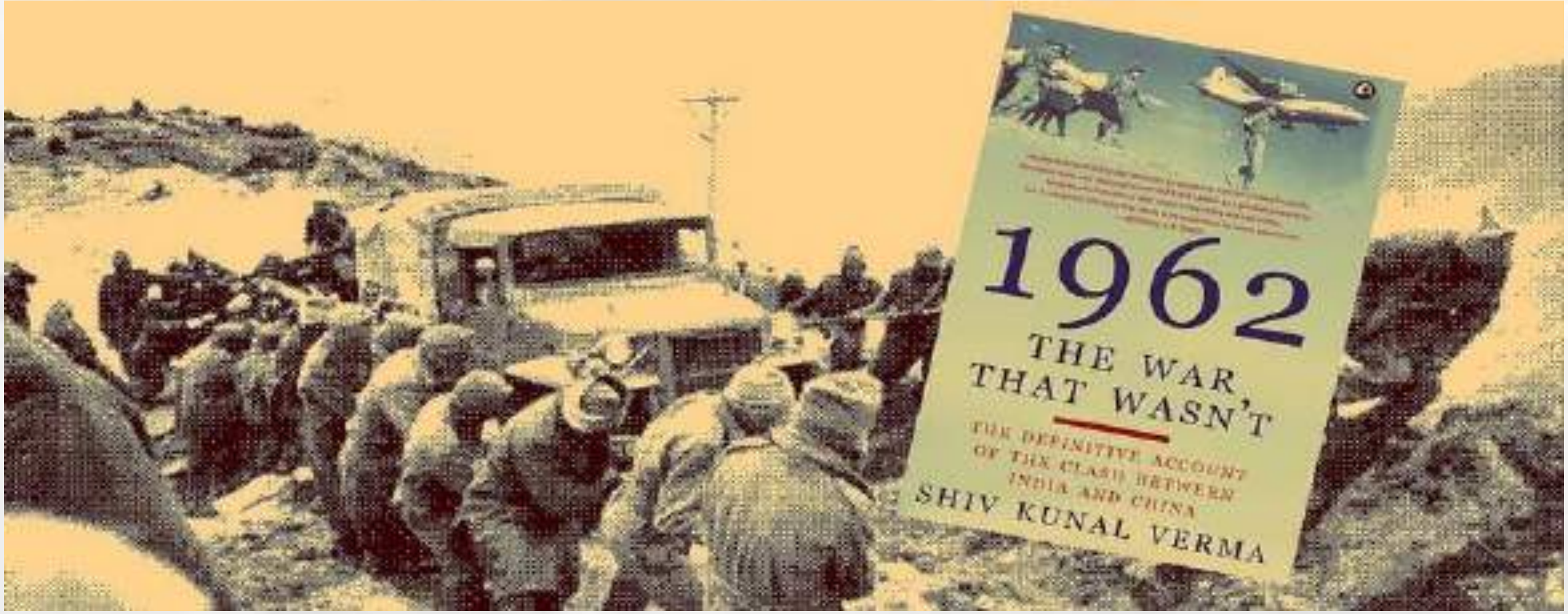
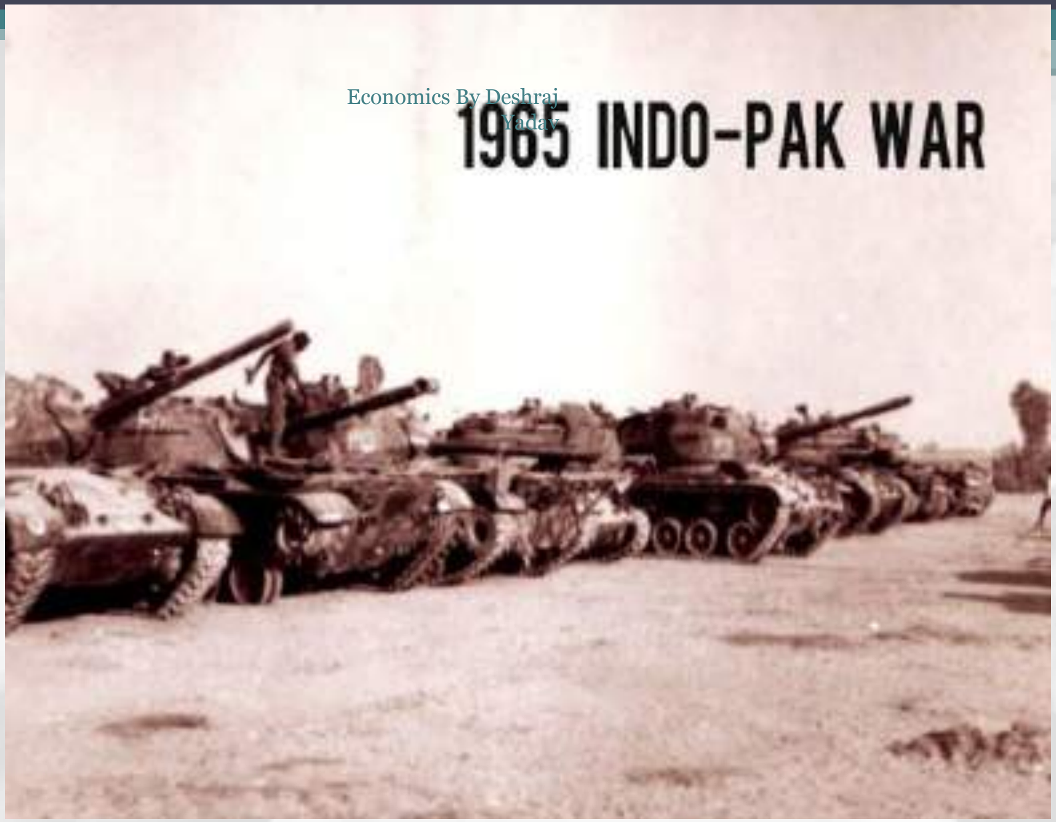
Based on Sukhmai Chakarvarthy Model

- Objective of Agriculture + Industry
- Bokaro Iron Steel Plant
- Chinese aggression (1962)



Indo-Pak war 1965



Severe Drought 1966

Plan Holiday (1966-69)

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- India was facing crisis on every fronts economic as well as Food too.
- Green Revolution in India

Plan Holiday (1966-69)

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- India was facing crisis on every fronts economic as well as Food too.

Green Revolution in India

Green Revolution in India

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- Green Revolution refers to a series of research, development, and technology transfer initiatives, occurring between 1943 and the late 1970s, that increased industrialized agriculture production in India; however, the yield increase has also occurred world wide.

- It involved the development of high-yielding varieties of cereal grains, expansion of irrigation infrastructure, and distribution of hybridized seeds, synthetic fertilizers, and pesticides to farmers. The term "Green Revolution" was first used in 1968 by former USAID director William Gaud,

- Borlaug was invited to India by the adviser to the Indian minister of agriculture M. S. Swaminathan.
- Despite bureaucratic hurdles imposed by India's grain monopolies, the Ford Foundation and Indian government collaborated to import wheat seed from CIMMYT

Fourth Five Year Plan (1969-74)

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- Objective :- Self Reliance
- Ashok Rudra / L N Mane / Gadgil Model
- Lk Jha committee
- 14 Banks Nationalised :- 19 July 1969
- Bangladesh Liberation War

Bangladesh Liberation War

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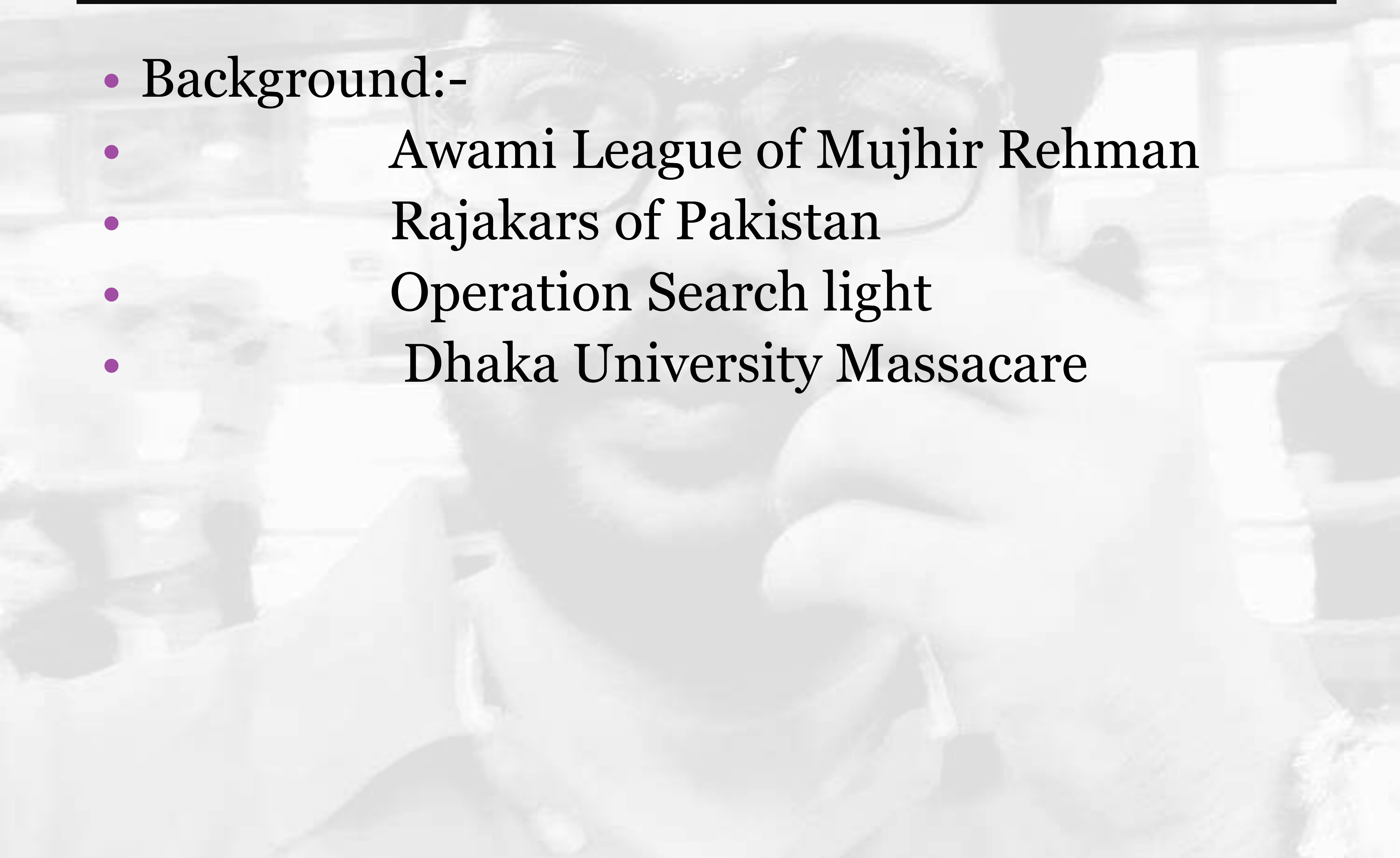
- Background:-
- Awami League of Mujhir Rehman
- Rajakars of Pakistan
- Operation Search light
- Dhaka University Massacare



Work Sheet

Worksheet

Fifth Five Year Plan

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Poverty removal became distinct objective for the first time.

- DP Dhar drafted.
- “Minimum Needs Programme” launched.
- Command Area Development Programme was started in 1974-75 to utilise water in major and medium irrigation projects in an optimum manner.
- Oil crisis : 1973 Sept.

Emergency In India

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- 25 June 1975.

Plan Holiday 1978-80

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- New PM Morarji Desai
- Rolling Plan
- DT Lakadwala
- Gunnar Mydryl

INDIAN EXPRESS

SAREES

MORARJI DESAI IS PRIME MINISTER

Consensus move dropped after letter from Charan Singh

CFD to stay separate, back Govt on merit

Immediate concern to right all wrongs of emergency

Rolling Plan

- The meaning of the Rolling Plan was that now, every year the performance of the plan will be assessed and a new plan will be made next year based upon this assessment.
- In the rolling plans there are three kind of plans.
- First is the plan for the current year which comprises the annual budget.
- Second is a plan for a fixed number of years, which may be 3, 4 or 5 years. This second plan is kept changing as per the requirements of the economy (and politics).
- Third is a perspective plan which is for 10, 15 or 20 years.

Sixth FYP 1980-85

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- mainly focused on increasing industrialization and reducing long-standing problems such as poverty and unemployment

- Narsimhan Committee
-     6 Banks were Nationalized
- NABARD was established
- 5 RRB were opened

- 1984 Anti Sikh Riots

Anti Sikh Riots

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Work Sheet

Seventh FYP 1985-90

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- Food Work and Productivity
- For the first time the private sector got the priority over Public sector
- Its growth target was 5.0% but it achieved 6.0%

Plan Holiday 1990-92

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- Eighth five Plan could not take place due to volatile political situation at the centre. So two annual programmes are formed in 1990-91& 1991-92

Eighth FYP 1992-97

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- In this plan the top priority was given to development of the human resources i.e. employment, education, and public health.
- Duing this plan Narasimha Rao Govt. launched New Economic Policy of India.
- This plan was successful and got annual growth rate of 6.8% against the target of 5.6%.

- **Ninth FYP 1997-2002**
- The main focus of this plan was “**growth with justice and equity**”

- **Tenth Five Year Plan:** 2002 to 2007.

- **Eleventh Five Year Plan:** 2007 to 2012.
- It was prepared by the C. Rangarajan.
- Its main theme was **“faster and more inclusive growth”**

- **Twelfth Five Year Plan:** 2012 to 2017.

Its main theme is “**Faster, More Inclusive and Sustainable Growth**”.

National Income

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- 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.
- National income is a flow not a stock.
- In India, national income estimates are related to the financial year (**April 1 to March 31).**

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

- In **1949, a National Income Committee (NIC) was** appointed, with P.C. Mahalnobis as its Chairman, and Dr. D.R. Gadgil and V.K.R.V. Rao as members.

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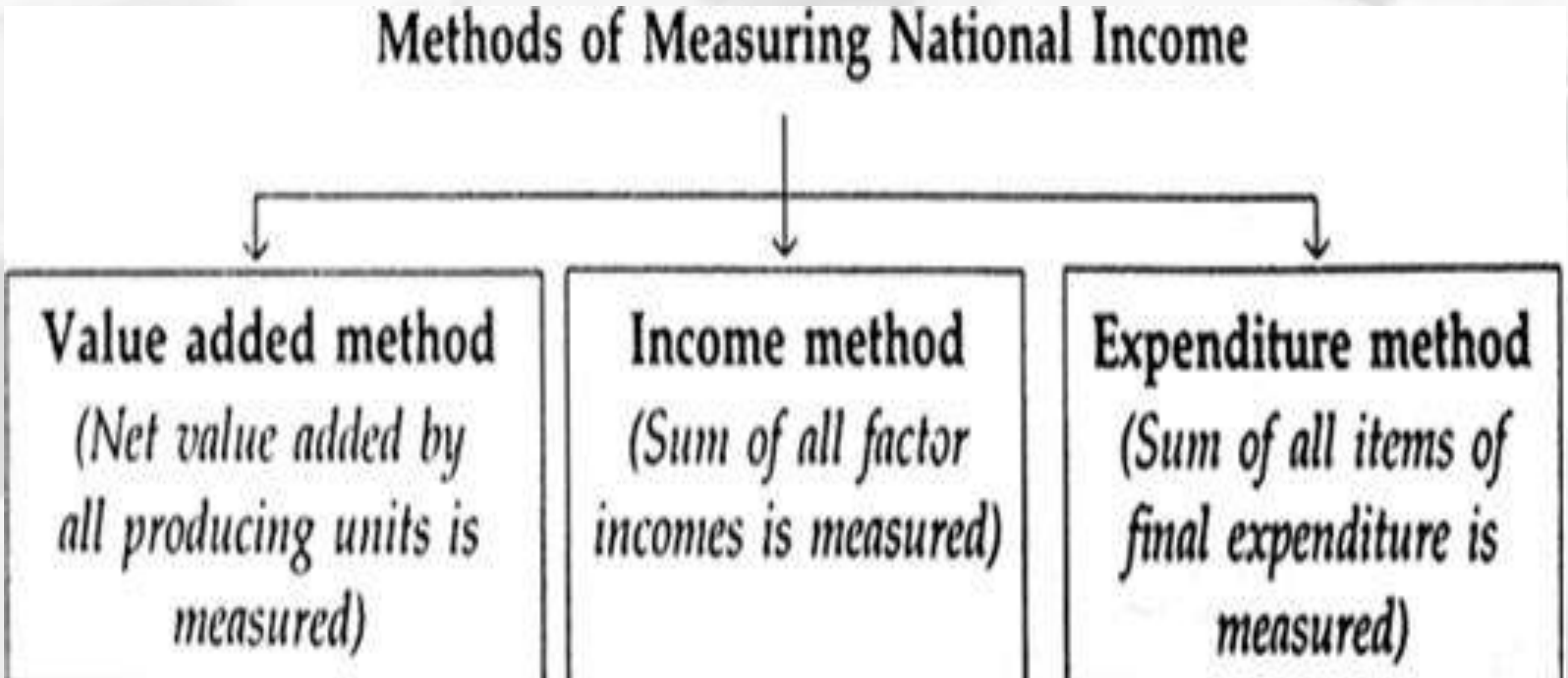
Methods of Measuring National Income

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



Product Method

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- In this method net value 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.

Income Method

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- In this method, a total of net incomes earned by working people in different sectors and commercial enterprises is obtained.

- By income method national income is obtained by adding receipts as total rent, total wages, total interest and total profit.

- National Income = Total Rent + Total Wages + Total Interest + Total Profit

Expenditure Method

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- National Income =

=Consumption Private + Government Expenditure + Investment + Export- Import

- 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

What is inflation?

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- 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.

- “Inflation is a state in which the value of money is falling or prices are rising.” — **Crowther**

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Features of Inflation

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

Inflation occurs under the following circumstances

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- The quantity of money is increasing but the volume of production is static or is even declining.
- 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.
- 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.
- The quantity of money, i.e., supply is in excess of demand or requirements.

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Causes of inflation in India

- Increase in government expenditure
- Expansion of money supply
- Deficit financing
- Bank credit
- Black money
- Population growth
- Over-dependence on agriculture
- Natural calamites
- Dependence on imports
- Etc

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Types of inflation

- Demand-Pull Inflation

This theory can be summarized as “too much money chasing too few goods”. It is a mismatch between demand and supply , if demand is growing faster than supply, prices will increases.

- Cost-Push Inflation

When production costs go up, there is an increase in prices to maintain profit margins. Increased costs can include things such as wages, taxes, or increased costs of imports

- **Creeping Inflation:**
- Price rise at very small rate (<3%)

- **Walking or Trotting Inflation:** Price rise at moderate rate (3% <Inflation< 10%)

- **Running Inflation:** Price rise at high rate (10% < Inflation < 20%)

- **Hyperinflation or Galloping Inflation or Runway Inflation:** Price rise at very high rate (20% < Inflation < 100%)

Variations in Inflation

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- **Deflation** is when the general level of prices is falling. It is the opposite of inflation.

- **Hyperinflation** is unusually rapid inflation in very short span of time. In extreme cases, this can lead to the breakdown of a nation's monetary system with complete loss of confidence in the domestic currency.

One of the earlier examples of hyperinflation occurred in Germany in early 1920s after the First World War, when prices rose 2,500% in one month.

- **Stagflation** is the combination of high unemployment with high inflation.

This happened in industrialized countries during the 1970s, when a bad economy was combined with OPEC raising oil prices led to low growth.

Impact or Effect of Inflation

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Possible Winners and Losers from High Inflation

One of the effects of inflation is that it can lead to arbitrary changes in the distribution of real incomes and wealth in a country

Winners

- Workers with strong wage bargaining power
- Debtors if real interest rates are negative
- Producers if prices rise faster than costs

Losers

- Retired on fixed incomes
- Lenders if real interest rates are negative
- Savers if real returns are negative
- Workers in low paid jobs

Inflation Indices

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

Wholesale Price Index

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- The Wholesale Price Index is an indicator designed to measure the changes in the price levels of commodities that flow into the wholesale trade intermediaries

- Calculation is done by the Office of the Economic Adviser in Ministry of commerce & Industry
- Items: There are total 696 items in WPI
- These items are divided into three broad categories viz. (1) Primary Articles (2) Fuel & power and (3) Manufactured Products

Consumer Price Index

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- It shows the cost of living of the group. It is based on the changes in the retail prices of goods or services.
- Based on their incomes, consumer spends money on these particular set of goods and services.

- It was computed separately by the Labour Bureau, for the following three groups: (i) CPI for Industrial workers, (ii) CPI for Rural labourers and (iii) CPI for Agricultural labourers.
- But Later CPI New was made as indices for decision on monetary Policy
- At present, CPI uses 2012 as the base year measure.

Consumer Price Index(New)

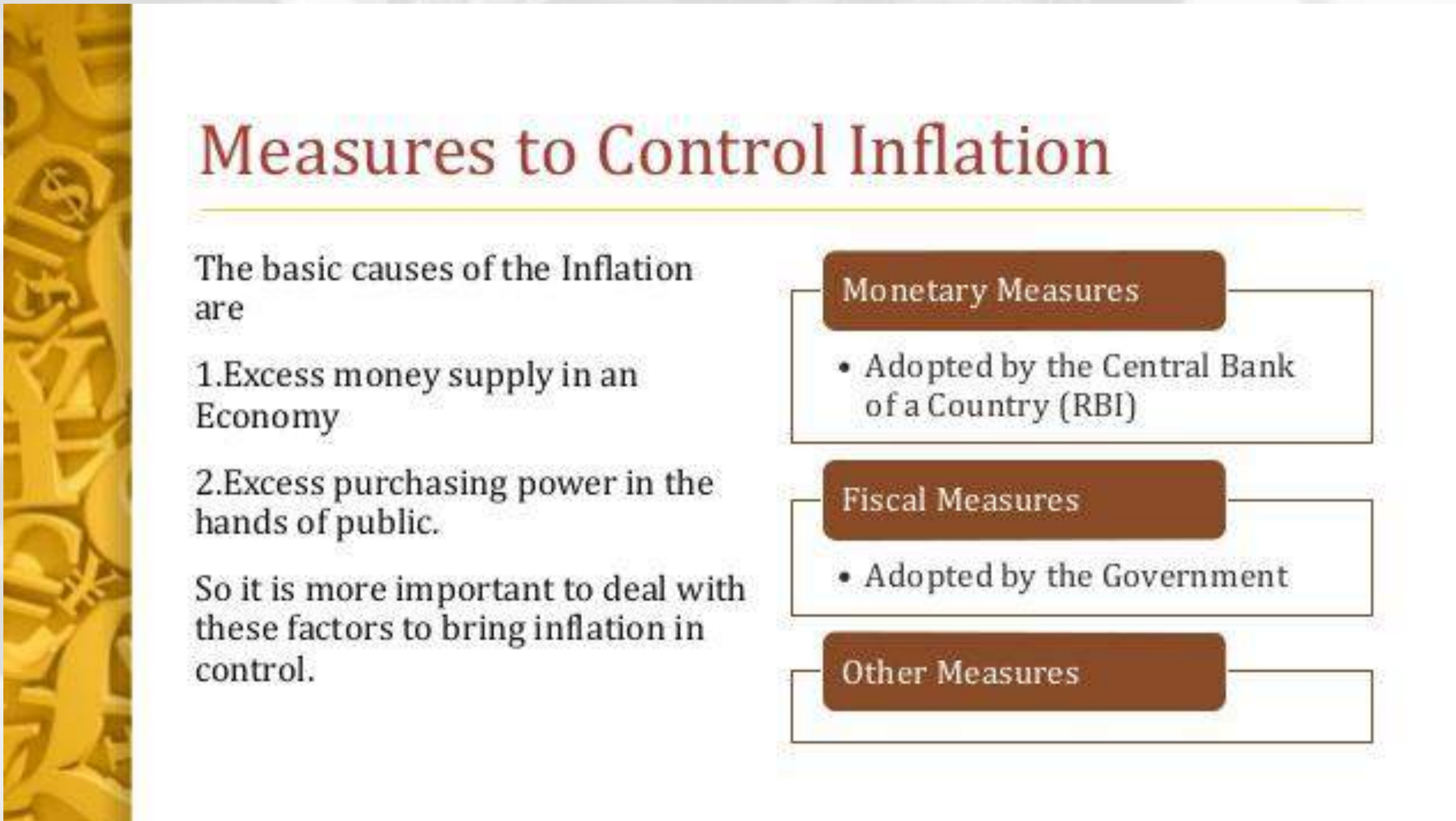
- CPI Rural
- The number of items in CPI basket include 448 in rural.

- CPI Urban
- The number of items in CPI Urban basket is 460.

GDP Deflator

- 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.

Measures to control inflation



Methods to control Inflation

Contractionary Monetary Policy

- OMO by selling the securities
- Raise:
  - Reserve requirement (r.r)
  - Bank Rate/discount rate
  - Interest rate (r)

Contractionary Fiscal Policy

- Lowering Government Spending (G)
- Increase Taxes (T)

Direct control measure

- Price control
- Compulsory savings
- Increase labor production
- Wages control
- Anti-hoarding campaign

MONETARY POLICY

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Yadav

MEANING

- Monetary policy refers to the steps taken by the RBI to regulate the cost & supply of money & credit in order to achieve the socio-economic objectives of the economy.

- The primary objective is to maintain price stability while keeping in mind the objective of growth. In May 2016, RBI Act, 1934 was amended to provide a statutory basis for the implementation of the flexible inflation targeting framework.
- Other Objectives are as Follows

OBJECTIVES OF MONETARY POLICY

- To accelerate the process of economic growth.
- Controlled expansion.
- Price stability
- High Employment
- Financial market stability
- Interest rate stability
- Stability in foreign exchange market

Monetary policy committee (MPC)

- According to the section 45ZB of the amended RBI Act, 1934 provides for an empowered six-member monetary policy committee (MPC) to be constituted by the Central Government.

Members of MPC

- The Members of the current MPC are as follows:-
- Governor of RBI – Chairperson, ex officio;
- Deputy Governor of RBI, in charge of Monetary Policy - Member, ex officio;
- One officer of RBI to be nominated by the Central Board – Member, ex officio;

Working of MPC

- The MPC determines the policy interest rate required to achieve the inflation target. RBI's Monetary Policy Department (MPD) assists the MPC in formulating the monetary policy. Financial Markets Operations

- Department (FMOD) operationalizes the monetary policy, mainly through day-to-day liquidity management operations.

Tools of Monetary Policy

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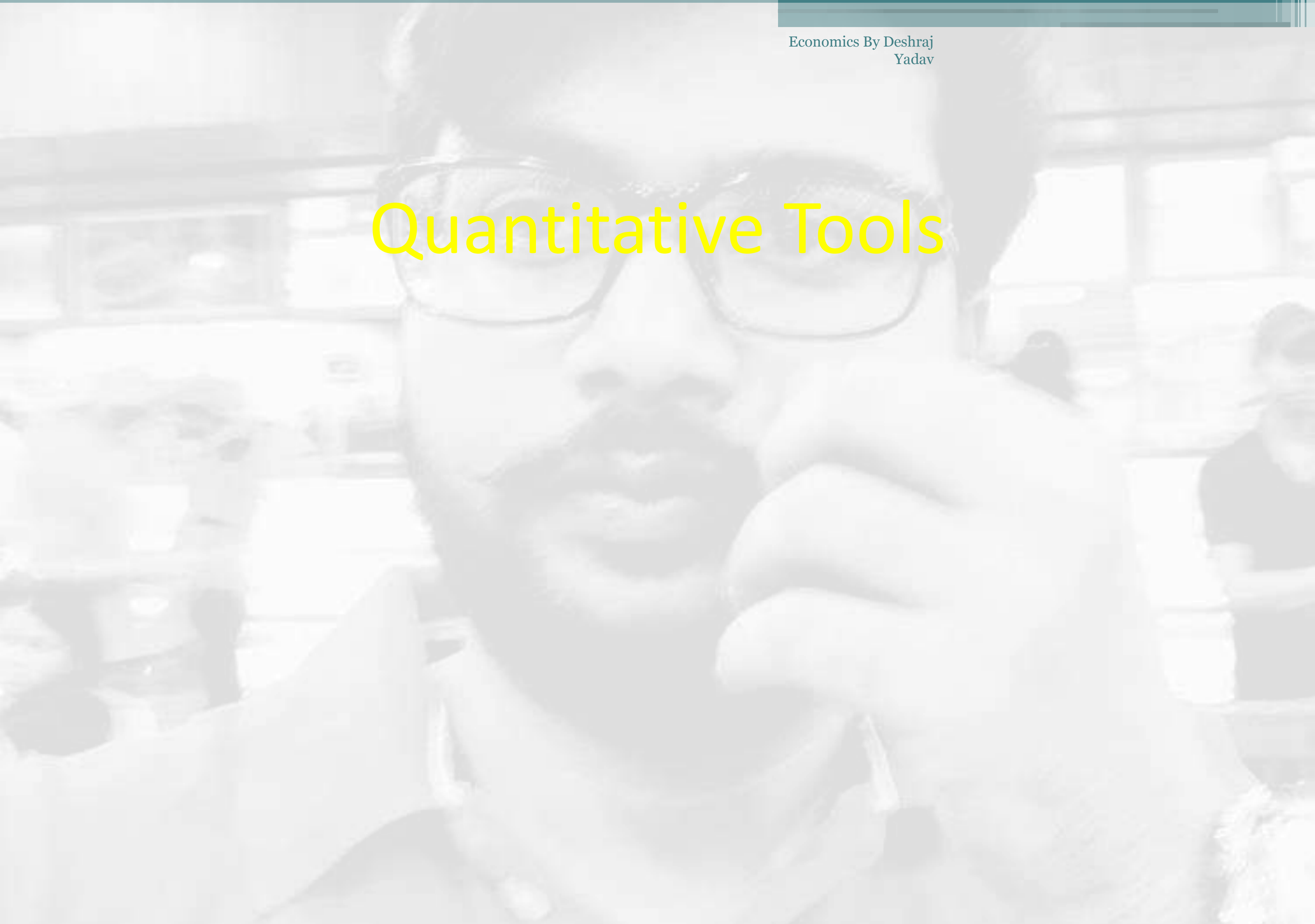
Quantitative Tools

- Bank Rate
- Cash Reserve Ratio
- Statutory Liquidity Ratio
- Repo Rate
- Reverse Repo Rate
- Open Market Operations
- MSF

Qualitative Tools

- Margin Requirement
- Selective credit control
- Moral persuasion
- Direct Action
- Credit Rationing



Quantitative Tools

Bank Rate

- The Rate at which central bank gives loan to other commercial banks for Long term i.e. from a period ranging from 90 days to 1 year.

❖The current Bank rate is 6.25% p.a

What is Reserve Requirement?

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❖A certain fraction of deposits that a depository institution is required to reserve.

Cash Reserve Ratio

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❖The current CRR is 4% p.a

❖**The amount of money/ratio of money that a bank has to keep with RBI in form of cash.**

For ex - When a bank's deposits increase by Rs100, and if the cash reserve ratio is 4%, the banks will have to hold additional Rs 4 with RBI and Bank will be able to use only Rs 96 for investments and lending / credit purpose. Therefore, higher the ratio (i.e. CRR), the lower is the amount that banks will be able to use for lending and investment.

Statutory Liquidity Ratio

❖The amount of money/ratio of money that a bank has to keep with himself in the form of Cash, Gold or Government Securities.

❖**The current SLR is 19 % p.a**

Repo Rate

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- ❖The Rate at which RBI lends money to commercial banks for the short term

- ❖**The current Repo Rate is 6% p.a.**

Reverse Repo Rate

Reverse Repo Rate – It is the rate at which the RBI borrows money from commercial banks. Banks are always happy to lend money to the RBI since their money is in safe hands with a good interest.

Open Market Operations

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❖ Buying and selling of Government securities by RBI in Open market

Marginal Standing Facility Rate (MSF)

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- At financial shortage
- Avail this special facility offered by RBI.
- In MSF, banks can borrow cash from RBI against their approved government securities.
- Preferred during emergency and critical situations only.
- MSF rate is always higher than Repo Rate as banks need the funds instantly.

The MSF rate currently stands at 6.25% p.a.

Qualitative tools

Margin Requirement : -Percentage of a security's value that may be used as a collateral for a loan to finance its purchase.

Rationing of credit

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

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.

Direct Action

Expansionary

Contractionary

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Increases the total supply of money in the economy more rapidly than usual

Expands the money supply more slowly than usual or even shrinks it.


Fiscal Policy

Fiscal Policy

- **Fiscal policy deals with the taxation and expenditure decisions of the government. Some of the major instruments of fiscal policy are as follows: Budget, Taxation, Public Expenditure, public revenue, Public Debt, and Fiscal Deficit in the economy**

Objectives of Fiscal Policy in India

1. To maintain and achieve full employment.

2. To stabilize the price level.

3. To stabilize the growth rate of the economy.

4. To maintain equilibrium in the Balance of Payments.

5. To promote the economic development of underdeveloped countries.

FISCAL POLICY

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FISCAL POLICY is an essential tool at the disposable of govt. to influence a nation's economic growth based on Keynesian economics. It is used in coordination with monetary policy.

OBJECTIVES

- Boosting employment levels & economic development
- Maintain economy's growth rate
- Raising the standard of living
- Maintaining equality in price levels & Balance of Payment

TOOLS

1. TAXATION

It includes taxes on income, property, sales, & investments.

2. PUBLIC SPENDING

It includes subsidies, transfer payments, welfare, and public works projects.

TYPES

1. EXPANSIONARY

To stimulate economic growth by increasing spending /lowering taxes/both.

2. CONTRACTIONARY

To slow the economic growth.

FISCAL DEFICIT

If a govt. spends more than what it earns, it leads to the deficit.

FISCAL SURPLUS

If the govt. spends less than what it earns, it creates a fiscal surplus.

MONETARY POLICY

- Controls money supply.
- Raises/lows the fed funds rate.
- Works faster than fiscal policy
- Helps in maintaining efficiency..


BUDGET
2019

What is Budget?

- A government budget is an annual financial statement presenting the government’s proposed revenues and spending for a financial year that is often passed by the legislature, approved by the chief executive or president and presented by the Finance Minister to the nation.

Basics to Budget

- The word “Budget” is derived from an early 15th century French word, “Bougette”, which means purse or a leather bag.

- According to several popular accounts, Bougette or the purse was used by the British Chancellor to carry his papers, which he presented to the British Parliament. But, it was only in the year 1873 that the word was used particularly to describe an annual financial statement.

- India’s First Budget was presented by James Wilson during Britishers.
- The first budget of India was presented by then finance minister RK Shanmukham Chetty on November 26, 1947.
- The maximum number of 10 budgets have been presented by Morarji Desai.
-

- The printing of budget every year starts with a "halwa-making ceremony". As a part of the ritual, which has continued for long, "halwa" (an Indian sweet dish) is prepared in a bi g "kadhai" (cooking pot) and served to the entire staff in the Ministry.

- **Budget**
- Prepared by Department of Economic Affairs For Current year (April) to next year (March)

- **Survey**
- Draft prepared by Dept. of Economic Affairs Ministry of Statistics & Programme implementation under CSO provide inputs Draft passes through Chief Economic Advisor to FM → Finance Secretary + Finance Minister For previous year (April) till current year (March)

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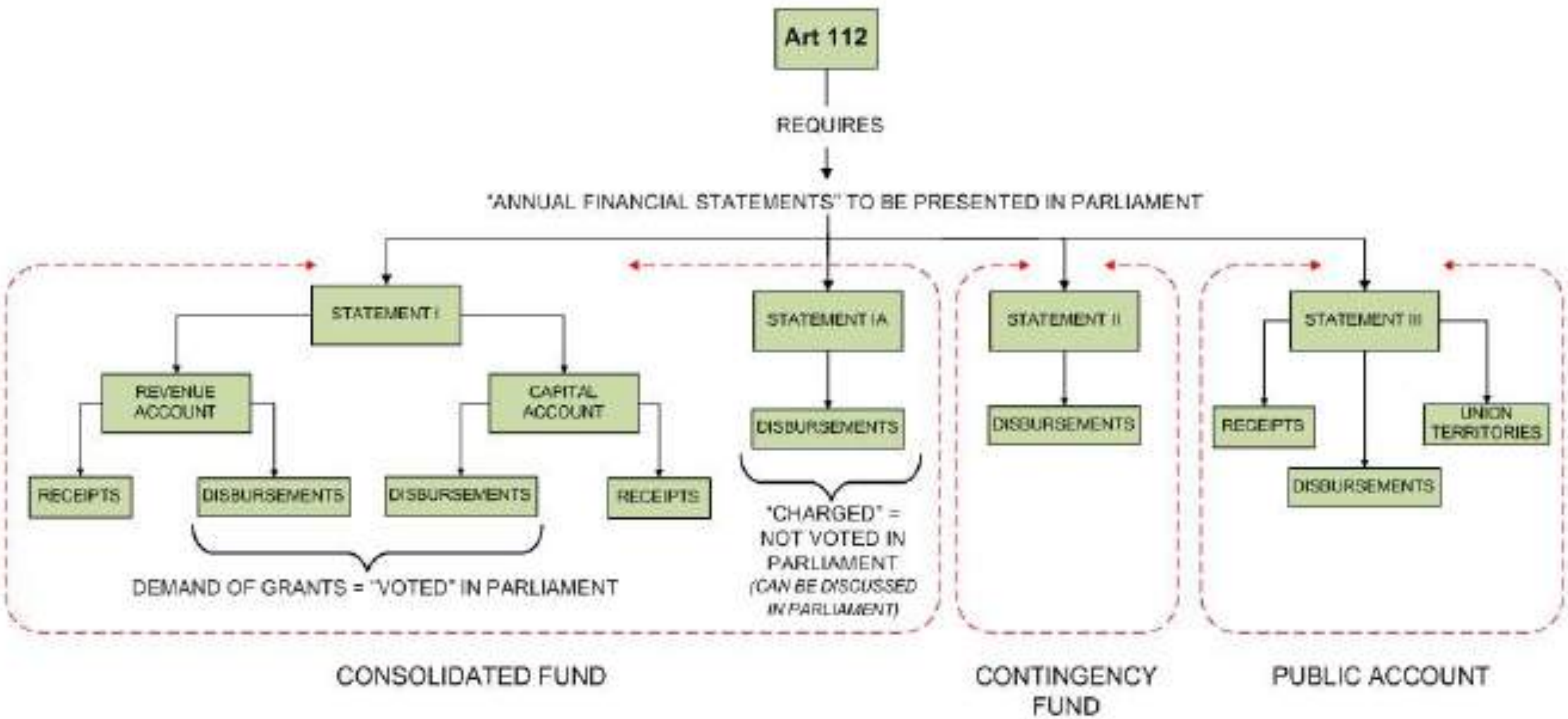


Basic Terms Used in Budget

Vote on Account

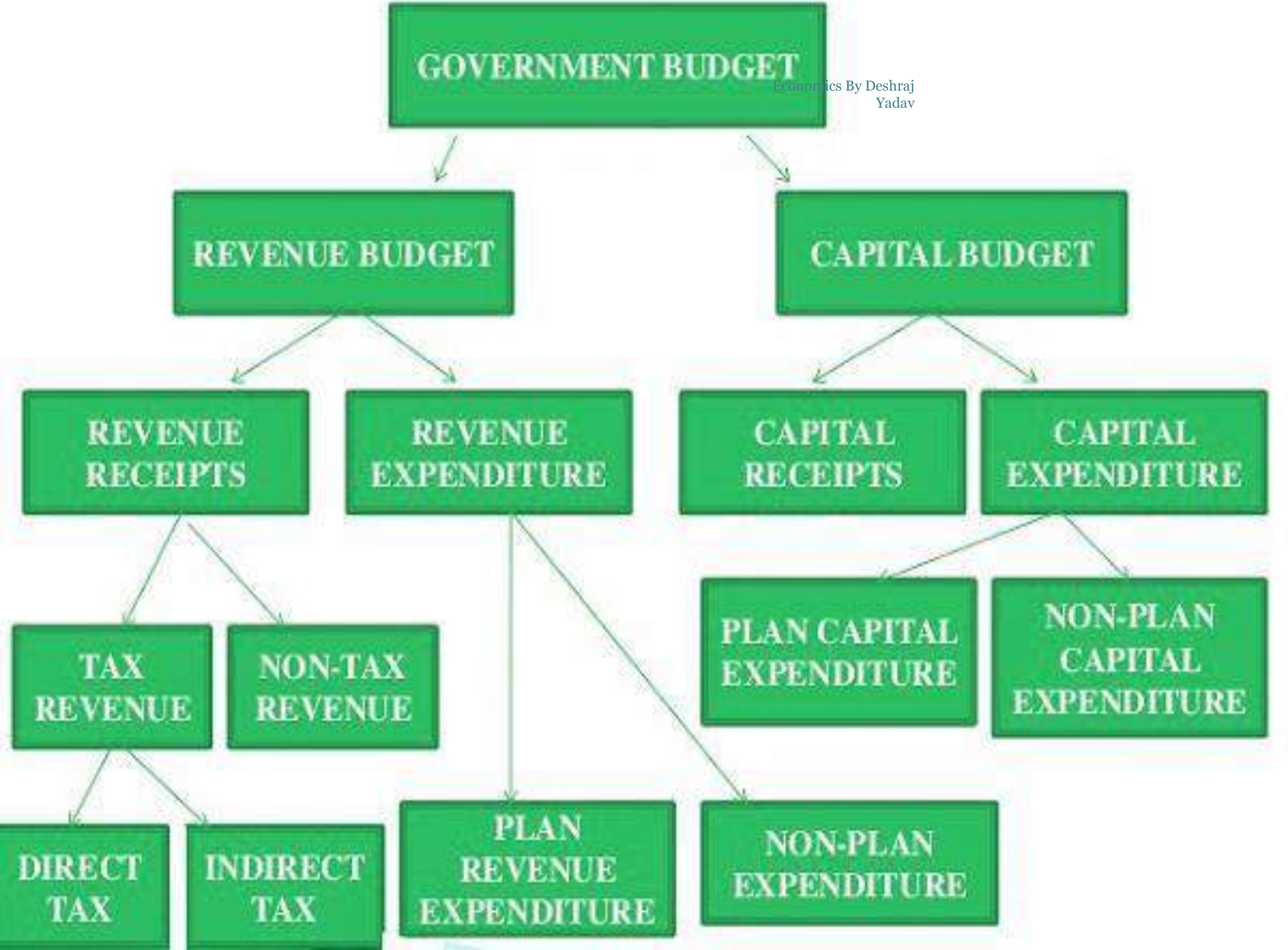
- Passed By Lok Sabha every year → Bill for only Expenditure permission

- Cash required to meet the expenditure that it incurs mainly during the first two months of an financial year, until new appropriation bill is passed by the Lok Sabha, to keep the machinery running Cash is given from Consolidate Fund of India Generally 1/6thof the total estimated expenditure

- **Interim budget**

- Passes in election year or in extreme situation

- Not morally correct for outgoing Government to make drastic changes
- Valid for Entire year viz. 1^{st} April – 31^{st} March; but new Government can change it
- Encloses all major portions of full-fledged budget viz. Annual financial statement
- Finance Bill for tax purpose
- Appropriation Bill to take out money from consolidated fund of India to run the system for given financial year
- Vote on Account to sort out cash problem for first two – four months of new financial year until new appropriation bill is passed



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Budget (Govt.) Receipts

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Revenue Receipts

Tax Revenue

Direct Tax

(Liability to pay and burden of tax falls on the same person)

(Components)

- (*i*) Income tax
- (*ii*) Corporate tax
- (*iii*) Wealth tax
- (*iv*) Gift tax
- (*v*) Estate duty
- (*vi*) Expenditure tax

Indirect Tax

(Liability to pay and burden of tax falls on different persons)

(Components)

- (*i*) Sales tax
- (*ii*) Custom duty
- (*iii*) Excise duty
- (*iv*) Service tax
- (*v*) Entertainment tax

Non-tax Revenue

(Components)

- (*i*) Interest receipts
- (*ii*) Profits and dividend
- (*iii*) Fees and fines
- (*iv*) External grants
- (*v*) Special assessment (or tax)

Capital Receipts

(Components)

- (*i*) Recovery of loans
- (*ii*) Disinvestment
- (*iii*) Borrowings
- (*iv*) Provident funds

Revenue Budget

- The Revenue Budget illustrates the –
  - The Revenue (current) receipts (of the government) and
  - The Revenue expenditure (that can be met from these receipts).
- Revenue Receipts
- **Revenue receipts** are receipts of the government which are non-redeemable, i.e., they cannot be reclaimed from the government.
- Revenue receipts are categorized as –
  - **Tax** Revenue.
  - **Non-tax** Revenues.

- Tax revenues consist of the proceeds of the taxes and other duties levied by the central government.
- Tax revenues are further classified into **direct taxes** (levied directly from the individuals as income tax) and **indirect taxes** (levied on goods and products within the country).
- Corporation tax contributes the largest share in revenue receipts, followed by income tax.

- **Non-tax revenue** of the central government largely comprises of –
  - Interest receipts on account of loans by the central government.
  - Dividends and profits on investments made by the government.
  - Fees and other receipts for services rendered by the government.
  - Cash grants-in-aid from foreign countries and international organizations.

- Revenue Expenditure
- On the other hand, **Revenue Expenditure** largely includes –
  - The expenses incurred for the normal functioning of the government departments and various services.
  - Interest payments on debt incurred by the government.
  - Grants those are given to the state governments and other parties.

- Budget documents classify total expenditure into **plan** and **non-plan expenditure**.
- The plan revenue expenditure includes the central Plans (the Five-Year Plans) and central assistance for State and Union Territory plans.
- Non-plan expenditure includes interest payments, defence services, subsidies, salaries, and pensions.
- **Subsidies** are important policy instruments, destined to promote welfare in the society.

Capital Budget

- The Capital Budget is an account of the assets as well as liabilities of the central government; it takes into consideration changes in capital.
- The capital account is further categorized as follows −
  - Capital Receipts
  - Capital Expenditure (of the government).

Capital Receipts

- Capital Receipts include all those receipts of the government, which create liability or reduce financial assets.
- Main items of capital account are **loans** raised by the government from –
  - The public, which is known as market borrowings.
  - From the Reserve Bank and commercial banks.
  - Other financial institutions through the sale of treasury bills.
  - Loans received from the foreign governments and the international organizations.
  - Recoveries of the loans granted by the central government.

Capital Expenditure

- Capital Expenditure includes the expenditures of the government, which result in the creation of physical or financial assets or reduction in financial liabilities.
- Examples of capital expenditure are as follows –
  - Acquisition of land, building, machinery, equipment, investment in shares, and
  - Loans and advances by the central government to the governments of state and union territory, PSUs and other parties.

Central Government	State Governments	Local Bodies
Income Tax	Sales Tax	Tax on properties
Service Tax	Stamp Duty	Octroi
Customs duties	State Excise	Tax on Markets
Central Excise	Land Revenue	User Charges for utilities like water supply, drainage, etc.
Sales Tax	Duty on Entertainment	
	Tax on Professions & Callings	

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Budget Deficit

- When a government spends more than it receives by the way of revenue, it is known as the **budget deficit**.
- The difference between revenue expenditure and revenue receipts is known as the **revenue deficit**.
- The difference between the government’s total expenditure and its total receipts excluding borrowing is known as the **fiscal deficit**.


Budget
2019-20

Taxes changes

- No income tax for income up to Rs. 5 lakh.(only Rebate from Rs. 2500 to Rs. 12500 has been increased not the slab)
- No tax on notional rent on second self - occupied house.
- Capital Gain exemption under Section 54 to be available on two house properties.
- Standard deduction increased to Rs 50,000 from Rs 40,000.
- TDS limit increased from Rs 10,000 to Rs 40,000 on Bank/post-office savings.

FOR ECONOMY

- Expenditure target for FY20 set at Rs 27.84 lakh crore.
- Capital expenditure for FY20 set at Rs 3.36 lakh crore.
- FY19 fiscal deficit pegged at 3.4 percent of GDP.
- Current account deficit at 2.5 percent of GDP.

For Farmers

- Farmers with less than two hectares to be offered Rs. 6,000 per year as direct transfer under PM Kisaan Samman Nidhi.
- The benefit will be transferred directly into the bank account of beneficiary farmers in three instalments of Rs 2,000 each.
- Around 12 crores farmers expected to be benefited from the scheme.
- This scheme will cost the government around Rs. 75,000 crore.

For Workers

- Monthly pension of Rs 3,000 for workers in the unorganized sector to be paid out after retirement.
- Pension scheme to benefit 10 crore workers in the unorganized sector.
- Those who join at 18 years of age will have to contribute a mere Rs 55 per month. The government will contribute equal matching share in the pension account. This scheme will cost the government Rs 500 crore

- Defence budget for FY20 raised to Rs 3 lakh crore.

- New portal to support national programme on artificial intelligence.
- 1 lakh villages to be transferred into digital ones in 5 years.
- Allocation for north east increased by 21 % to 58166 crore in fy20.
- 6. 25 % additional seats in educational institutions to meet the 10 % reservation for the poor.

Money

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

Functions of Money

(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 THROUGH THE AGES
From shell money to cashless transactions
HUMBLE BEGINNINGS
Cowrie Shells are some of the earliest documented forms of a currency system in India, pre-dating many Indian dynasties and kingdoms.
EARLY COINAGE
The first coinage systems appeared around the 7th to 6th Centuries BC. Pictured on the left is a collection of silver Mauryan coins.
COLONIAL CURRENCY
Under British rule, Indian currency went through several iterations with different series. (Right) 1 Mohur from 1862, the Victoria series.
THE AGE OF PAPER MONEY
Post-Independence, cash - especially paper money - established an unshakeable foothold in India. Despite two denomination cycles, paper money continues to hold sway over large chunks of the Indian currency system.
THE ROAD AHEAD
The recent demonetisation cycle has increased adoption of digital and cashless payment systems in India. Is paper money on the way out? Only time will tell.

Work Sheet

History of the Indian currency & its evolution

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- The first Indian coins – punch marked coins called Puranas, Karshapanas or Pana – were minted in the 6th century BC by the Mahajanapadas (republic kingdoms) of ancient India.
- These coins had irregular shapes, standard weight and different markings.

- Mauryas punch marked their coins with a royal standard, minting of silver, gold, copper or lead.
- The Indo-Greek Kushan kings who came next introduced the Greek custom of engraving portrait heads on coins.
- Then, the Gupta Empire produced large numbers of gold coins depicting the Gupta kings performing various rituals

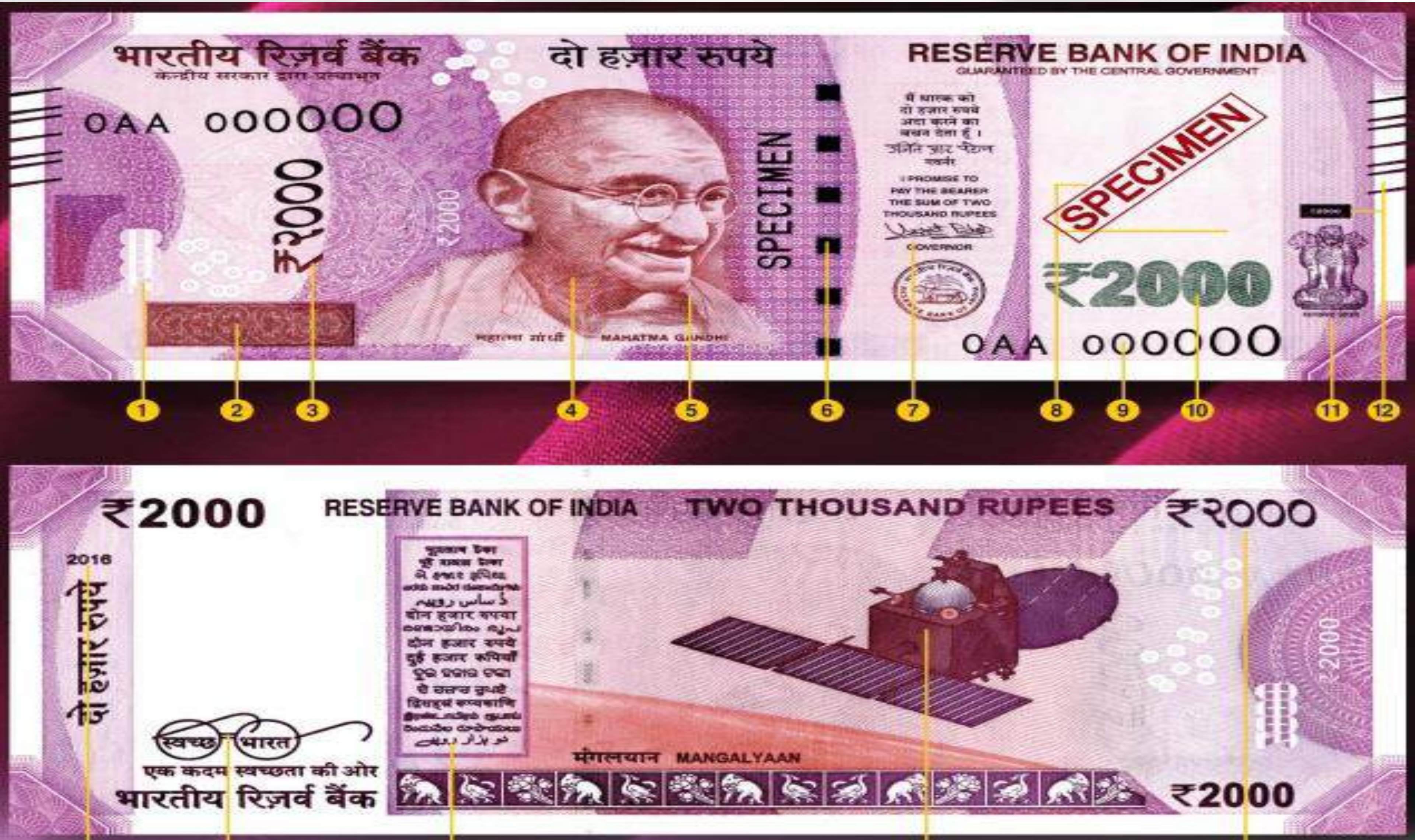
- During Turkish Sultan of delhi currency made in gold, silver and copper – was now referred to as tanka, with the lower valued coins being called jittals.
- The Mughal Empire from 1526 AD consolidated the monetary system for the entire empire

- When Sher Shah Suri defeated Humayun and issued a silver coin of 178 gms, known as Rupiya and was divided into 40 copper pieces or paisa.

- In 1717 AD, the English obtained permission from Mughal emperor Farrukh Siyar to coin Mughal money at the Bombay Mint.
- The British gold coins were termed carolina, the silver coins angelina, the copper coins cupperoon, and the tin coins tinny

- Paper money was first issued in British India in the 18th century, with the Bank of Hindostan, General Bank in Bengal and the Bengal Bank becoming the first banks in India to issue paper currency.

- In 1861, the Government of India enacted the Paper Currency Act which granted it a monopoly over the issue of notes and ended the issuance of notes by private and Presidency Banks.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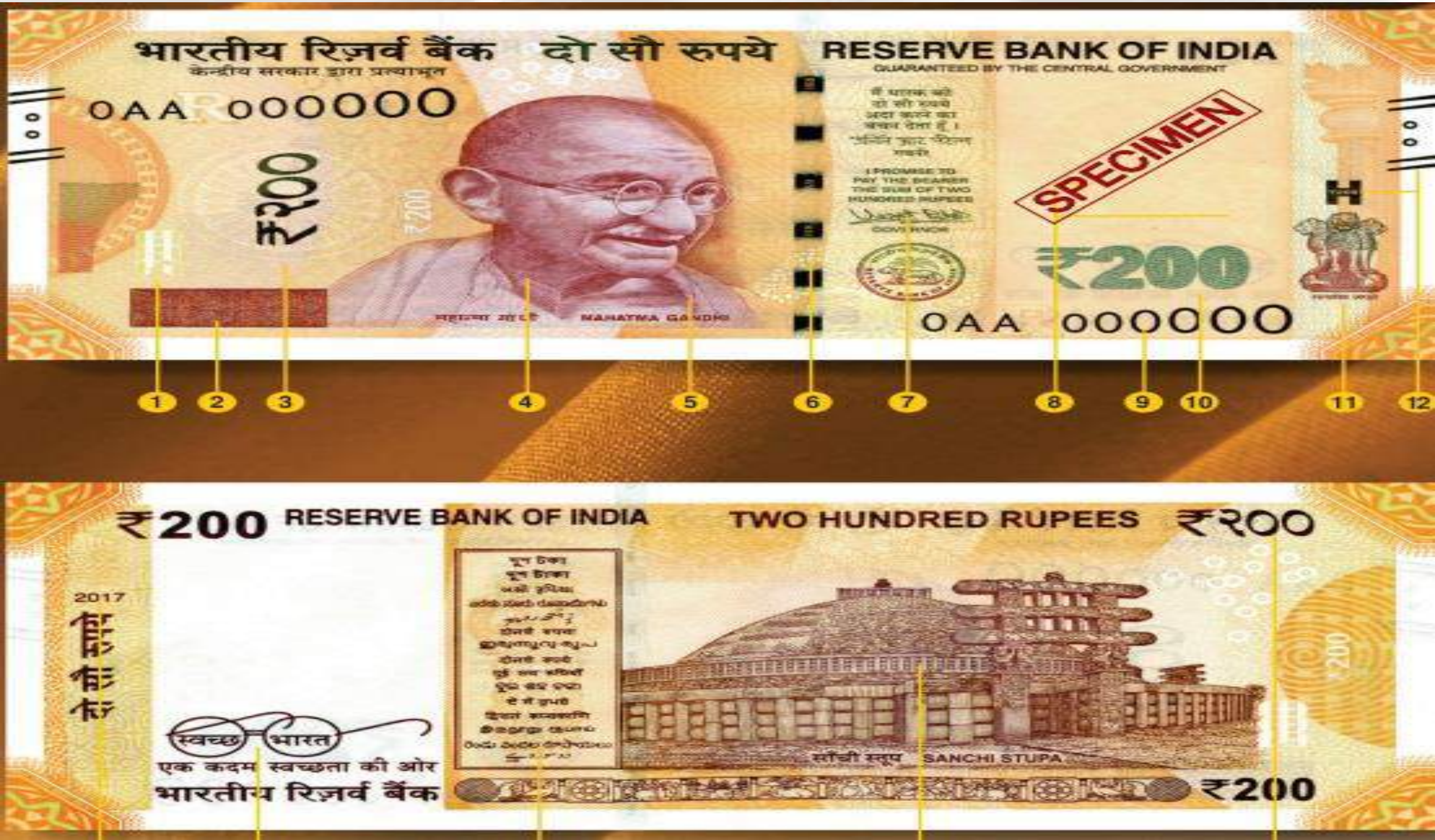
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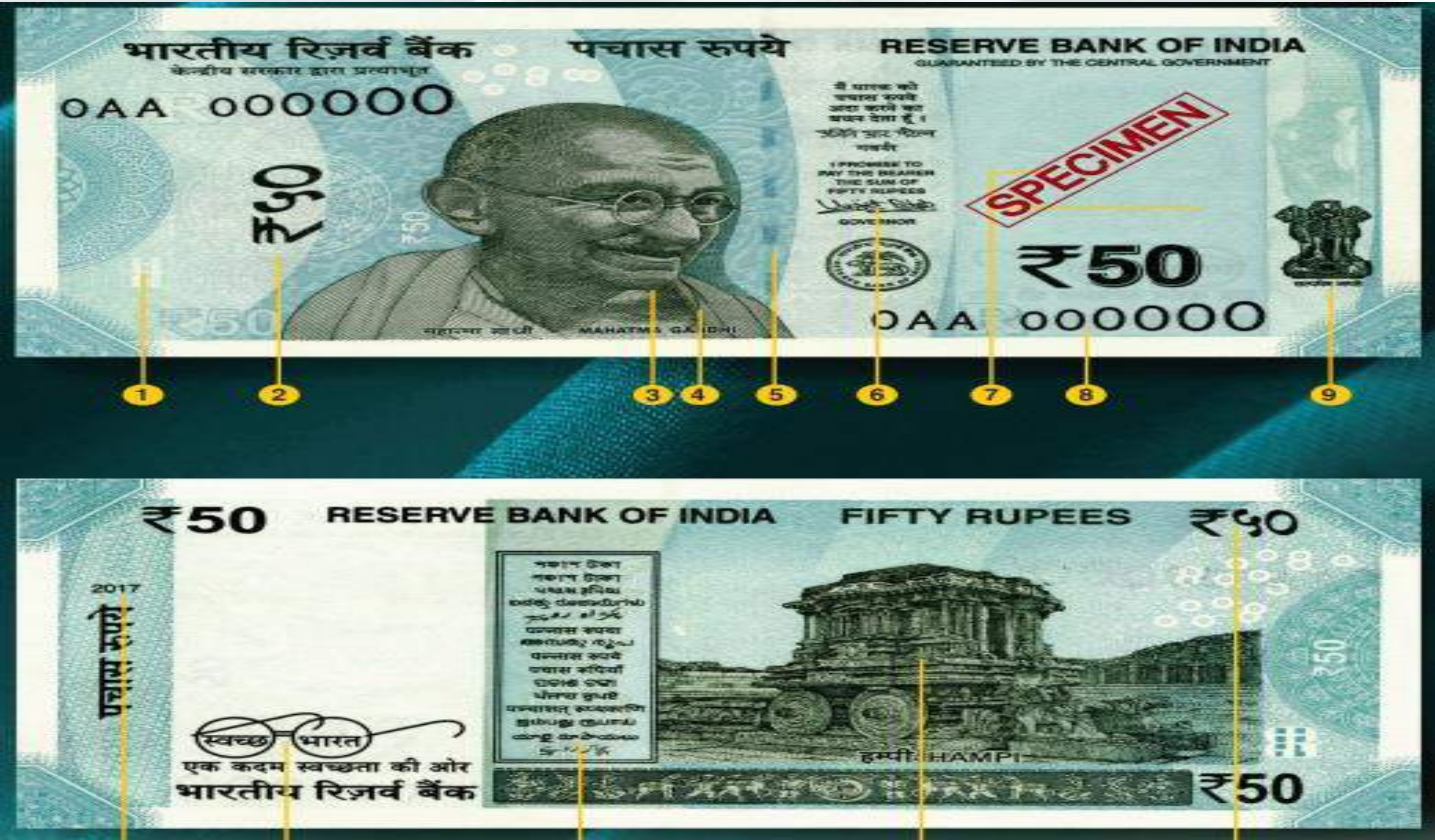
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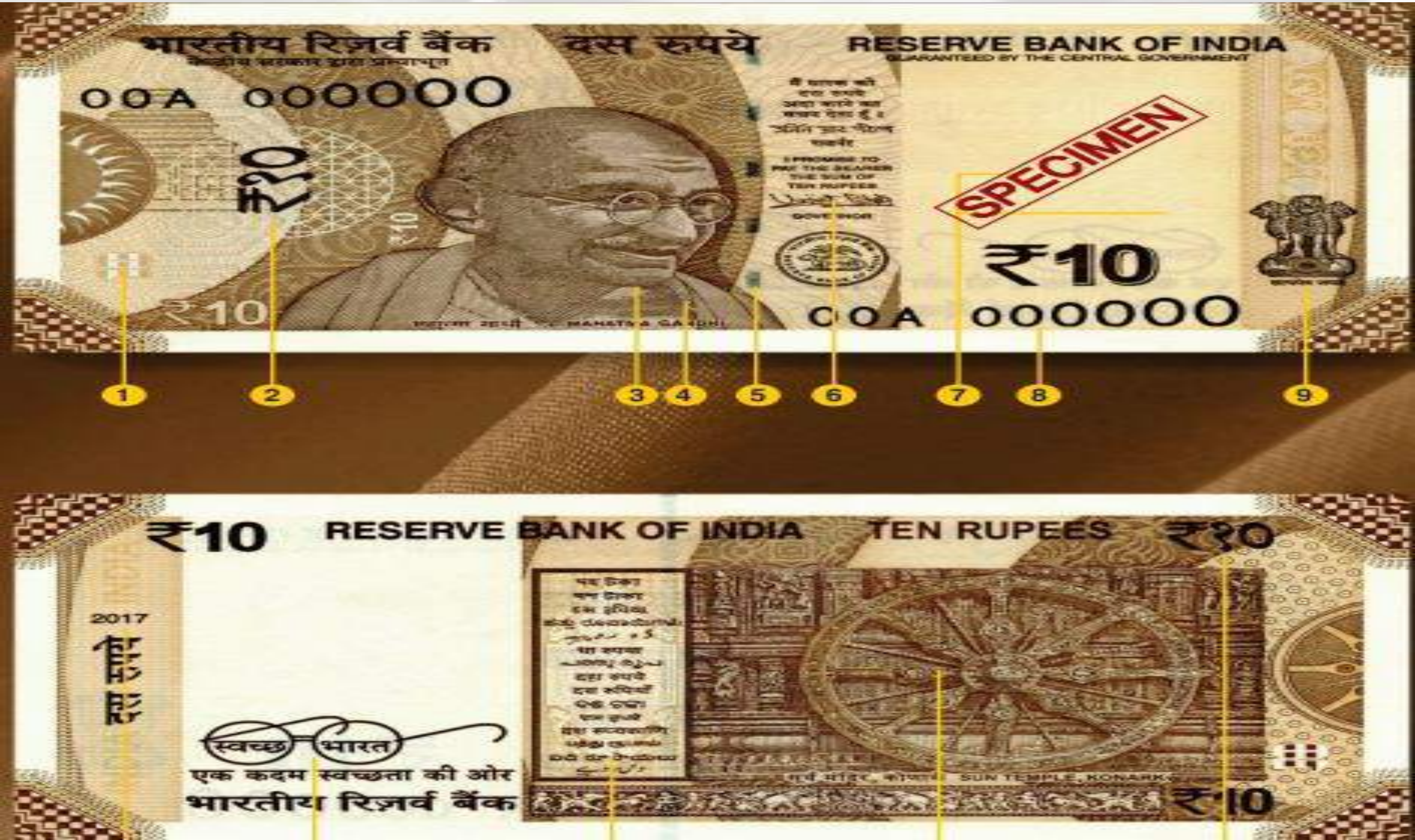
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एक कदम स्वच्छता की ओर
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Indian Currency

- 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.
- Presently Indian Currency system is based on the **Minimum Reserve System.**

What is Plastic Money ?

- Plastic money is a term that is used predominantly in reference to the hard plastic cards we use everyday in place of actual bank notes.

- Examples :- Cash Cards Credit Cards Debit Cards Pre-paid Cash Cards In-store cards

What is cryptocurrency?

- Cryptocurrency is an encrypted decentralized digital currency transferred between peers and confirmed in a public ledger via a process known as mining.
- Examples :-
- Bitcoins
- Litecoin
- Namecoin
- Swiftcoin
- Bytecoin
- Gridcoin

Important terms

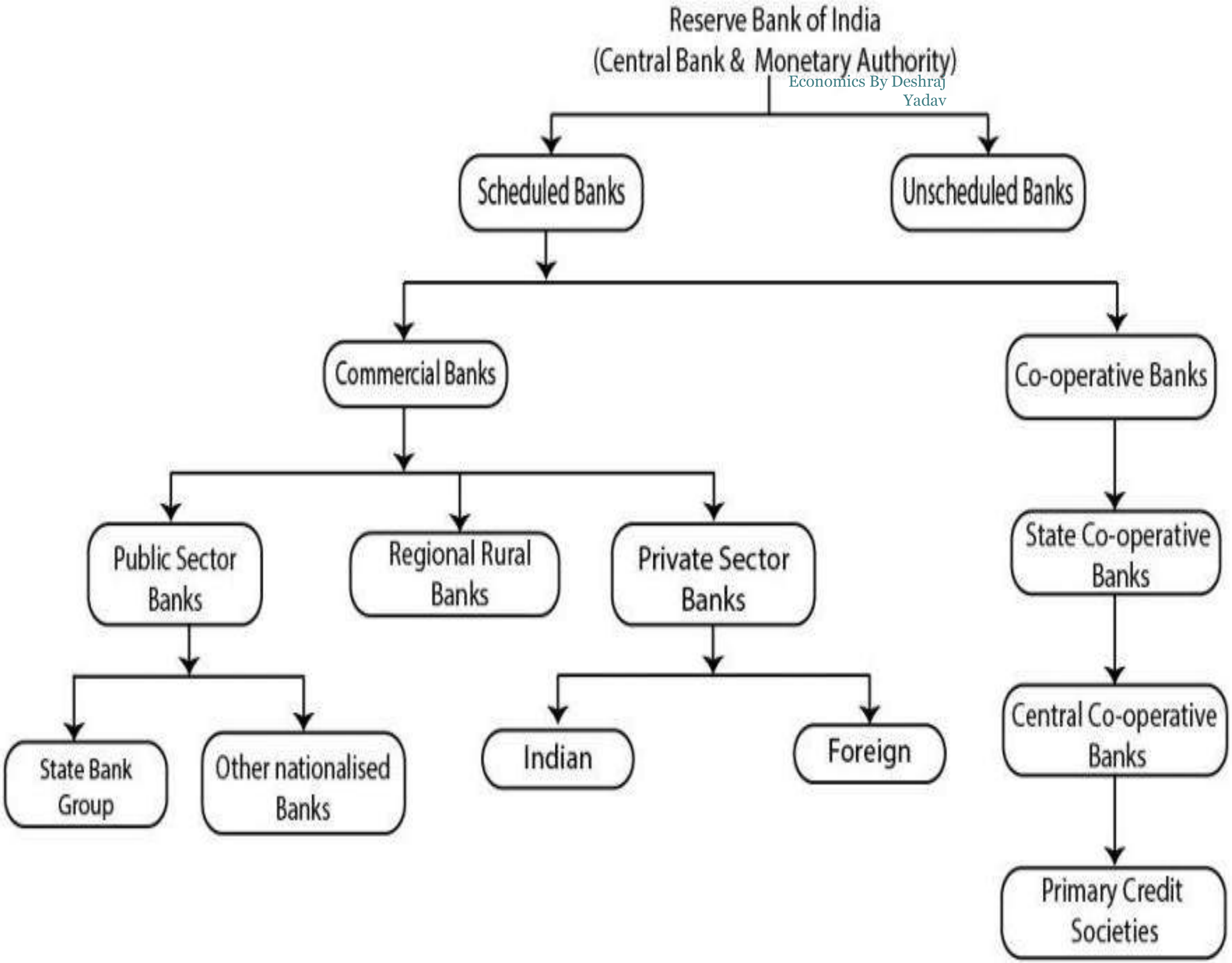
- **Blockchain technology**
- The blockchain is an incorruptible digital ledger of economic transactions that can be programmed to record not just financial transactions but virtually everything of value.
- **Public Ledgers**
- All confirmed transactions from the start of a cryptocurrency's creation are stored in a public ledger. The identities of the coin owners are encrypted, and the system uses other cryptographic techniques to ensure the legitimacy of record keeping. The ledger ensures that corresponding digital wallets can calculate an accurate spendable balance.
- **Transactions**
- A transfer of funds between two digital wallets is called a transaction. That transaction gets submitted to a public ledger and awaits confirmation.
- **Mining**
- In simple terms, mining is the process of confirming transactions and adding them to a public ledger. In order to add a transaction to the ledger, the "miner" must solve an increasingly-complex computational problem (like a mathematical puzzle).

Banking History

- The first commercial bank was established in 1770 by Alexander & Company. It was named *Hindustan Bank.*
- 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.

- On July 1, 1955, the Imperial Bank of India was partially nationalised and it was named State Bank of India.

- 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



Economics By Deshraj Yadav