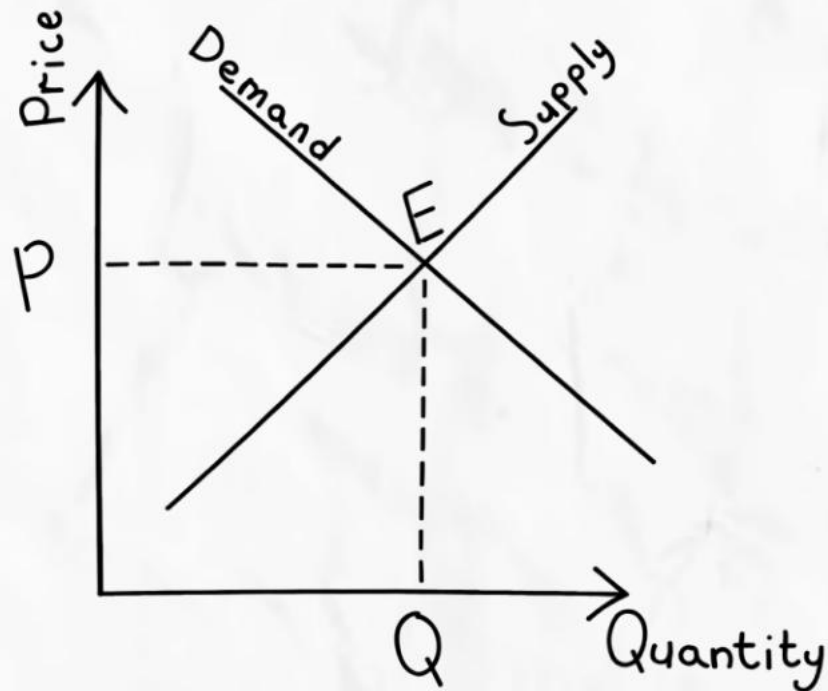


BUSINESS ECONOMICS

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On behalf of TEAM YES

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PAPER 3: BUSINESS ECONOMICS

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CHAPTER – 1 – BASICS OF DEMAND AND SUPPLY AND FORMS OF MARKET COMPETITION

LESSON 1

BASICS OF DEMAND AND SUPPLY AND FORMS OF MARKET COMPETITION

INTRODUCTION:

Study of Economics

- Study of Economics provides a systematic understanding of economic events
 - These events are very significant for day to day functioning of:
 - a family
 - a company
 - a country
 - world at large

Restaurant Bill as an Economic Document

- A restaurant-bill provides us a lot of information about restaurant business in a locality
 - To interpret that information one must have a basic understanding about economics

Information Visible on a Restaurant Bill

- The first visible information on the bill is the rate of tax charged on eatables from a restaurant
- If due attention is paid, one must come across reason behind the specific prices charged for dishes listed in the bill

Basis of Pricing of Dishes

- Prices are basically charged upon:
 - the cost of purchasing
 - the cost of processing
- These costs are calculated for each item separately

Cost Difference Between Food Items

- Dairy and Bakery products are relatively less-costlier than poultry products
 - Such are their costs in a restaurant

Processing Cost and Labour Cost

- The cost involved in processing of an ice-cream is lesser than meat
- So the meat served in a restaurant is priced higher than the market price of the raw meat
- While the price of ice-cream served there will only be little bit higher than the price of ice-cream in market
- This processing charge is the labour cost or wage payment for the workers in that restaurant

Wages and Restaurant Reputation

- Labour wages in famous restaurants are higher than other restaurants
- So are their processing charges

Other Economic Insights from a Restaurant Bill

- There can be several other insights from the bill like:
 - rents for the place occupied by restaurant
 - supply of unprocessed food materials
 - fresh vegetables
 - meat
 - dairy products
 - etc. and others

Participation in Economic Activities

- It shows that with or without understanding of economics we take part in various economic activities
- We take part as an agent on a regular basis

Importance of Studying Economics

- The study of economics gives us an advantage to:
 - understand the dynamics behind economic activities
 - develop ability to interpret them
- This sort of interpretation helps in:
 - understanding business for all possible changes
 - manipulation
 - further advancement in future

In general, there are following reasons for studying economics;



- a) **Economics for citizenship** – Solution to most of the problems we confront in day to day life have political aspect. And *majority of political problems are resolved through economic strategies and planning*. Be it the issue of international trade agreement, tax restructuring or launching welfare program. The basic understanding of economics is beneficial for both – voters as well as elected officials.

- b) **Achieving Social Change** – There is no dearth of social problems that required our attention. Be it poverty, inequality, hunger, crime, unemployment, terrorism, illiteracy, malnutrition or any other social problems, *economics can certainly help us understand the origins of these problems, explain why previous efforts to solve them haven't succeeded, and help us to design new, more effective solutions.*
- c) **Personal and Professional Development** – Economics has been one of the *most popular subject choice in leading colleges and universities in India at bachelor degree level for students intending to work in business.* It has also been popular among students planning for career in law, politics, international law, industrial engineering and other profession only because it can help them in understanding their field better and may affect their business.
- d) **Tool for Rational Thinking** – Economics has great deal of *dependency over mathematics and statistics in pursuit of finding objective explanation for the problem* and complex solutions to those problems. For example, the development of 'Human Development Index' or HDI which is a comprehensive tool for mapping not only economic but social and educational development of the country or region.

THE ECONOMIC PROBLEM- SCARCITY AND CHOICE?

The word 'Economics' is derived from the Greek word 'Oikonomia' which can be divided into two parts:

- (a) 'Oikos', which means 'House', and
- (b) 'Nomos', which means 'Management'.

Together they mean managing household. The coverage of economics is broader than the meaning of the word 'Economics'.

The study of economics is a social science primarily concerned with analyzing the choices that individuals, businesses, governments, and nations make to allocate limited resources.

Economics is the study of choice under conditions of scarcity.

This definition has two parts;

- a) Choice and*
- b) Scarcity.*

Scarcity is a situation in which the amount of something available is insufficient to satisfy the desire for it. As an individual, for instance, we face scarcity of time and spending power. Given more of either, we could have more of the good and services that we desire.

Because of the scarcities of time and spending power, each of us is forced to make choices. We must allocate our scarce time to different activities: work, play, study, sleep, shopping and more.

At any given point of time, a society also faces unlimited wants and limited resources. The limited resources have alternative uses to which they can be put to use. Out of these alternative uses of scarce resources and unlimited wants, society has to make choice. The problem of scarcity and choice forms the core of Economics.

Hence, economics is the study of alternate systems requisite to allocate these resources between competing ends.

In view of allocation of resources, it can be said that;

Economics is the study of how we choose to use limited resources with alternative uses to obtain the maximum satisfaction of unlimited human wants.

HOW TO DEFINE ECONOMICS?

Steven D. Levitt, an award winning economist, said that "Since the science of economics is primarily a set of tools, as opposed to a subject matter, then no subject, however offbeat, need be beyond its reach."

Steven Levitt had pointed in 'Freakonomics' that economics is primarily a set of tools before being a subject and the range of issues economics deals with is vast enough (ranging from individual consumer choices to buy a burger or not to buy a burger to enumerating causes of global financial crisis) to be captured in one definition.

There are four such notable definitions;

a) The Wealth Definition Of Economics

Adam Smith (1723-1790) defined Economics as- Science of wealth with an objective to increase wealth and richness of a country.

Key Features of Wealth Definition:

- i) The objective of Economics is to increase the wealth of a country.
- ii) It considers production, distribution and consumption as core of economic activity.
- iii) It deals with causes of creation of wealth in an economy.
- iv) The term 'wealth' used in this definition considers material wealth.

b) The Welfare Definition of Economics

Alfred Marshall (1842 - 1924) defined Economics as - the study of mankind in the ordinary business of life. According to him, "Economics examines that part of individual and social action which is most closely connected with the attainment and with the use of material requisites of well being."

Key features of Welfare Definition:

- i) It defines Economics as the study of activities related with human being and their material welfare.
- ii) Marshall clarified that Economics is related with incomes of individuals and its uses for creating material welfare.
- iii) Collectively incomes of a group of individuals form the wealth of a nation and ultimate objective of Economics is to increase welfare of individual by their day to day activities.

c) The Scarcity Definition of Economics:

Lionel Charles Robbins (1898 – 1984) defined Economics as – a science which studies human behaviour as a relationship between ends and scarce means which have alternative uses.

Key features of Scarcity Definition:

- i) It recognized that Economics is a science deals with the economic behaviours of human being.
- ii) It also assessed that all the physical and non-physical resources have associated with scarcity.
- iii) The resources have multiple utility and it can only be used either for one purpose or another. The use of most of the resources are mutually-exclusive.
- iv) There is a need of efficient use of scarce resources, and primary objective of Economics is to ensure efficiency in use of resources with a purpose to satisfy human wants.

d) The Growth Definition of Economics:

Paul Samuelson (1915 – 2009) defined Economics as – the study of how man and society choose with or without the use of money to employ the scarce productive resources, which have alternative uses, to produce various commodities over time and distributing them for consumption, how or in the future among various person or groups in society.

Key features of Growth Definition:

- i) It deals with allocation of scarce resource to be used in productive purposes.
- ii) The selection of most efficient use of the resources from the alternative ways.
- iii) The growth of economies will depend upon the consumption and production in the economy.
- iv) This definition also points towards Economics as a study of economic system. Other definitions of economics, as provided by various economists are as under: “Economics is the science which deals with wealth.” – J.B. Say.

“Economics is the body of knowledge which relates to wealth” – Prof. Walker.

“Economics investigates the nature of wealth and the laws of production and its distribution,”
– J.S. Mill “The subject treated by political economics is not happiness, but wealth” – Prof.

Senior

WHAT IS THE NATURE OF ECONOMICS?

The very first question to describe the nature of economics is to ask - *whether economics is a science or an art or both.*

Science uses empirical approach. Here are five key features of scientific study;

- a. Verifiability,
- b. Objectivity,
- c. Controllability
- d. Reliability and
- e. Predictability.

The definition of Economics clearly underlines it as a subject which is centered around economic behaviour of human beings. *The study of human behaviour is different from the study of nature.* The objectivity, controllability and other features of typical science subjects do not amicably fit for the study of human behavior in a social setting.

Further, it is also mentioned that basic economics is a set of tools for measurement of economic process; be it GDP growth rate, inflation rate, elasticity of demand etc., and this feature adds significant limitation on Economics being an art. Therefore, *Economics is being placed in the midst of being science or art.*

Economics as a Science

A subject is considered science if:

- It is a *systematised body of knowledge* which studies the relationship between cause and effect.
- It is *capable of measurement.*
- It has its own *methodological apparatus.*
- It should have the *ability to forecast.*

The law of demand: It explains the *cause and effect relationship* between price and quantity demanded for a commodity. It says, given that other things remain constant, as price rises,

the demand for a commodity falls and vice versa. Here, the cause is price and the effect is change in quantity demanded.

Similarly, the *outcomes are measurable* in terms of money.

It has its *own methodology of study* (induction and deduction) and it forecasts the future market condition with the help of various statistical and non-statistical tools.

Thus, a majority of economic laws are of this type and therefore, *economics is science*.

But it is to be noted that *economics is not a perfect science like physical science*. The fact is that we cannot rely upon the accuracy of the economic laws. The predictions made on the basis of economic laws can easily go wrong.

This is because *economists do not have uniform opinion about a particular event*. The problem of actual results differing from the predicted ones arises on account of the fact that in economics we cannot have controlled experiments.

This is so because *economic processes involve human agency, their behaviours and adaptation to a particular economic situation*. In other words, the subject matter of economics is the economic behaviour of man which is highly unpredictable. *Money which is used to measure outcomes in economics is itself a dependent variable*. It is not possible to make correct predictions about the behaviour of economic variables.

Economics as an Art

A discipline of study is termed as art if it tells us how to do a thing that is to achieve an end (objective).

Prof. J. M. Keynes says that "An art is a system of rules for the achievement of a given end."

"Every individual economic unit whether acting as a consumer or a producer or an investor or a supplier of an input or in any other capacity has an economic goal to achieve."

- *Example:*
 - consumer → has an economic goal to achieve
 - producer → has an economic goal to achieve
 - investor → has an economic goal to achieve
 - supplier of an input → has an economic goal to achieve

Art is nothing but practice of knowledge. Whereas science teaches us to know, art teaches us to do. Unlike science which is theoretical, art is practical.

Its various branches provide practical solutions to various economic problems. It helps in solving various economic problems which we face in our day-to-day life.

Hence, Economics is not a pure science as other natural sciences. Economics does follow standard practices adopted by science subjects, since it has human element attached in its processes, it cannot completely satisfy the fundamental requirements of being a science subject. Economics is both a science and an art. It is science in its methodology and art in its application.

Positive and Normative Economics:

The application of mathematical models, empirical testing of economic theories, scientifically obtainable results for business or policy decisions makes Economics as being positive in nature while moral, ethical and collective welfare approaches used in Economics make it normative in nature.

A positive or pure science analyses cause and effect relationship between variables but it does not pass value judgment. In other words, it states what is and not what ought to be. Positive statements are about facts. They state what the reality is.

According to **Robbins**, economics is concerned only with the study of the economic decisions of individuals and the society as positive facts but not with the ethics of these decisions. Economics should be neutral between ends.

It is not for economists to pass value judgments and make pronouncements on the goodness or otherwise of human decisions.

An individual with a limited amount of money may use it for buying liquor and not milk, but that is entirely his business. A community may use its limited resources for making guns rather

than butter, but it is no concern of the economists to condemn or appreciate this policy. *Economics only studies facts and makes generalizations from them.* It is a pure and positive science, which excludes from its scope the normative aspect of human behaviour.

Complete neutrality between ends is, however, neither feasible nor desirable. It is because in many matters the economist has to suggest measures for achieving certain socially desirable ends.

For example, when he suggests the adoption of certain policies for increasing employment and raising the rates of wages, he is making value judgments; or that the exploitation of labour and the state of unemployment are bad and steps should be taken to remove them. Similarly, when he states that *the limited resources of the economy should not be used in the way they are being used and should be used in a different way*; that the choice between ends is wrong and should be altered, etc. he is making value judgments.

Normative Economics is concerned with normative statements. *Normative statements are concerned with what ought to be?* In this case, economics is not concerned with facts rather it is concerned with how things should be.

As normative science, economics involves value judgments. It is *prescriptive in nature* and describe 'what ought to be' or 'what should be the things'.

For example, the questions like what should be the level of national income, what should be the wage rate, how much of national product be distributed among people - all fall within the scope of normative economics. Thus, normative economics is concerned with welfare propositions.

Thus, *Economics is both positive as well as normative in nature.*

SCOPE OF ECONOMICS

The scope of the subject of economics is vast and ever expanding. It is no more a branch of knowledge that deals only with the production and consumption.

- One example gives us an understanding of how vast the scope of the subject of economics is.
- In December 2007, the **IPCC** was awarded the **Nobel Peace Prize**
 - for their efforts to build up and disseminate greater knowledge about man-made climate change
 - and to lay the foundations for the measures that are needed to counteract such change
- IPCC basically presented economic analysis of impacts of climate change
 - and estimates to mitigate the challenge of climate change
- Economics is being extensively used in assessment of impact of climate change in:
 - industrial zone
 - environmental projects
 - energy plants
 - investment in renewable energy resources like solar, wind, tidal and others
- Economics is also used for assessment of:
 - economic efficiency of space mission
 - socio-economic problems like expenditure on health-care
 - eradication of poverty
 - management of government budget
 - taxation
 - investment in industrial production

Given this, we can list some of the major branches of economics as under:

- (i) **Micro Economics:** *This is considered to be the basic economics. Microeconomics may be defined as that branch of economic analysis which studies the economic behaviour of the individual unit, may be a person, a particular household, or a particular firm. It is a study of one particular*

unit rather than all the units combined together. The microeconomics is also described as price and value theory, the theory of the household, the firm and the industry.

- (ii) **Macro Economics:** Macroeconomics may be defined as that branch of economic analysis which studies behaviour of not one particular unit, but of all the units combined together. Macroeconomics is a study in aggregates. Hence, it is often called Aggregative Economics. In this method, we study how the equilibrium in the economy is reached consequent upon changes in the macro- variables and aggregates. The publication of Keynes' General Theory, in 1936, gave a strong impetus to the growth and development of modern macroeconomics.
- (iii) **International Economics:** As the countries of the modern world are realising the significance of trade and commerce with other countries, the role of international economics is getting more and more significant nowadays.
- (iv) **Public Finance:** The great depression of the 1930s led to the realization of the role of government instabilising the economic growth besides other objectives like growth, redistribution of income, etc. Therefore, a full branch of economics known as Public Finance or the fiscal economics has emerged to analyse the role of government in the economy. Earlier the classical economists believed in the laissez faire economy ruling out role of the government in economic issues.
- (v) **Development Economics:** After the Second World War many countries got freedom from the colonial rule, their economics required different treatment for growth and development. This led to emergence of new branch of economics known as development economics.
- (vi) **Health Economics:** A new realisation has emerged from human development for economic growth. Therefore, branches like health economics are gaining momentum. Similarly, educational economics is also coming up.
- (vii) **Environmental Economics:** Unchecked emphasis on economic growth without caring for natural resources and ecological balance, now, economic growth is facing a new challenge from the

environmental side. Therefore, *Environmental Economics* has emerged as one of the major branches of economics that is considered significant for sustainable development.

(viii) **Urban and Rural Economics:** Role of location is quite important for economic attainments. There is also much debate on urban-rural divide.

Therefore, *economists have realised that there should be specific focus on urban areas and rural areas*. Therefore, there is expansion of branches like urban economics and rural economics. Similarly, regional economics is also being emphasised to meet the challenge of geographical inequalities.

There are many other branches of economics that form the scope of economics. There are welfare economics, monetary economics, energy economics, transport economics, demography, labour economics, agricultural economics, gender economics, economic planning, economics of infrastructure, etc.

WORKING OF AN ECONOMIC SYSTEM

An **Economic System** is an entire set of arrangements and institutions meant for meeting the two-fold objectives of a society:

- increasing the availability of resources
- ensuring the economic use

Broadly speaking, types of economic systems are based upon per capita income, prioritization of individuals to spend their resources and scarcity of both income and resources.

The best possible solution to these three potential problems is the basis of a successful economic system. Precedence set by society, its individuals and the government for the attainment of resource mobility and individual freedom is fundamental to the right choice of system for any society.

There are three different types of economic system.



A CAPITALIST ECONOMY:

A Capitalist economic system is one which is characterized by free markets and the absence of government intervention in the economy. In practice a capitalist economy will need some government intervention, primarily to protect private property.

In the real world, many economies which are viewed to have a capitalist economic system may have government spending taking up 35% of GDP. This is because the government pays for welfare, health, education and national defence. However, the economy is still viewed as capitalist because in the area of private enterprise firms are free to decide what to produce and for whom. Capitalist economic systems invariably lead to inequalities of wealth and income.

However, it is argued that this inequality provides an incentive for wealth generation and economic growth.

Features:

1. Capitalism derives its name from the fact that in this system, *means of production are not owned by the government or by cooperatives. They are owned privately, that is by individuals and households.* Business units (and therefore, the resources owned by them) also belong to individuals and households. The institution of private property also covers the right to inheritance.
2. People acquire a *motive for earning more, because they are allowed to keep their earnings both for current and future use.* For this reason, they are always on the look out for opportunities of increasing their income. In the process, if need be, they are also ready to work hard. The net result is that a *capitalist system is characterised by a high production potential.*
3. Private property and inheritance *lead to ever-increasing inequalities of income and wealth.* These inequalities, in their turn, result in unequal opportunities of earning an income. The market prices of various goods and services fail to correspond to their relative worth to the society.
Therefore, a cumulative process develops in which the *owners of capital are able to add to their incomes faster than the workers can add to their incomes,* since they have to depend upon the income from their labour only.
4. Capitalism is also characterised by what is known as the *policy of laissez-faire on the part of the authorities.* The term *laissez-faire* means *absence of state intervention in the working of the economy.* The solution of the basic problems of the economy is left in the hands of market mechanism.

In other words, the authorities do not try to regulate the prices, demand or supply. The market mechanism, through the interaction between demand and supply forces, brings about changes

in prices. The prices, in turn, act as signals for individual economic units and guide them in their respective activities as consumers and producers, etc.

5. In theory, it is usually assumed that the *market structure of a capitalist economy is competitive in nature*. In practice, however, it need not be so. It is possible that while the authorities are following a policy of *laissez-faire*, the market itself is not competitive enough. *It may have strong monopoly elements*.
6. Another salient feature of capitalism is the *use of money and credit*. The producers undertake production mainly for sale in the market and not for self- consumption. Similarly, a capitalist economy tends to have production projects which have a long technical life. All these aspects of capitalism necessitate an *elaborate system of financing its economic activities and therefore the use of money and credit*.
7. In capitalism, *all economic activities are guided by market forces*. Producers produce only those goods and services which are demanded by consumers in the market. *The entire economy operates to meet the needs and preferences of the consumers*. This characteristic of capitalism is known as that of '*consumer sovereignty*'.

MERITS:

1. Capitalist system is *self- regulatory*.
2. The process of *economic growth is faster under capitalism*. It has a tendency to register a huge rate of growth in national income and per capita income.
3. The capitalist system decides '*what to produce*' and '*how to produce*' in consonance with the forces of *demand and supply*.
4. Capitalistic system provides an *incentive for efficient decision making* and their implementation in the form of economic gains to the decision makers which ensure a high degree of operative efficiency in the system.
5. It provides *flexibility to adapt to the changed circumstances*.
6. It ensures individual freedom *giving entrepreneurs incentive to work hard*.
7. Capitalism ensures *optimal allocation of resources* in different uses.

DEMERITS:

1. Capitalism generates *inequalities of income and wealth*.
2. Wide *differences in economic opportunities*.
3. *Distortion* in the production pattern.
4. Capitalism *wastes* its productive resources.
5. Production of merit goods is *not profitable*.
6. Business units produce only those goods and services which are *profitable*.
7. *Loss* of human values and welfare.
8. Increases the *wastage of resources* as a result of competition.

SOCIALIST ECONOMY:

The concept of a socialist economy has its origin in the drawbacks of capitalism. This system tries to get rid of the drawbacks of capitalism and incorporate those features which are considered to be desirable.

For example, it aims at removing the problems of inequalities of income and wealth, inequalities of economic opportunities, unemployment, cyclical fluctuations, and waste of productive resources. The advocates of socialism believe that most of these drawbacks come into being because of certain basic features of capitalism including the institutions of private property and inheritance, and the use of market mechanism.

In the words of **H. D. Dickinson**, "Socialism is an organization of the society in which the material means of production are owned by the whole community and operated by organs, representative of and responsible to, all members of community according to a general plan, all members of community being entitled to get benefits from the results of such socialist planned production on the basis of equal rights."

According to **Maurice Dobb**, "The fundamental character of socialism consists in its abolition of class relations which form the basis of Capitalist production through expropriation of the propertied class and the socialization of land and capital."

Features:

Features	Details
Abolition of private property and inheritance	• In a socialist economy, the institutions of private property and inheritance are abolished. • The 'private sector', does not exist. • It means that the ownership of means of production is not in the hands of individuals and households.

	• Instead, they are owned by the government authorities and/or cooperatives or society. • Private ownership is allowed only in the case of consumption goods and personal belongings, and that too only to a limited extent. • And to that extent, even inheritance of 'private property' may be allowed. • An important implication of the abolition of private property and inheritance is that economic decision-making is no longer left in private hands.
No free working of market mechanism	• A socialist economy is not guided by free working of a market mechanism. • In a sense, its operation is "frozen". • The consumers have to take decisions within the limits set by the authorities.
Central authority decides production	• They also lay down production schedules. • Decide what to produce. • Decide how much to produce. • Decide what resources to be used as inputs.
Regulation of demand and supply	• Thus, demand and supply forces are not to respond to changes in prices. • Instead they are regulated with the objective of serving the national interests as a whole.
Price control by authorities	• Similarly, prices are not allowed to fluctuate in response to changes in demand and supply. • They are also controlled and regulated by the authorities. • Only in some cases, cooperatives may be permitted to change the prices within certain limits.
Centralised economic planning	• In capitalism, this complex task is handled by market mechanism.

	• But in socialism, its substitute has to be created. • This is usually done in the form of centralised economic planning.
Restriction on money and credit	• A socialist economy recognises the ill-effects of money and credit. • In capitalist system, these create cyclical fluctuations and inequalities of income and wealth. • Ideally, therefore, a socialist economy prefers not to have these institutions. • But the hard reality is that it cannot do without them.
Limited use of money and credit	• In an economy, which produces a large number of goods and services, cannot have an efficient system of physical rationing. • It has to create and operate a complex system of income distribution which is not possible without using money in some form. • Accordingly, it is not able to completely discard the use of money and credit but restricts it to the minimum necessary extent.
Private ownership under capitalism	• Capitalism derives its name from the fact that in this system, means of production are not owned by the government or by cooperatives. • They are owned privately, that is by individuals and households. • Business units (and therefore, the resources owned by them) also belong to individuals and households. • The institution of private property also covers the right to inheritance.
Class less society	• Another important feature of socialism is to have class less society. • Since under socialism, no property is privately owned, so

there is no question of existence of classes.

• Every person in the society gets the share in production according to his own merits.

MERITS:

A socialist economy discards the use of market mechanism and replaces it with some form of regulatory authority, such as the planning commission. It also abolishes the institutions of private property and inheritance. Given these features of the socialist economy, it tries to remove the basic demerits of capitalism by pursuing the objectives of;

- distributive justice
- social security
- elimination of fluctuations of economy
- coordinated development
- elimination of social disputes.

DEMERITS:

While socialism is able to get rid of the problems of income inequalities, unemployment and cyclical fluctuations of national income and prices, it is not able to provide economic incentives and disincentives for hard work and initiative. As a result, it continues to suffer from slow growth rate, poor productivity of labour and low per capita income. On account of these weaknesses of the economy, it becomes difficult to raise the consumption standards of the masses. And this gives rise to the necessity of restructuring the economic system for better results.

A MIXED-ECONOMY:

A mixed economy tries to avoid the ill-effects of both capitalism and socialism and secure the benefits of both. For this reason, it incorporates some elements of both capitalism and socialism. However, there is no pre-determined and standardised proportion in which their features could be selected and combined.

Features:

1. The selection of detailed features of a mixed economy is made with reference to the working of market mechanism, and its expected effects (both beneficial and harmful) on the society as a whole. In other words, we take up one segment of the economy at a time, and adopt the following procedure.
2. It is decided that working of the selected segment of the economy should be guided by free market mechanism if the net effect of this arrangement is expected to be beneficial for the society as a whole.
3. If the working of the segment under consideration can be made beneficial for the society by subjecting the working of market mechanism to some regulatory measures, then the said segment is subjected to be governed by a regulated market mechanism. In other words, in this case, the interaction between demand, supply and prices is regulated in a manner and to the extent found necessary.
4. Working of a segment under free market mechanism may be harmful for the society in certain respects. If it is possible to make its working beneficial by regulating the market mechanism, the said segment is again subjected to a regulated market mechanism. However, the extent and nature of regulatory measures are revised from time to time in light of the changing circumstances.
5. In some other cases, it may be found that market mechanism continues to have net ill-effects even after restrictions and regulations. In such cases, therefore, market mechanism is not allowed to operate at all. The authorities take over one or more functions of market mechanism, namely, demand decisions, supply decisions and prices. This is generally done through public sector undertakings, which need not be guided market forces.
6. Socialistic society offers equal opportunity to all to rise above level of standards. For this, state authority make available health, education, transport facilities to all, either subsidized or free of cost.

7. Since equalities of income and wealth in society is the major objectives in socialist economy, the authority tries to achieve it by social or state ownership of means of production.

Thus, in a mixed economy, the net result is that market mechanism is not totally abolished. It is allowed to operate with different degrees of freedom in different segments of the economy. Indian economy provides a very good example of a mixed economy as it operates in practice. In theory, a mixed economy is far superior to either capitalism or socialism since it tries to acquire beneficial features of both.

Demerits:

In practice, however, it suffers from many drawbacks. Some of these arise on account of the fact that it is extremely difficult to work out the details of a mixed economy. The system has a tendency to suffer from several inner contradictions. Once the rules and procedures for its working have been formulated, it is not possible to revise them frequently or rapidly. The economy, therefore, fails to adjust itself to changing circumstances as rapidly as it should. The success of a mixed economy also depends upon the integrity and expertise of the government administration, the expertise and freedom of the management, and the willingness of the workers to recognize their moral duty of increasing productivity.

THEORY OF DEMAND AND SUPPLY

Meaning of Demand

Demand is an economic principle referring to a consumer's desire to purchase goods and services and willingness to pay a price for a specific good or service.

Law of Demand

According to the law of demand, *other things being equal, if price of a commodity falls, the quantity demanded of it will rise, and if price of the commodity rises, its quantity demanded will decline.* It implies that there is an *inverse relationship between the price and quantity demanded of a commodity.* In other words, other things being equal, quantity demanded will be more at a lower price than at a higher price.

The law of demand describes the functional relationship between price and quantity demanded. Among various factors affecting demand, price for a commodity is the most critical factor.

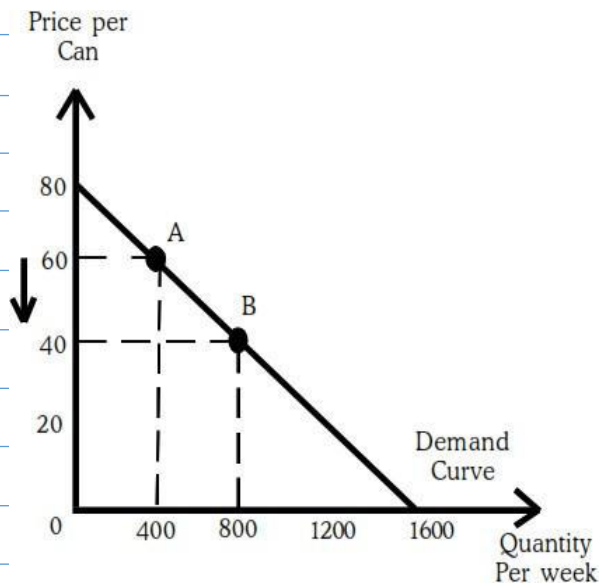
Thus, demand of a commodity is mainly determined by the price of commodity.

$$D_x = f(P_x).$$

The law of demand may be understood from the following example:

PRICE PER CAN (INR)	QUANTITY DEMANDED
80	0
70	200
60	400
50	600
40	800
30	1000

20	1200
10	1400
0	1600



Thus, it may be observed that with the rise in price per can, the demand for the cans is reducing.

Assumptions of the law of demand

Law of Demand is always stated with the 'other things being equal'. It relates to the change in price variable only, assuming other determinants of demand to be constant. The law of demand is thus, based on the following ceteris paribus assumptions:

1. No Change in **Consumer's Income**
2. No Change in **Consumer's Preferences**
3. No Change in the **Fashion**
4. No Change in the **Price of Related Goods**
5. No **Expectation of Future Price Changes or Shortages**
6. No Change in **Size, Age Composition and Sex Ratio** of the Population
7. No Change in the **Range of Goods** Available to the Consumers

8. No Change in the *Distribution of Income and Wealth* of the Community
9. No Change in *Government Policy*
10. No Change in *Weather Conditions*.

EXCEPTIONS TO THE LAW OF DEMAND:

There are few exceptional cases where the law of demand is not applicable, which may be categorised as follows:

Giffen Goods: In the case of certain inferior goods called Giffen goods (*named after Sir Robert Giffen*), when the prices fall, quite often less quantity will be purchased than before because of the negative income effect and people's increasing preference for a superior commodity with the rise in their real income.

Examples of Giffen goods can include bread, rice, and wheat.

Articles of Snob Appeal: Sometimes, certain commodities are demanded just because they happen to be *expensive or prestige goods*, and have a 'snob appeal'. They satisfy the aristocratic desire to preserve exclusiveness for unique goods.

Speculation: When people *speculate about changes in the price of a commodity in the future*, they may not act according to the law of demand at the present price, say, when people are convinced that the price of a particular commodity will rise still further, they will not contract their demand with the given price rise: on the contrary, they may purchase more for the purpose of hoarding.

Consumer's Psychological Bias or Illusion: When the consumer is *wrongly biased against the quality of the commodity with the price change*, he may contract this demand with a fall in price.

Law of Supply

Supply represents how much the market can offer. The **quantity supplied** refers to the amount of a good producers are willing to supply when receiving a certain price. The **supply of a good** or service refers to the quantities of that good or service that producers are prepared to offer for sale at a set of prices over a period of time.

Supply means a schedule of possible prices and amounts that would be sold at each price.

The supply is not the same concept as the stock of something in existence, for example, the stock of commodity X in Delhi means the total quantity of Commodity X in existence at a point of time; whereas, the supply of commodity X in Delhi means the quantity actually being offered for sale, in the market, over a specified period of time.

The law of supply states that a firm will produce and offer to sell greater quantities of a product or service as the price of that product or service rises, other things being equal. There is a direct relationship between price and quantity supplied.

In this statement, change in price is the cause and change in supply is the effect. Thus, the price rise leads to an increase in supply and not otherwise. It may be noted that at higher prices, there is a greater incentive to the producers or firms to produce and sell more. Other things including the cost of production, change of technology, prices of inputs, level of competition, size of the industry, government policy and non-economic factors.

Thus '**Ceteris Paribus**'

- (a) With an increase in the price of a good, the producer is willing to offer more quantity in the market for sale.
- (b) The quantity supplied is related to the specified time interval over which it is offered.

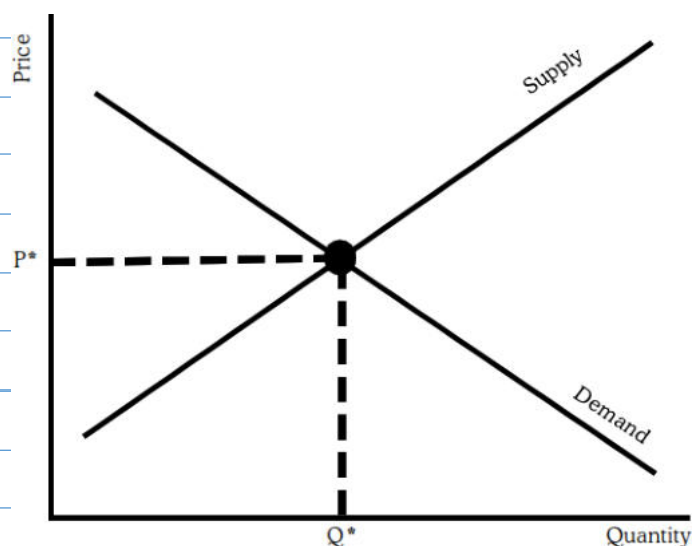
The law of supply is the microeconomic law that states that, all other factors being equal, as the price of a good or service increases, the quantity of goods or services that suppliers offer will increase, and vice versa. The law of supply says that as the price of an item goes up, suppliers will attempt to maximize their profits by increasing the quantity offered for sale.

Assumptions of Law of Supply

The term “other things remaining the same” refers to the following assumptions in the law of supply:

1. No change in the state of technology.
2. No change in the price of factors of production.
3. No change in the number of firms in the market.
4. No change in the goals of the firm.
5. No change in the seller's expectations regarding future prices.
6. No change in the tax and subsidy policy of the products.
7. No change in the price of other goods.

The equilibrium price is the market price where the quantity of goods supplied is equal to the quantity of goods demanded. This is the point at which the demand and supply curves in the market intersect.



At **Equilibrium**, there is no shortage or surplus unless a determinant of demand or a determinant of supply changes. If a change in the price of a good or service creates a shortage, it means that consumers want to buy a higher quantity than the one offered by producers.

In this case, demand exceeds supply and consumers are not satisfied. In contrast, if a change in the price of a product or a service creates a surplus, it means that consumers want to buy less quantity than the one offered by producers. In this case, supply exceeds demand and producers need to lower the price of the product or the service to avoid excessive inventory.

Price (\$)	Quantity Demanded (Kg)	Quantity Supplied (Kg)	Surplus (kg)	Shortage (kg)
100	5	50	45	
90	12	41	29	
80	18	35	17	
70	22	28	6	
60	25	25	0	0
50	34	22		12
40	41	18		23
30	47	14		33
20	50	9		41
10	55	5		50

In the table above, the quantity demanded is equal to the quantity supplied at the price level of \$60. Therefore, the price of \$60 is the equilibrium price. At any other price level, there is either surplus or shortage. Specifically, for any price that is lower than \$60, the quantity supplied is greater than the quantity demanded, thereby creating a surplus. For any price that is higher than \$60, the quantity demanded is greater than the quantity supplied, thereby creating a shortage.

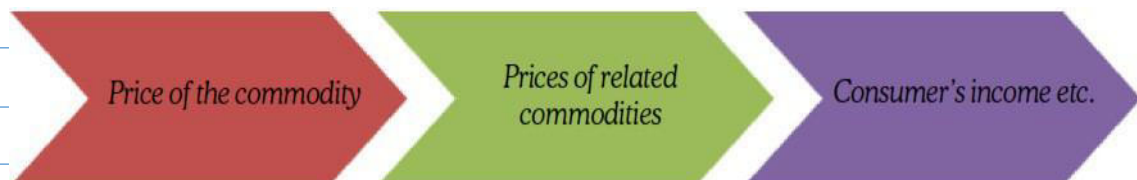
ELASTICITY OF DEMAND

In economics, the **demand elasticity (elasticity of demand)** refers to how sensitive the demand for a good is to changes in other economic variables, such as prices and consumer income.

“Elasticity of demand is the responsiveness of the quantity demanded of a commodity to changes in one of the variables on which demand depends.

Demand elasticity is calculated as the percent change in the quantity demanded divided by a percent change in another economic variable. A higher demand elasticity for an economic variable means that consumers are more responsive to changes in this variable.

In other words, it is the percentage change in quantity demanded divided by the percentage in one of the variables on which demand depends. The variables on which demand can depend are:



There are major three types of elasticity of demand, i.e. Price elasticity; Income elasticity and Cross elasticity. However, this lesson focuses only on price elasticity of demand.

Price Elasticity of Demand

The **Price Elasticity Of Demand** is the **response of the quantity demanded to change in the price of a commodity**. It is assumed that the consumer's income, tastes, and prices of all other goods are steady. It is measured as a percentage change in the quantity demanded divided by the percentage change in price. Therefore, price elasticity of demand is:

$$E_p = \frac{\text{Percentage Change in Quantity Demanded}}{\text{Percentage Change in Price}}$$

$$\text{Or, } E_p = \frac{\text{Change in Quantity}}{\text{Original Quantity}} \times \frac{\text{Original Price}}{\text{Change in Price}}$$

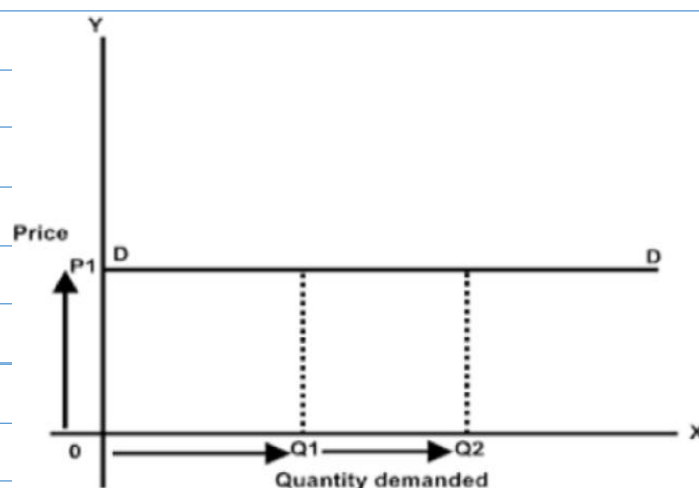
Types of Price Elasticity of Demand

The extent of responsiveness of demand with change in the price is not always the same. The demand for a product can be elastic or inelastic, depending on the rate of change in the demand with respect to change in price of a product.

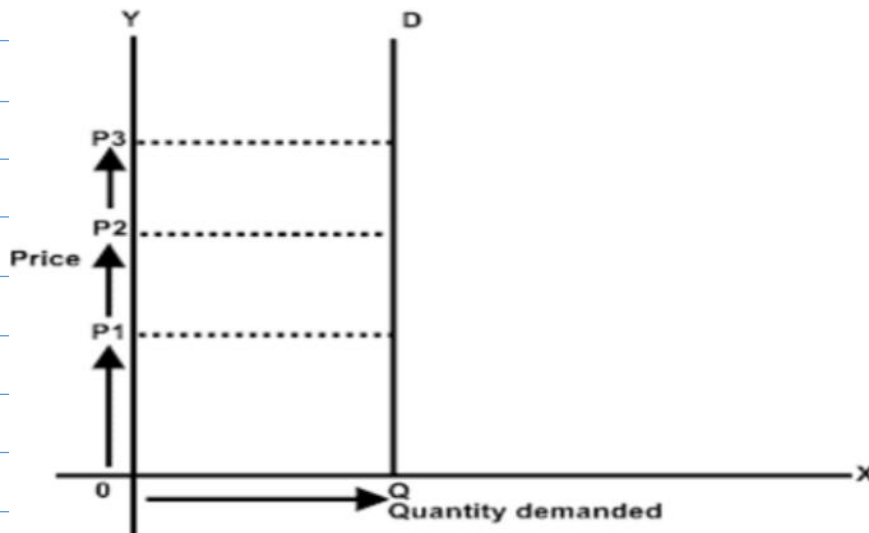
Elastic demand is the one when the response of demand is greater with a small proportionate change in the price. On the other hand, inelastic demand is the one when there is relatively less change in the demand with a greater change in the price.

The various forms of price elasticity of demand are as under:

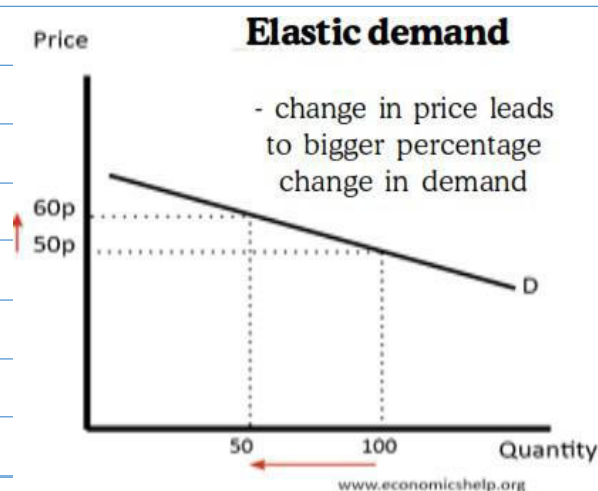
1. **Perfectly Elastic Demand:** When a small change in the price of a product causes a major change in its demand, it is said to be perfectly elastic demand. In perfectly elastic demand, a small rise in price results in a fall in demand to zero, while a small fall in price causes an increase in demand to infinity. In such a case, the demand is perfectly elastic or $E_p = \infty$.



2. **Perfectly Inelastic Demand:** A perfectly inelastic demand is one when *there is no change produced in the demand of a product with a change in its price*. The numerical value for perfectly inelastic demand is zero ($E_p=0$).

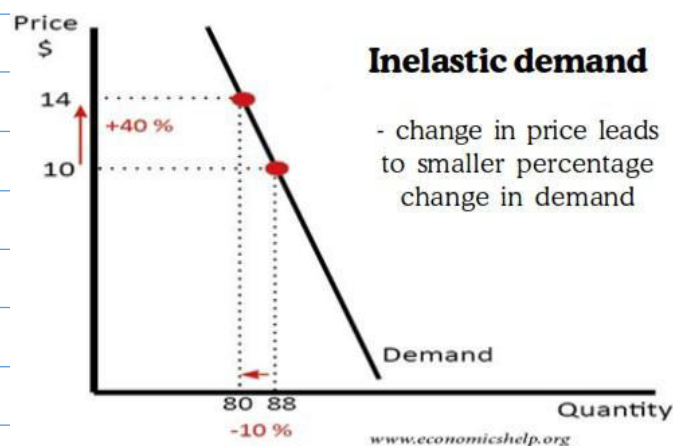


3. **Relatively Elastic Demand:** Relatively elastic demand refers to the demand *when the proportionate change produced in demand is greater than the proportionate change in price of a product*. The numerical value of relatively elastic demand ranges between one to infinity ($E_p > 1$).

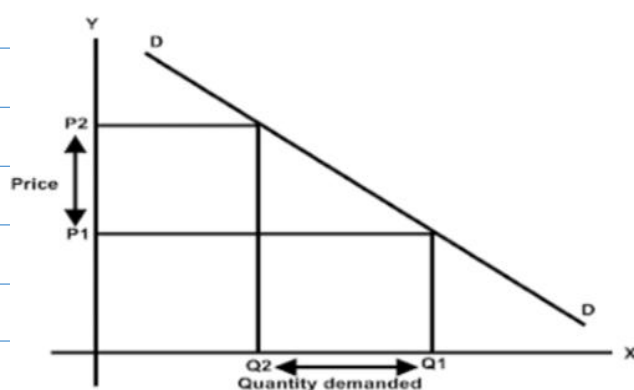


4. **Relatively Inelastic Demand:** Relatively inelastic demand is one when the percentage change produced in demand is less than the percentage change in the price of a product.

For example, if the price of a product increases by 30% and the demand for the product decreases only by 10%, then the demand would be called relatively inelastic. The numerical value of relatively elastic demand ranges from zero to one ($E_p < 1$).



5. **Unitary Elastic Demand:** When the proportionate change in demand produces the same change in the price of the product, the demand is referred as unitary elastic demand. The numerical value for unitary elastic demand is equal to one ($E_p = 1$).



A quick recap

- Perfectly Elastic Demand ($E_p = \infty$)
- Perfectly Inelastic Demand ($E_p = 0$)
- Relatively Elastic Demand ($E_p > 1$)
- Relatively Inelastic Demand ($E_p < 1$)
- Unitary Elastic Demand ($E_p = 1$)

Factors affecting Price Elasticity of Demand

1. **Price Level:** The demand is generally elastic for moderately priced goods but, the demand for very costly and very cheap goods is inelastic. The rich do not bother about the prices of the goods that they buy.
Very costly goods are demanded by the rich people and hence their demand is not affected much by the change in prices.
For Example, on increase in the price of Toyota car from Rs. 5,00,000 to Rs. 5,20,000 will not make any noticeable difference in its demand. Similarly, the change in the price of very cheap goods (such as salt) will not have any effect on their demand, for their consumption which is very small and fixed.
2. **Availability of Substitutes:** If a good has close substitutes, the price elasticity of demand for a commodity will be very elastic as some other commodities can be used for it. A small rise in the price of such a commodity will induce consumers to switch their consumption to its substitutes.
For Example gas, kerosene oil, coal etc. will be used more as fuel if the price of wood increases. On the other hand, the demand of such commodities which have no close substitutes is inelastic, such as salt.
3. **Necessities:** If a good is a necessity, then the demand tends to be inelastic.
For Example, if the price for drinking water rises, then there is unlikely to be a huge drop in the quantity demanded since drinking water is a necessity.
4. **Time Period:** Over time, a good tends to become more elastic because consumers and businesses have more time to find alternatives or substitutes.
For Example, if the price of gasoline goes up, over time people will adjust for the change, i.e., they may drive less or use public transportation or form carpools.
5. **Habits:** The demand for addictive or habitual products is usually inelastic. This is because the consumer has no choice but to pay whatever the producer is demanding.

For Example, if the price for a pack of cigarettes goes up, it will likely not have any effect on demand.

6. **Nature of the Commodities:** *The demand for necessities is inelastic and that for comforts and luxuries is elastic.* This is so because certain goods which are essential will be demanded at any price, whereas goods meant for luxuries and comforts can be dispensed with easily if they appear to become costlier.

7. **Various Uses:** *A commodity which has several uses will have an elastic demand such as milk, wood etc. On the other hand, a commodity having only one or fewer uses will have inelastic demand.*

The consumer finds it easier to adjust the quantity demanded of a good when it is to be used for satisfying several wants than if it is confined to a single or few uses. For this reason, a multiple-use good tends to have more elastic demand.

8. **Postponing Consumption:** *Usually the demand for commodities, the consumption of which can be postponed, is elastic as the prices rise and are expected to fall again.*

For Example, the demand for mp3 is elastic because its use can be postponed for some time if its price goes up, but the demand for rice and wheat is inelastic because their use cannot be postponed when their prices increase.

Income Elasticity of Demand

Income elasticity of demand is the degree of responsiveness of demand to the change in income. **Prof. Watson** defines it as: "Income elasticity of demand is the rate of change of quantity with respect to changes in the income, other determinants remaining constant."

The income elasticity of demand can be measured by the following formula:

$$E_y = \text{Percentage change in quantity demanded} / \text{Percentage change in income}$$

Percentage change in quantity demanded = New quantity demanded (ΔQ) / Original quantity demanded (Q)

Percentage change in income = New income (ΔY) / original income (Y)

Symbolically,

$$E_y = \Delta Q / Q \times \Delta Y / Y$$

Income elasticity of demand, thus explains the responsiveness of demand to a change in income. Ordinarily, demand for most goods increases with an increase in household's level of income. Demand for inferior goods, however, shows a negative relation to change in income.

Types of Income Elasticity of Demand

Income elasticity of demand can be of five different types: These are tabulated with description below:

S. No.	Numerical Measure of Income elasticity of demand	Verbal description
1.	Negative Demand for a commodity falls as income rises.	The trend is visible in case of inferior goods.
2.	Zero Demand for a commodity does not change as income changes.	This is true in the case of essential goods.
3.	Greater than zero but less than one.	Demand for commodity rises in proportion to a rise in income.
4.	Unity	Demand for commodity rises in the same proportion as rise in income.
5.	Greater than the unity	Demand for commodity rises more than in proportion to rise in income.

Cross Elasticity of Demand

The responsiveness of demand to changes in prices of related commodities is called cross elasticity of demand. **Prof. Watson** defines it as, "Cross elasticity of demand is the rate of change in quantity associated with a change in the price of related goods."

Thus cross elasticity of demand is the responsiveness of demand for commodity X to change in price of commodity Y and is represented as follows:

Symbolically:

Cross Elasticity of Demand $E_c = \frac{\% \text{ increase in quantity demanded of A}}{\% \text{ increase in price of product B}}$

The relationship between X and Y commodities may be substitutive as in case of tea and coffee or complementary as in the case of ball pens and refills.

Main measures of cross elasticity with description are as follows:

1. **Cross elasticity = Infinity** (Commodity X is nearly a perfect substitute for commodity Y)
2. **Cross elasticity = Zero** (Commodity X and Y are not related)
3. **Cross elasticity = Negative** (Commodities X and Y are complementary)

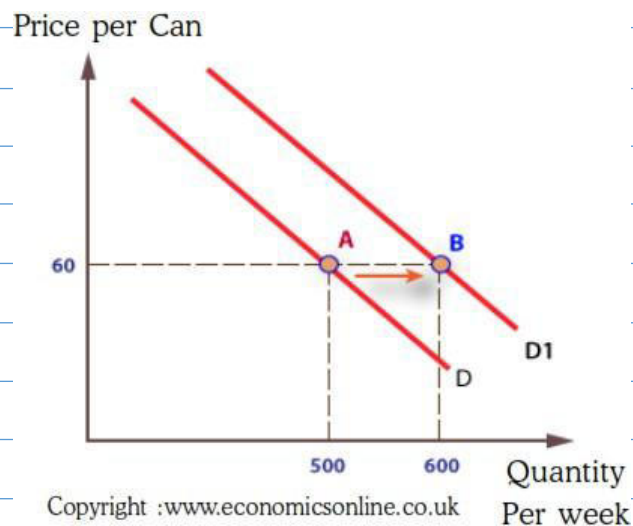
Thus, if E_c approaches infinity, it means that commodity X is nearly a perfect substitute for commodity Y. On the other hand, if E_c approaches Zero it would mean that the two commodities in question are not related at all. E_c shall be negative when commodity Y is complementary to commodity X.

INCREASE AND DECREASE IN DEMAND AND EXPANSION AND CONTRACTION OF DEMAND

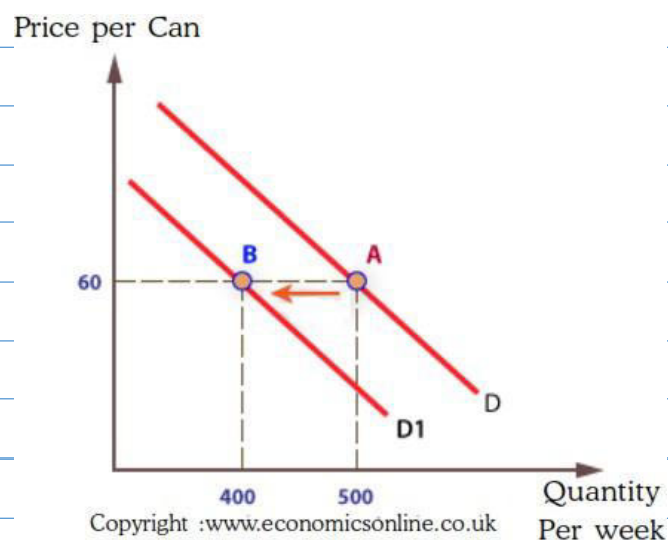
Changes in demand include an increase or decrease in demand. Due to the change in the price of related goods, the income of consumers, and the preferences of consumers, etc. the demand for a product or service changes.

- (a) **Increase in Demand:** When demand changes not because of price but because of changes in other determinants of demand, it is a case of either increase or decrease in demand. “**Increase in demand means more demand at same price**”.

Increases in demand are shown by a shift to the right in the demand curve. This could be caused by a number of factors, including a rise in income, a rise in the price of a substitute or a fall in the price of a complement.

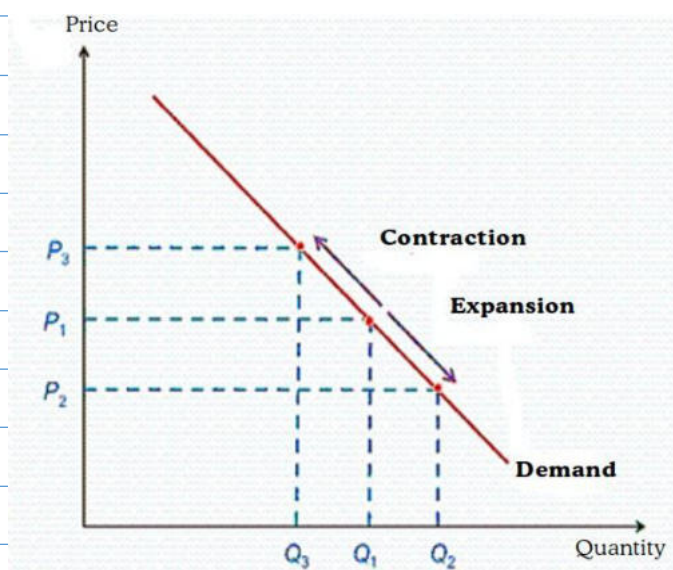


(b) **Decrease in Demand:** Decrease in demand means, “Less demand at same price”. Demand can decrease and cause a shift to the left of the demand curve for a number of reasons, including a fall in income, assuming a good is a normal good, a fall in the price of a substitute and a rise in the price of a complement.



Expansion and Contraction of Demand

When the quantity demanded of a commodity increases as a result of the fall in the price, it is called **extension (or expansion) in demand** and when the quantity demanded decreases as a result of an increase in the price of the commodity, it is called **contraction in demand**. The following is the diagrammatical presentation of expansion and contraction of demand:



FORMS OF MARKET COMPETITION

A variety of market structures will characterize an economy. Such market structures essentially refer to the degree of competition in a market.

There are other determinants of market structures such as the nature of the goods and products, the number of sellers, number of consumers, the nature of the product or service, economies of scale etc.

(I) Perfect Competition

In a perfect competition market structure, there are a **large number of buyers and sellers**. All the sellers in the market are small sellers in competition with each other. There is **no one big**

seller with any significant influence on the market. So, all the firms in such a market are price takers.

Assumptions are as follows:

- The products on the market are *homogeneous*, i.e. they are completely identical
- All firms only have the *motive of profit maximization*
- There is *free entry and exit* from the market, i.e. there are no barriers
- And there is *no concept of consumer preference*

(2) Monopolistic Competition

This is a more realistic scenario that actually occurs in the real world. In monopolistic competition, there are still a *large number of buyers as well as sellers*. But they all *do not sell homogeneous products*. The products are similar but all sellers sell *slightly differentiated products*.

Now consumers have the preference of choosing one product over another. The sellers can also charge a *marginally higher price* since they may enjoy some market power. So, the sellers become the price setters to a certain extent

For example, the market for cereals is a monopolistic competition. The products are all similar but slightly differentiated in terms of taste and flavours. Another such example is toothpaste.

(3) Oligopoly

In an oligopoly, there are only a *few firms in the market*. While there is no clarity about the number of firms, *3-5 dominant firms are considered the norm*. So, in the case of an oligopoly, the buyers are far greater than the sellers.

The firms in this case *either compete with another to collaborate* together, they use their market influence to set the prices and in turn maximize their profits. So, the *consumers become the price takers*. In an oligopoly, there are various barriers to entry into the market, and new firms find it difficult to establish themselves.

(4) Monopoly

In a monopoly type of market structure, there is **only one seller**, so a single firm will control the entire market. It can set any price it wishes since it has **all the market power**. Consumers do not have any alternative and must pay the price set by the seller. **Monopolies are extremely undesirable**. Here the consumers lose all their power and market forces become irrelevant. However, a **pure monopoly is very rare in reality**.

(5) Duopoly

A Duopoly Is A Kind Of Oligopoly: a market dominated by a **small number of firms**. In the case of a duopoly, a **particular market or industry is dominated by just two firms** (this is in contrast to the more widely-known case of a monopoly when just one company dominates).

In very rare cases, this means they are the **only two firms** in the entire market (this almost never occurs); in practice, it usually means the **two duopolistic firms have a great deal of influence**, and their actions, as well as their relationship to each other, powerfully shape their industry. **Duopolistic markets are imperfectly competitive**, so entry barriers are typically significant for those attempting to enter the market, but there are usually still other, smaller businesses persisting alongside the two dominant firms.

ELASTICITY OF SUPPLY

The **Elasticity Of Supply** establishes a *quantitative relationship between the supply of a commodity and its price*. Hence, we can express the numeral change in supply with the change in the price of a commodity using the concept of elasticity.

However, the *major factor controlling the supply of a commodity is its price*. Therefore, we generally talk about the price elasticity of supply. The price elasticity of supply is the ratio of the percentage change in the price to the percentage change in quantity supplied of a commodity.

$$E_s = [\Delta q/q] \times 100 \div [(\Delta p/p) \times 100] = (\Delta q/q) \div (\Delta p/p)$$

Δq = The change in quantity supplied

q = The quantity supplied

Δp = The change in price

p = The price

Types of Price Elasticity of Supply

1. **Perfectly Inelastic Supply:** A service or commodity has a perfectly inelastic supply *if a given quantity of it can be supplied whatever might be the price*. The elasticity of supply for such a service or commodity is *zero*. A perfectly inelastic supply curve is a straight line parallel to the Y-axis. This is representative of the fact that the supply remains the same irrespective of the price.

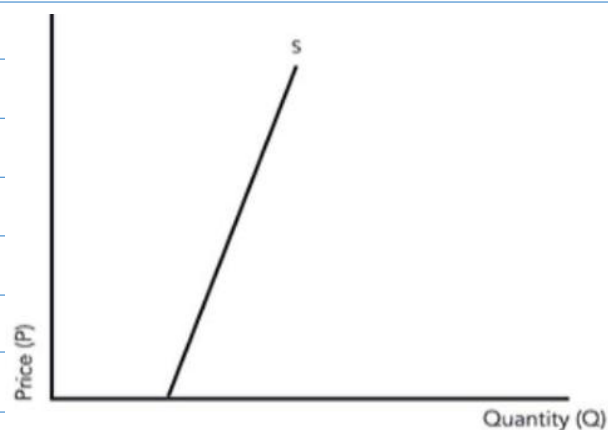
The supply of exclusive items, like the painting of Mona Lisa, falls into this category. Whatever might be the price on offer, there is no way we can increase its supply.

($E_s = 0$), The Quantity Supplied doesn't change as the price changes.



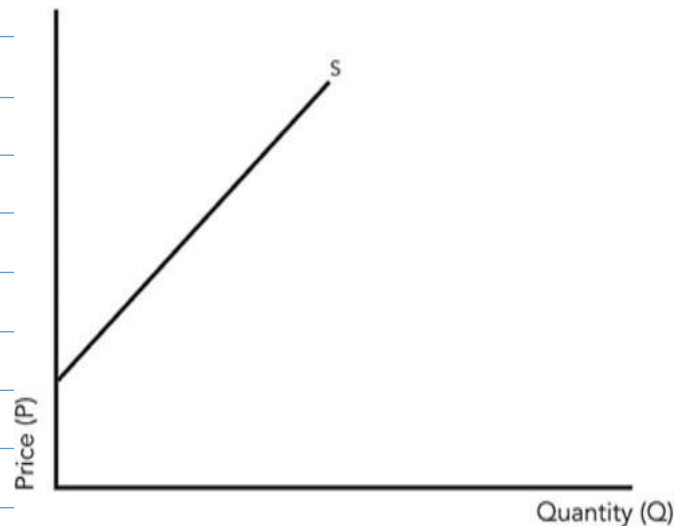
2. **Relatively Less-Elastic Supply:** When the change in supply is relatively less when compared to the change in price, we say that the commodity has a relatively-less elastic supply. In such a case, the price elasticity of supply assumes a value less than 1.

($0 < PES < 1$), Quantity Supplied changes by a lower percentage than a percentage change in price.



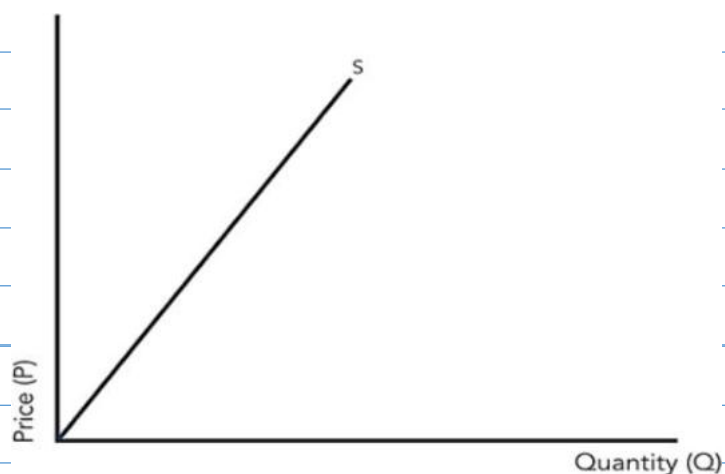
3. **Relatively Greater-Elastic Supply:** When the change in supply is relatively more when compared to the change in price, we say that the commodity has a relatively greater-elastic supply. In such a case, the price elasticity of supply assumes a value greater than 1.

(PES > 1), The Quantity Supplied changes by a larger percentage than the percentage change in price.



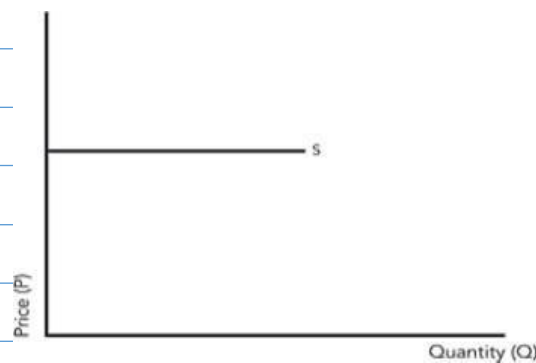
4. **Unitary Elastic Supply:** For a commodity with a unit elasticity of supply, the change in quantity supplied of a commodity is exactly equal to the change in its price. In other words, the change in both price and supply of the commodity is proportionately equal to each other. To point out, the elasticity of supply in such a case is equal to one. Further, a unitary elastic supply curve passes through the origin.

(PES = 1), Quantity Supplied changes by the same percentage as the change in price.



5. **Perfectly Elastic supply** : A commodity with a perfectly elastic supply has an infinite elasticity. In such a case the supply becomes zero with even a slight fall in the price and becomes infinite with a slight rise in price. This is indicative of the fact that the suppliers of such a commodity are willing to supply any quantity of the commodity at a higher price. A perfectly elastic supply curve is a straight line parallel to the X-axis.

($PES = \infty$), Suppliers will be willing and able to supply any amount at a given price but none at a different price.



Factors influencing the elasticity of supply

1. **Price of the Good**: The supply and elasticity of supply of a good depend upon the price of the good. If the price of a good increases or decreases, the quantity supplied of it will also increase or decrease, respectively. This is the law of supply. Also, the coefficient of price-elasticity of supply (ES) will depend on the price of the good. ES may be greater than, less than, or equal to one, depending on the price.
2. **Probability that the Price would Change in Future**: If the sellers think that the price of the good will increase (or decrease) in near future, then, at any particular price at present, they would want to decrease (or increase) their supply. In this case, the supply curve for the good would shift to the left (or to the right).

3. **Conditions regarding Cost of Production:** If the *cost of production of good increases* (or decreases), i.e., if its cost curve shifts upwards (or downwards), *then the quantity supplied of the good would decrease* (or increase) at any particular price, i.e., the supply curve would shift to the left (or to the right).
4. **Nature of the Good:** The supply of a good depends upon the nature of the good, e.g., on the *perishability and lumpiness of the good*. The more the perishability or lumpiness of the good, the more would be its market localised, and, in a localised market, the supply of a good at any particular price would be relatively small.
5. **Length of Time:** If the price of good rises, then by how much would supply rise, or, how large will be the price-elasticity of supply, *would depend on the length of time available for the necessary adjustments* (e.g., in the quantities of the factor inputs used) to complete. That is why; the elasticity of supply in the long-period market would be larger than that in the short-period market.

CHAPTER 2: NATIONAL INCOME ACCOUNTING AND RELATED CONCEPTS

INTRODUCTION

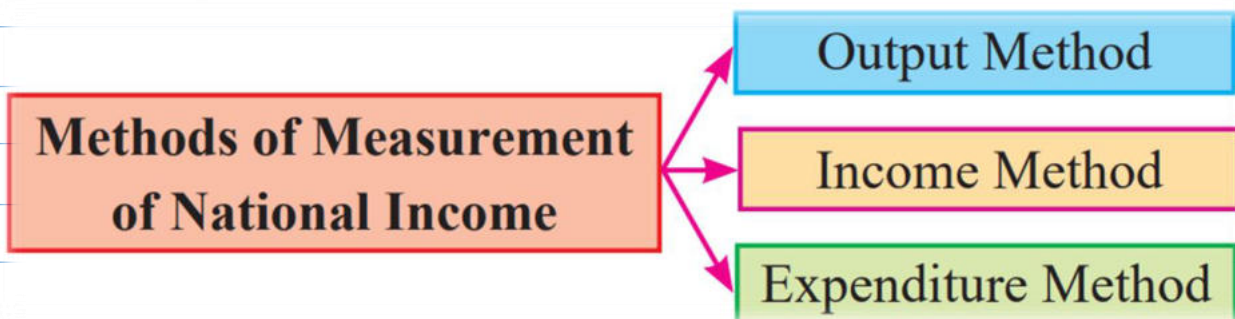


National Income is an uncertain term which is used interchangeably with national dividend, national output and national expenditure. On this basis, national income has been defined in a number of ways. In common parlance, *national income means the total value of goods and services produced annually in a country.*

In other words, the total amount of income accruing to a country from economic activities in a year's time is known as national income. It includes payments made to all resources in the form of wages, interest, rent and profits.

National Income or Net National Income is Gross National Income or Gross National Product less depreciation. It is to be noted that National Income includes Net Factor Income Earned from Abroad also. While computing National Income only finished or final goods are considered as factoring intermediate goods used for manufacturing would amount to double counting. It includes taxes but does not include subsidies.

METHODS TO MEASURE NATIONAL INCOME



There are three methods of measuring the national income of a country. They yield the same result. **These methods are:**

- (1) The Product Method or Value Added Method.
- (2) The Income Method.
- (3) The Expenditure Method

(1) THE PRODUCT METHOD:

The **Product method** measures the contribution of each producing enterprise in the domestic territory of the country. This method involves the following steps:

- (a) Identifying the producing enterprise and classifying them into individual sectors according to their activities.
- (b) Estimating net value added by each producing enterprise as well as each industrial sector and adding up the net value added by all the sectors.

Goods and services are counted in gross domestic product (GDP) at their **market values**. The product approach **defines a nation's gross product as that market value of goods and services currently produced within a nation during a one year period of time.**

The product approach measuring national income involves adding up the value of all the final goods and services produced in the country during the year.

Here we focus on various sectors of the economy and add up all their production during the year.

The main sectors whose production value is added up are:

- (i) agriculture
- (ii) manufacturing
- (iii) construction
- (iv) transport and communication
- (v) banking
- (vi) administration and defence and
- (vii) distribution of income.

Precautions for Product Method or Value Added Method:

- (i) **Problem of double counting:** When we add up the value of output of various sectors, we should be careful to avoid double counting. This pitfall can be avoided by *either counting the final value of the output or by including the extra value* that each firm adds to an item.
- (ii) **Value addition in particular year:** While calculating national income, the *values of goods added in the particular year in question are added up*. The *values which had previously been added to the stocks of raw material and goods have to be ignored*. GDP thus includes only those goods, and services that are newly produced within the current period.
- (iii) **Stock appreciation:** Stock appreciation, if any, must be *deducted from value added*. This is necessary as there is no real increase in output.
- (iv) **Production for self consumption :** The *production of goods for self consumption should be counted while measuring national income*. In this method, the production of goods for self consumption should be valued at the prevailing market prices.

(2) EXPENDITURE METHOD:

The **Expenditure Approach** measures national income as total spending on final goods and services produced within the nation during a year. The expenditure approach to measuring national income is to add up all expenditures made for final goods and services at current market prices by households, firms and government during a year.

Total aggregate final expenditure on final output thus is the sum of four broad categories of expenditures:

- (i) **Consumption expenditure (C):** Consumption expenditure is the largest component of national income. It includes expenditure on all goods and services produced and sold to the final consumer during the year.
- (ii) **Investment expenditure (I):** Investment is the use of today's resources to expand tomorrow's production or consumption. Investment expenditure is expenditure incurred by business firms on (a) new plants, (b) adding to the stock of inventories and (c) on newly constructed houses.
- (iii) **Government expenditure (G) :** It is the second largest component of national income. It includes all government expenditure on currently produced goods and services but excludes transfer payments while computing national income.
- (iv) **Net exports (X - M) :** Net exports are defined as total exports minus total imports. National income calculated from the expenditure side is the sum of final consumption expenditure, expenditure by a business on plants, government spending and net exports.

Precautions for Expenditure Method:

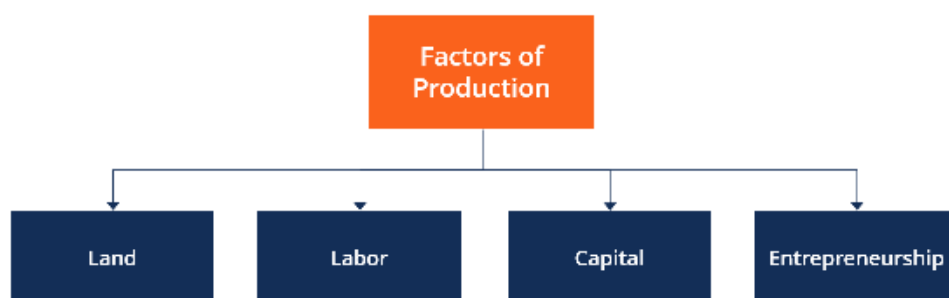
- (i) The expenditure on second hand goods should not be included as they do not contribute to the current year's production of goods.
- (ii) Similarly, expenditure on purchase of old shares and bonds is not included as these also do not represent expenditure on currently produced goods and services.
- (iii) Expenditure on transfer payments by government such as unemployment benefit, old age pensions, interest on public debt should also not be included because no productive service is rendered in exchange by recipients of these payments.

(3) INCOME METHOD:

Income Approach is another alternative way of computing national income, This method seeks to measure national income at the phase of distribution.

In the production process of an economy, the factors of production are engaged by the enterprises. They are paid money incomes for their participation in the production. The payments received by the factors and paid by the enterprises are wages, rent, interest and profit.

National income thus may be defined as the sum of wages, rent, interest and profit received or occurred to the factors of production in lieu of their services in the production of goods. Briefly, national income is the sum of all income, wages, rents, interest and profit paid to the four factors of production. The four categories of payments are briefly described below:



- (i) **Wages** : It is the **largest component of national income**. It consists of wages and salaries along with fringe benefits and unemployment insurance.
- (ii) **Rents**: Rents are the **income from property** received by households.
- (iii) **Interest**: Interest is the **income private businesses pay to households** who have lent the business money.
- (iv) **Profits**: Profits are normally divided into two categories (a) profits of **incorporated businesses** and (b) profits of **unincorporated businesses** (sole proprietorship, partnerships and producers cooperatives).

Precautions for Income Method:

While estimating national income through income method, the following precautions should be undertaken.

- (i) **Transfer payments** such as gifts, donations, scholarships, indirect taxes should **not be included** in the estimation of national income.
- (ii) **Illegal money** earned through smuggling and gambling should **not be included**.
- (iii) **Windfall gains** such as prizes won, lotteries etc. are **not to be included** in the estimation of national income.
- (iv) **Receipts from the sale of financial assets** such as shares, bonds should **not be included** in measuring national income as they are not related to the generation of income in the current year's production of goods.

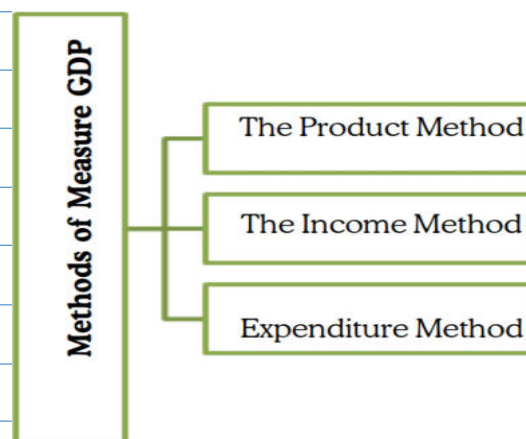
KEY CONCEPTS OF NATIONAL INCOME

Gross Domestic Product (GDP)

Dernberg defines GDP at market price as “the market value of the output of final goods and services produced in the domestic territory of a country during an accounting year.”

GDP is the total value of goods and services produced within the country during a year. This is calculated at market prices and is known as GDP at market prices.

There are three different ways to measure GDP:



- (a) **The Product Method:** In this method, *the value of all goods and services produced in different industries during the year is added up*. This is also known as the value added method to GDP or GDP at factor cost by industry of origin.

The following items are included in India in this:

Agriculture and allied services; mining; manufacturing, construction, electricity, gas and water supply; transport, communication and trade; banking and insurance, real estates and ownership of dwellings and business services; and public administration and defence and other services (or government services). In other words, it is the sum of gross value added.

- (b) **The Income Method:** The people of a country who produce GDP during a year receive income from their work. Thus GDP by income method is the sum of all factor incomes: Wages and Salaries (compensation of employees) + Rent + Interest + Profit.
- (c) **Expenditure Method:** This method focuses on goods and services produced within the country during one year.

GDP by expenditure method includes:

1. **Consumer expenditure** on services and durable and non-durable goods (C).
2. **Investment** in fixed capital such as residential and non-residential building, machinery, and inventories (I).
3. **Government expenditure** on final goods and services (G).
4. **Export** of goods and services produced by the people of the country (X).
5. **Less imports (M)**. That part of consumption, investment and government expenditure which is spent on imports is subtracted from GDP. Similarly, any imported component, such as raw materials, which are used in the manufacture of export goods, is also excluded.

Thus GDP by expenditure method at market prices = $C + I + G + (X - M)$, where (X-M) is net export which can be positive or negative.

GDP at Factor Cost

GDP at factor cost is the sum of the net value added by all producers within the country. Since the net value added gets distributed as income to the owners of factors of production, GDP is the sum of domestic factor incomes and fixed capital consumption (or depreciation).

Thus **GDP at Factor Cost = Net value added + Depreciation.**

GDP at factor cost includes:

- (a) *Compensation of employees* i.e., wages, salaries, etc.
- (b) *Operating surplus* which is the business profit of both incorporated and unincorporated firms
[Operating Surplus = Gross Value Added at Factor Cost—Compensation of Employees—Depreciation].
- (c) *Mixed Income* of Self- employed.

Conceptually, GDP at factor cost and GDP at market price must be identical/This is because the factor cost (payments to factors) of producing goods must equal the final value of goods and services at market prices. However, the market value of goods and services is different from the earnings of the factors of production.

In GDP at market price, indirect taxes are included and subsidies by the government are excluded.

Therefore, in order to arrive at GDP at factor cost, indirect taxes are subtracted and subsidies are added to GDP at market price.

Thus, **GDP at Factor Cost = GDP at Market Price – Indirect Taxes + Subsidies.**

- (i) **Net Domestic Product (NDP):** NDP is the value of the net output of the economy during the year. Some of the country's capital equipment wears out or becomes obsolete each year during the production process. The value of this capital consumption is some percentage of gross investment which is deducted from GDP.

Thus **Net Domestic Product = GDP at Factor Cost – Depreciation.**

- (ii) **Nominal and Real GDP:** When GDP is measured on the basis of current price, it is called GDP at current prices or nominal GDP. On the other hand, when GDP is calculated on the basis of fixed prices in some year, it is called GDP at constant prices or real GDP.

Nominal GDP is the value of goods and services produced in a year and measured in terms of rupees (money) at current (market) prices. In comparing one year with another, we are faced with the problem that the rupee is not a stable measure of purchasing power. GDP may rise a great deal in a year, not because the economy has been growing rapidly but because of a rise in prices (or inflation).

On the contrary, GDP may increase as a result of a fall in prices in a year but actually it may be less as compared to the last year. In both cases, GDP does not show the real state of the economy. To rectify the underestimation and overestimation of GDP, we need a measure that adjusts for rising and falling prices.

This can be done by measuring GDP at constant prices which is called real GDP. To find out the real GDP, a base year is chosen when the general price level is normal, i.e., it is neither too high nor too low. The prices are set to 100 (or 1) in the base year.

Now the general price level of the year for which real GDP is to be calculated is related to the base year on the basis of the following formula which is called the deflator index:

Real GDP = GDP for the Current Year x Base Year (100) / Current Year Index

GDP Deflator

GDP deflator is an index of price changes of goods and services included in GDP. It is a price index which is calculated by dividing the nominal GDP in a given year by the real GDP for the same year and multiplying it by 100.

Thus,

$$\text{GDP Deflator} = \frac{\text{Nominal (or Current Prices) GDP}}{\text{Real (or Constant Prices) GDP}} \times 100$$

Gross National Product (GNP)

GNP is the total measure of the flow of goods and services at market value resulting from current production during a year in a country, including net income from abroad.

GNP includes four types of final goods and services:

1. **Consumers' goods and services** to satisfy the immediate wants of the people;
2. **Gross private domestic investment** in capital goods consisting of fixed capital formation, residential construction and inventories of finished and unfinished goods;
3. Goods and services produced by the **government**; and
4. **Net exports** of goods and services, i.e., the difference between the value of exports and imports of goods and services, known as net income from abroad.

In this concept of GNP, there are certain factors that have to be taken into consideration:

First, GNP is the measure of money, in which **all kinds of goods and services produced in a country during one year are measured in terms of money at current prices and then added together.**

Second, in estimating GNP of the economy, *the market price of only the final products should be taken into account*. Many of the products pass through a number of stages before they are ultimately purchased by consumers.

If those products were counted at every stage, they would be included many a time in the national product. Consequently, the GNP would increase too much. *To avoid double-counting, therefore, only the final products and not the intermediary goods should be taken into account.*

Third, *goods and services rendered free of charge are not included in the GNP*, because it is not possible to have a correct estimate of their market price.

For example, the bringing up of a child by the mother, imparting instructions to his son by a teacher, recitals to his friends by a musician, etc.

Fourth, *the transactions which do not arise from the produce of current year or which do not contribute in any way to production are not included in the GNP.*

The sale and purchase of old goods, and of shares, bonds and assets of existing companies are not included in GNP because these do not make any addition to the national product, and the goods are simply transferred.

Fifth, *the payments received under social security, e.g., unemployment insurance allowance, old age pension, and interest on public loans are also not included in GNP*, because the recipients do not provide any service in lieu of them. But the depreciation of machines, plants and other capital goods is not deducted from GNP.

Sixth, *the profits earned or losses incurred on account of changes in capital assets as a result of fluctuations in market prices are not included in the GNP* if they are not responsible for the current production or economic activity.

For example, if the price of a house or a piece of land increases due to inflation, the profit earned by selling it will not be a part of GNP. But if, during the current year, a portion of a house is constructed anew, the increase in the value of the house (after subtracting the cost of the newly constructed portion) will be included in the GNP. Similarly, variations in the value

of assets, that can be ascertained beforehand and are insured against flood or fire, are not included in the GNP.

Last, the income earned through illegal activities is not included in the GNP. Although the goods sold in the black market are priced and fulfil the needs of the people, but as they are not useful from the social point of view, the income received from their sale and purchase is always excluded from the GNP.

There are two main reasons for this. One, it is *not known whether these things were produced during the current year or the preceding years.* Two, *many of these goods are foreign made and smuggled* and hence not included in the GNP.

Three Approaches to GNP

After having discussed the basic constituents of GNP, it is essential to know how it is estimated. Three approaches are employed for this purpose. One, the income method to GNP; two, the expenditure method to GNP and three, the value added method to GNP. Since gross income equals gross expenditure, GNP estimated by all these methods would be the same with appropriate adjustments.

1. INCOME METHOD TO GNP:

The income method to GNP consists of the remuneration paid in terms of money to the factors of production annually in a country.

Thus GNP is the sum total of the following items:

- (a) **Wages and salaries:** Under this head are included *all forms of wages and salaries earned through productive activities by workers and entrepreneurs.* It includes all sums received or deposited during a year by way of all types of contributions like overtime, commission, provident fund, insurance, etc.

- (b) **Rents:** Total rent includes the *rents of land, shop, house, factory, etc. and the estimated rents of all such assets as are used by the owners themselves.*
- (c) **Interest:** Under interest comes *the income by way of interest received by the individual of a country from different sources.* To this is added, the estimated interest on that private capital which is invested and not borrowed by the businessman in his personal business. But the *interest received on governmental loans has to be excluded*, because it is a mere transfer of national income.
- (d) **Dividends :** Dividends *earned by the shareholders* from companies are included in the GNP.
- (e) **Undistributed corporate profits :** Profits which are *not distributed by companies* and are retained by them are included in the GNP.
- (f) **Mixed incomes :** These include *profits of an unincorporated business*, self-employed persons and partnerships. They form part of GNP.
- (g) **Direct taxes :** Taxes levied on *individuals, corporations and other businesses* are included in the GNP.
- (h) **Indirect taxes :** The government levies a number of indirect taxes, *like excise duties and sales tax. These taxes are included in the price of commodities.* But revenue from these goes to the government treasury and not to the factors of production. Therefore, the income due to such taxes is added to the GNP.
- (i) **Depreciation :** Every corporation makes *allowance for expenditure on wearing out and depreciation* of machines, plants and other capital equipment. Since this sum also is not a part of the income received by the factors of production, it is, therefore, also included in the GNP.

- (j) **Net income earned from abroad** : This is the difference between the value of exports of goods and services and the value of imports of goods and services. If this difference is positive, it is added to the GNP and if it is negative, it is deducted from the GNP.

GNP according to the Income Method = Wages and Salaries + Rents + Interest + Dividends + Undistributed Corporate Profits + Mixed Income + Direct Taxes + Indirect Taxes + Depreciation + Net Income from abroad.

2. EXPENDITURE METHOD TO GNP:

From the expenditure viewpoint, GNP is the sum total of expenditure incurred on goods and services during one year in a country.

It includes the following items:

- (a) **Private consumption expenditure**: It includes all types of expenditure on personal consumption by the individuals of a country.

It comprises expenses on durable goods like watch, bicycle, radio, etc., expenditure on single-used consumers' goods like milk, bread, ghee, clothes, etc., as also the expenditure incurred on services of all kinds like fees for school, doctor, lawyer and transport. All these are taken as final goods.

- (b) **Gross domestic private investment**: Under this the expenditure incurred by private enterprise on new investment and on replacement of old capital. It includes expenditure on house construction, factory- buildings, and all types of machinery, plants and capital equipment.

In particular, the increase or decrease in inventory is added to or subtracted from it. The inventory includes produced but unsold manufactured and semi-manufactured goods during the year and the stocks of raw materials, which have to be accounted for in GNP. It does not take into account the financial exchange of shares and stocks because their sale and purchase is not real investment. But depreciation is added.

(c) **Net foreign investment:** It means the *difference between exports and imports or export surplus*. Every country exports to or imports from certain foreign countries. The imported goods are not produced within the country and hence cannot be included in the national income, but the exported goods are manufactured within the country.

Therefore, the *difference in value between exports (X) and imports (M), whether positive or negative, is included in the GNP*.

(d) **Government expenditure on goods and services:** The *expenditure incurred by the government on goods and services is a part of the GNP*. Central, state or local governments spend a lot on their employees, police and army. To run the offices, the governments have also to spend on contingencies which include paper, pen, pencil and various types of stationery, cloth, furniture, cars, etc.

It also includes the expenditure on government enterprises. But *expenditure on transfer payments is not added*, because these payments are not made in exchange for goods and services produced during the current year.

Thus GNP according to the Expenditure Method = Private Consumption Expenditure (C) + Gross Domestic Private Investment (I) + Net Foreign Investment (X-M) + Government Expenditure on Goods and Services

$$(G) = C + I + (X - M) + G_g$$

3. VALUE ADDED METHOD TO GNP:

Another method of measuring GNP is by value added. *In calculating GNP, the money value of final goods and services produced at current prices during a year is taken into account. This is one of the ways to avoid double counting. But it is difficult to distinguish properly between a final product and an intermediate product.*

For instance, raw materials, semi-finished products, fuels and services, etc. are sold as inputs by one industry to the other. *They may be final goods for one industry and intermediate for others.* So, to avoid duplication, the value of intermediate products used in manufacturing final products must be subtracted from the value of total output of each industry in the economy.

Thus, the difference between the value of material outputs and inputs at each stage of production is called the value added. If all such differences are added up for all industries in the economy, we arrive at the GNP by value added.

GNP by value added = Gross value added + Net Income from Abroad.

GNP at Market Prices

When we multiply the total output produced in one year by the market prices prevalent during that year in a country, we get the **Gross National Product at market prices.**

Thus, GNP at market prices means the gross value of final goods and services produced annually in a country plus net income from abroad.

GNP at Market Prices = GDP at Market Prices + Net Income from Abroad.

GNP at Factor Cost

GNP at factor cost is the sum of the money value of the income produced by and accruing to the various factors of production in one year in a country.

It includes all items mentioned above under income method to GNP less indirect taxes.

GNP at market prices always includes indirect taxes levied by the government on goods which raise their prices. But GNP at factor cost is the income that the factors of production receive in return for their services alone. It is the cost of production.

Thus GNP at market prices is always higher than GNP at factor cost. Therefore, in order to arrive at GNP at factor cost, we deduct indirect taxes from GNP at market prices. Again, it often happens that the cost of production of a commodity to the producer is higher than a price of a similar commodity in the market.

In order to protect such producers, the government helps them by granting monetary help in the form of a subsidy equal to the difference between the market price and the cost of production of the commodity. As a result, the price of the commodity to the producer is reduced and equals the market price of a similar commodity.

For example, if the market price of rice is Rs. 3 per kg but it costs the producers in certain areas Rs. 3.50. The government gives a subsidy of 50 paise per kg to them in order to meet their cost of production. Thus in order to arrive at GNP at factor cost, subsidies are added to GNP at market prices.

GNP at Factor Cost = GNP at Market Prices – Indirect Taxes + Subsidies.

Net National Product (NNP)

NNP includes the value of the total output of consumption goods and investment goods. But the process of production uses up a certain amount of fixed capital. Some fixed equipment wears out, its other components are damaged or destroyed, and still others are rendered obsolete through technological changes.

All this process is termed depreciation or capital consumption allowance. In order to arrive at NNP, we deduct depreciation from GNP.

The word 'net' refers to the exclusion of that part of total output which represents depreciation.

So **$NNP = GNP - \text{Depreciation}$** .

NNP at Market Prices

Net National Product at market prices is the net value of final goods and services evaluated at market prices in the course of one year in a country.

If we deduct depreciation from GNP at market prices, we get NNP at market prices.

$NNP \text{ at Market Prices} = GNP \text{ at Market Prices} - \text{Depreciation}$.

NNP at Factor Cost

Net National Product at factor cost is the net output evaluated at factor prices. It includes income earned by factors of production through participation in the production process such as wages and salaries, rents, profits, etc. It is also called National Income.

This measure differs from NNP at market prices in that indirect taxes are deducted and subsidies are added to NNP at market prices in order to arrive at NNP at factor cost. Thus,

$NNP \text{ at Factor Cost} = NNP \text{ at Market Prices} - \text{Indirect taxes} + \text{Subsidies}$

$= GNP \text{ at Market Prices} - \text{Depreciation} - \text{Indirect taxes} + \text{Subsidies}$.

$= \text{National Income}$.

Normally, NNP at market prices is higher than NNP at factor cost because indirect taxes exceed government subsidies. However, NNP at market prices can be less than NNP at factor cost when government subsidies exceed indirect taxes.

DOMESTIC INCOME

Income generated (or earned) by factors of production within the country from its own resources is called **domestic income or domestic product**.

Domestic income includes:

- (i) Wages and salaries,
- (ii) rents, including imputed house rents,
- (iii) interest,
- (iv) dividends,
- (v) undistributed corporate profits, including surpluses of public undertakings,
- (vi) mixed incomes consisting of profits of unincorporated firms, self-employed persons, partnerships, etc., and
- (vii) direct taxes.

Since domestic income does not include income earned from abroad, it can also be shown as:

Domestic Income = National Income - Net income earned from abroad.

Thus the difference between domestic income and national income is the net income earned from abroad. If we add net income from abroad to domestic income, we get national income, i.e., **National Income = Domestic Income + Net income earned from abroad.**

But the net national income earned from abroad may be positive or negative. If exports exceed imports, net income earned from abroad is positive. In this case, national income is greater than domestic income. On the other hand, when imports exceed exports, net income earned from abroad is negative and domestic income is greater than national income.

PRIVATE INCOME

Private income is income obtained by private individuals from any source, productive or otherwise, and the retained income of corporations. It can be arrived at from NNP at Factor Cost by making certain additions and deductions.

The additions include transfer payments such as pensions, unemployment allowances, sickness and other social security benefits, gifts and remittances from abroad, windfall gains from lotteries or from horse racing, and interest on public debt.

The deductions include income from government departments as well as surpluses from public undertakings, and employees' contribution to social security schemes like provident funds, life insurance, etc.

Private Income = National Income (or NNP at Factor Cost) + Transfer Payments + Interest on Public Debt — Social Security — Profits and Surpluses of Public Undertakings.

PERSONAL INCOME

Personal income is the total income received by the individuals of a country from all sources before payment of direct taxes in one year.

Personal income is never equal to the national income, because the former includes the transfer payments whereas they are not included in national income.

Personal income is derived from national income by deducting undistributed corporate profits, profit taxes, and employees' contributions to social security schemes.

These three components are excluded from national income because they do not reach individuals.

But business and government transfer payments, and transfer payments from abroad in the form of gifts and remittances, windfall gains, and interest on public debt which are a source of income for individuals are added to national income.

Personal Income = National Income – Undistributed Corporate Profits – Profit Taxes – Social Security Contribution + Transfer Payments + Interest on Public Debt.

Personal income differs from private income in that it is less than the latter because it excludes undistributed corporate profits.

Personal Income = Private Income – Undistributed Corporate Profits – Profit Taxes

DISPOSABLE INCOME

Disposable income or personal disposable income means the actual income which can be spent on consumption by individuals and families.

The whole of the personal income cannot be spent on consumption, because it is the income that accrues before direct taxes have actually been paid. Therefore, in order to obtain disposable income, direct taxes are deducted from personal income.

Thus, **Disposable Income = Personal Income – Direct Taxes.**

But the whole of disposable income is not spent on consumption and a part of it is saved. Therefore, disposable income is divided into consumption expenditure and savings.

Thus **Disposable Income = Consumption Expenditure + Savings.**

If disposable income is to be deduced from national income, we deduct indirect taxes plus subsidies, direct taxes on personal and on business, social security payments, undistributed corporate profits or business savings from it and add transfer payments and net income from abroad to it.

Disposable Income = National Income – Business Savings – Indirect Taxes + Subsidies – Direct Taxes on Persons – Direct Taxes on Business – Social Security Payments + Transfer Payments + Net Income from abroad.

REAL INCOME

Real income is national income expressed in terms of a general level of prices of a particular year taken as a base.

National income is the value of goods and services produced as expressed in terms of money at current prices. But it does not indicate the real state of the economy.

It is possible that the net national product of goods and services this year might have been less than that of the last year, but owing to an increase in prices, NNP might be higher this year.

On the contrary, it is also possible that NNP might have increased but the price level might have fallen, as a result, national income would appear to be less than that of the last year. In both situations, the national income does not depict the real state of the country. To rectify such a mistake, the concept of real income has been evolved.

In order to find out the real income of a country, a particular year is taken as the base year when the general price level is neither too high nor too low and the price level for that year is assumed to be 100. Now the general level of prices of the given year for which the national

income (real) is to be determined is assessed in accordance with the prices of the base year. For this purpose, the following formula is employed.

$$\text{Real NNP} = \text{NNP for the Current Year} \times \text{Base Year Index (=100)} / \text{Current Year Index}$$

PER CAPITA INCOME

The average income of the people of a country in a particular year is called Per Capita Income for that year.

This concept also refers to the measurement of income at current prices and at constant prices. For instance, in order to find out the per capita income for 2018, at current prices, the national income of a country is divided by the population of the country in that year.

$$\text{Per Capita Income for 2018} = \frac{\text{National Income for 2018}}{\text{Population of 2018}}$$

Similarly, for the purpose of arriving at the Real Per Capita Income, this very formula is used.

$$\text{Real Per Capita Income for 2018} = \frac{\text{Real National Income for 2018}}{\text{Population of 2018}}$$

This concept enables us to know the average income and the standard of living of the people. But it is not very reliable, because in every country due to unequal distribution of national income, a major portion of it goes to the richer sections of the society and thus income received by the common man is lower than the per capita income.

CHAPTER 3 INDIAN UNION BUDGET

INTRODUCTION:



A description of anticipated receipts and expenses, known as the “**Annual Financial Statement**,” must be presented to the Parliament for consideration each fiscal year in accordance with Article 112 of the constitution.

The Indian Union Budget is an annual financial statement presented by the Finance Minister of India in the Parliament. It outlines the government's revenue and expenditure for the upcoming financial year, which begins on April 1st and ends on March 31st of the following year.

The Union Budget is an important tool for the government to manage the economy, allocate resources, and implement policies to achieve its economic and social objectives.

Here are some key aspects of the Indian Union Budget:

1. **Budget Speech:** The finance minister delivers a budget speech in Parliament, *highlighting the government's economic policies, fiscal measures, and priorities for the upcoming year. The speech provides an overview of the state of the economy, key challenges, and policy initiatives.*
2. **Revenue and Expenditure:** The budget provides *details of the government's revenue sources, including taxes, duties, and non-tax revenues, as well as its planned expenditures across various sectors such as infrastructure, healthcare, education, defence, agriculture, and social welfare programs.*

3. **Fiscal Deficit:** The budget outlines the government's fiscal deficit target, *which is the difference between total revenue and total expenditure*. Fiscal deficit management is crucial for maintaining macroeconomic stability and investor confidence.
4. **Taxation:** The budget may introduce changes to the tax regime, *including revisions to income tax rates, corporate tax rates, customs duties, excise duties, and other levies*. Tax reforms are often aimed at promoting economic growth, incentivizing investments, and improving tax compliance.
5. **Policy Initiatives:** The budget may announce *policy measures and reforms* to address key economic challenges, promote inclusive growth, enhance infrastructure development, boost investment climate, and improve governance and transparency.
6. **Sectoral Allocations:** The budget *allocates funds to different sectors based on government priorities and development needs*. Major sectors such as agriculture, healthcare, education, infrastructure, and defence receive significant attention in budget allocations.
7. **Public Debt Management:** The budget *outlines the government's borrowing program to finance its expenditure*, including both domestic and external borrowings. Effective debt management is essential for maintaining fiscal sustainability and debt sustainability.
8. **Social Welfare Programs:** The budget may include *provisions for social welfare schemes and programs* aimed at poverty alleviation, rural development, employment generation, healthcare access, and education.
9. **Budget Implementation:** Following the budget announcement, *various ministries and departments prepare detailed expenditure plans and undertake budget execution* throughout the fiscal year, subject to parliamentary approval and oversight.

OBJECTIVES AND SIGNIFICANCE OF BUDGET:

One of the key objectives of the Indian Union Budget is to promote economic growth and development. To achieve this, the government allocates resources to various sectors such as agriculture, education, health, infrastructure, and defense.

The budget also aims to promote social welfare and reduce poverty by increasing investments in social programs and schemes.

Another objective of the Union Budget is to maintain macroeconomic stability by managing inflation and reducing the fiscal deficit. To achieve this, the government may introduce measures such as increasing taxes, reducing subsidies, and rationalizing government expenditure. The government may also take steps to attract foreign investment and promote exports, in order to increase foreign exchange reserves and stabilize the economy.

The Indian Union Budget is also a reflection of the government's policy priorities and political agenda. For instance, in the 2021-22 Union Budget, the government focused on promoting infrastructure development, increasing healthcare spending, and boosting rural and agricultural growth. The government also announced several measures to promote digitalization, innovation, and entrepreneurship, as part of its vision to make India self-reliant and a global manufacturing hub.

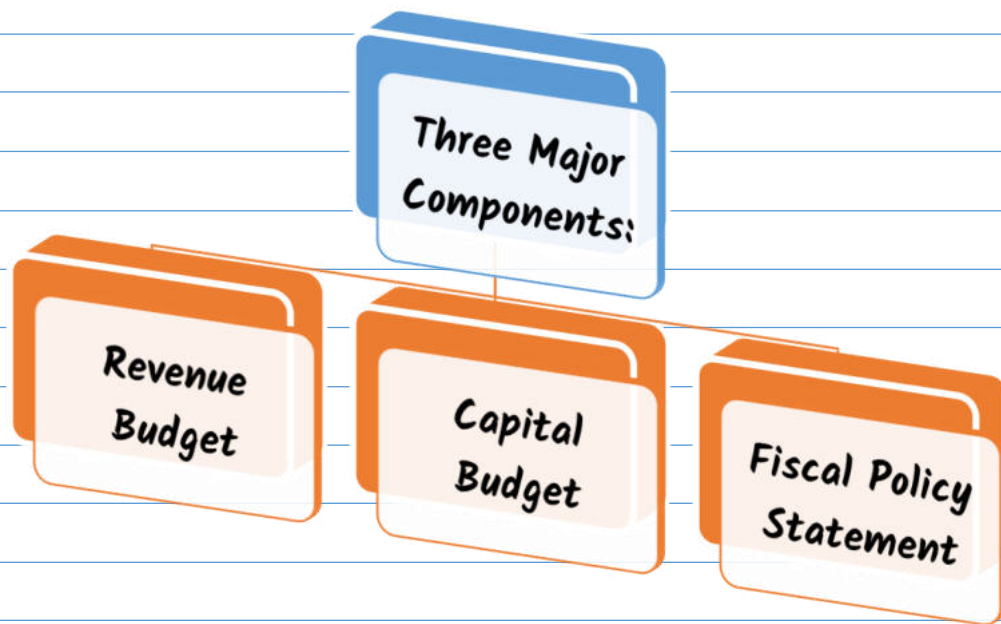
The Union Budget has a significant impact on the Indian economy and its various stakeholders. For instance, businesses and industries are affected by changes in tax rates, subsidies, and government policies. Investors and financial markets also closely monitor the budget announcements, as they can affect stock prices, bond yields, and currency exchange rates. Similarly, individual taxpayers are affected by changes in income tax rates, deductions, and exemptions.

The Union Budget is also a platform for the government to announce policy reforms and initiatives. For instance, in recent years, the government has introduced several reforms such

as the Goods and Services Tax (GST), Digital India, Make in India, and Atmanirbhar Bharat, which have had a significant impact on the Indian economy and society.

MAJOR COMPONENTS OF UNION BUDGET:

The Union Budget comprises three major components:



REVENUE BUDGET:

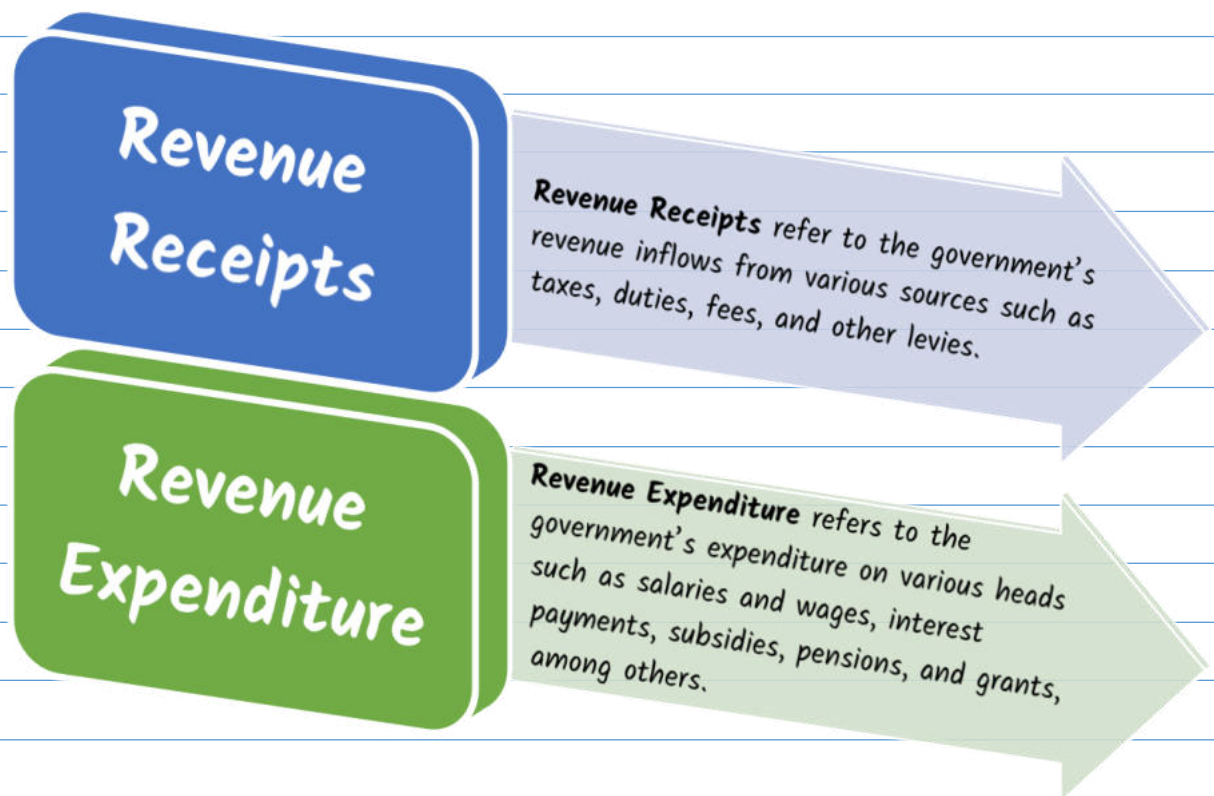
The Revenue Budget consists of the revenue receipts of the Government (Tax revenues and non-tax revenues) and the revenue expenditure.

Tax revenues comprise proceeds of taxes and other duties levied by the Union. Other revenues are receipts of the government mainly consisting of interest and dividend on investments made by the government, and fees and receipts for other services rendered by the government.

The Revenue Budget of India is an essential component of the Union Budget, which lays out the government's revenue and expenditure plans for the upcoming fiscal year. The Revenue Budget is a crucial tool for promoting economic growth and development in India, as it enables

the government to allocate resources efficiently and effectively towards critical areas such as education, healthcare, infrastructure, and social welfare programs.

The Revenue Budget comprises two major components:



Revenue receipts includes tax revenue and non-tax revenue.

TAX REVENUE:

Tax revenue is the **most significant source of revenue for the Indian government**, which includes both direct and indirect taxes.

Direct taxes refer to taxes that are paid directly by individuals and corporations, whereas Indirect taxes refer to taxes that are levied on goods and services. Tax revenue contributes around 70% of the government's total revenue receipts.

The followings are the examples of tax revenue:

1. **Income Tax:** Tax levied on the income earned by individuals and entities.

2. **Corporate Tax:** Tax imposed on the profits earned by companies.
3. **Goods and Services Tax (GST):** A consumption tax levied on the sale of goods and services.
4. **Customs Duty:** Tax imposed on goods imported into or exported out of the country.
5. **Excise Duty:** Tax levied on the production or sale of certain goods within the country.

NON-TAX REVENUE:

Non-tax revenue *refers to the government's revenue inflows from sources other than taxes.*

Non-tax revenue contributes around 30% of the government's total revenue receipts.

Non-tax revenue includes sources such as:

1. **Interest Receipts:** Interest earned on loans extended by the government.
2. **Dividend and Profits:** Income earned from investments in public sector enterprises.
3. **Fees and Fines:** Revenue generated from fees for government services and fines imposed for violations of regulations.
4. **Revenue from Public Sector Enterprises:** Income earned by the government from its ownership of public sector companies.

Revenue Expenditure: Revenue expenditure is the government's expenditure on various heads such as salaries and wages, interest payments, subsidies, pensions, and grants, among others.

The Revenue Expenditure is broadly classified into two categories:

1. Plan Revenue Expenditure
2. Non-Plan Revenue Expenditure.
3. Other Revenue Expenditure:

Plan Revenue Expenditure: Plan Revenue Expenditure *refers to the government's expenditure on various Plan schemes and programs* such as the National Rural Health Mission, National Rural Employment Guarantee Scheme, and National Highways Development Project, among others. Plan Revenue Expenditure is an *essential tool for promoting economic growth and*

development as it supports the government's socio-economic objectives and promotes inclusive growth.

Non-Plan Revenue Expenditure: Non-Plan Revenue Expenditure *includes the government's expenditure on defense, interest payments, and subsidies, among others.*

Defense expenditure is a critical component of the government's expenditure as it ensures national security and sovereignty. *Interest payments refer to the government's expenditure on servicing its debt*, which is an essential component of fiscal management. Subsidies are provided by the government to promote specific sectors such as agriculture, energy, and food, among others, and to support vulnerable sections of society.

Other Revenue Expenditure: Other Revenue Expenditure *refers to the government's expenditure on various heads such as pensions, grants, and loans, among others.* Pensions are provided to retired government employees as a form of social security.

Grants are provided to various organizations and institutions for promoting specific sectors such as education, healthcare, and social welfare. Loans are provided by the government to various organizations and institutions for promoting economic growth and development.

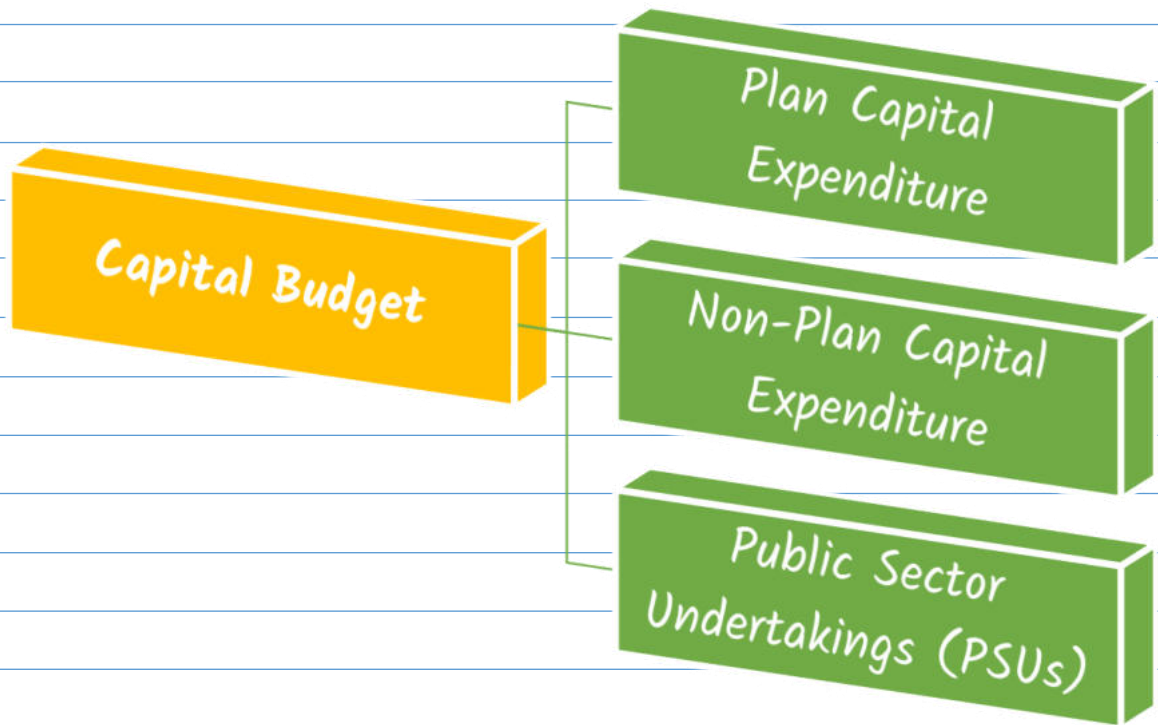
CAPITAL BUDGET:

It refers to the government's expenditure on long-term assets, such as infrastructure, machinery, and equipment, which are expected to yield benefits over a period of time. The capital budget is an essential tool for promoting economic growth and development by investing in critical areas such as transportation, energy, water supply, and communication.

It enables the government to invest in critical areas such as infrastructure, energy, and education, among others, which are essential for promoting economic development and improving the quality of life of its citizens. The Capital Budget also plays an important role in promoting social welfare and reducing poverty by investing in social programs and schemes.

COMPONENTS OF CAPITAL BUDGET:

Capital budget comprises three major components:



Plan Capital Expenditure:

Plan Capital Expenditure includes the government's expenditure on various Plan schemes and programs such as the National Rural Health Mission, National Rural Employment Guarantee Scheme, and National Highways Development Project. Non-Plan Capital Expenditure includes the government's expenditure on defense, interest payments, and subsidies.

Public Sector Undertakings refer to government-owned companies such as Indian Oil, BHEL, and SAIL, among others, in which the government invests to promote their growth and development.

Plan Capital Expenditure is a crucial component of the Capital Budget as it supports the government's socio-economic objectives and promotes inclusive growth. The government allocates resources to various sectors such as agriculture, education, health, infrastructure, and defense, among others, to promote economic development and improve the quality of life of its citizens.

For instance, the government may invest in building roads, railways, airports, and ports to improve connectivity and promote trade and commerce. It may also invest in education and healthcare to improve human capital and reduce poverty.

Non-Plan Capital Expenditure:

It is an important component of the Capital Budget as it includes expenditure on defense, interest payments, and subsidies, among others. Defense expenditure is a critical component of the government's expenditure as it ensures national security and sovereignty.

Interest payments refer to the government's expenditure on servicing its debt, which is an essential component of fiscal management. Subsidies are provided by the government to promote specific sectors such as agriculture, energy, and food, among others, and to support vulnerable sections of society.

Public Sector Undertakings (PSUs):

They are government-owned companies in which the government invests to promote their growth and development. The government may invest in PSUs to promote strategic sectors such as defense, energy, and infrastructure, among others. The government may also invest in PSUs to promote social welfare and support vulnerable sections of society, such as through investments in healthcare, education, and housing.

FISCAL DEFICIT:

Fiscal Deficit is the gap between a government's total expenditure and its total revenue. In the context of India's budget, it refers to the amount of money the government borrows to finance its spending when its revenue falls short of expenses.

The fiscal deficit is a crucial component of the budget, as it indicates the government's borrowing requirement and its impact on the economy.

There are several components of fiscal deficit in India's budget:

Component of Fiscal Deficit	Explanation
Primary Deficit	The primary deficit is the difference between the government's revenue from taxes and non-tax sources and its expenses, excluding interest payments on past debt. This component reflects the government's ability to finance its expenses from its revenue, excluding the cost of borrowing.
Interest Payments on Past Debt	Another component of fiscal deficit is the interest payments on past debt. This component indicates the burden of interest payments on the government's borrowing, which can impact the country's future borrowing ability and overall economic growth.

Revenue Deficit

Fiscal deficit also includes the revenue deficit, which is the difference between the government's revenue from taxes and non-tax sources and its expenses, excluding capital expenses.

This component indicates the government's inability to finance its regular expenses from its revenue, excluding investments in long-term projects.

Capital Expenses

Capital expenses are another significant component of the fiscal deficit. These expenses are investments made by the government in infrastructure, education, healthcare, and other long-term projects.

Capital expenses can help boost economic growth, but they also increase the government's borrowing requirement, leading to a higher fiscal deficit.

CHAPTER 4 INDIAN FINANCIAL MARKETS

INTRODUCTION



Financial Markets refer to the markets where buyers and sellers participate in the trade of assets like equities, bonds, currencies and derivatives. Financial markets provide a platform for investors to invest money in securities and for companies to raise money by issuing securities.

Financial markets help direct resources to their most valuable use, fueling innovation and employment. A well-regulated, transparent system allows both small investors and large corporations to raise money in public securities markets. This lowers the cost of capital for businesses while offering optionality and wealth growth opportunities.

The securities are traded on exchanges like the **National Stock Exchange (NSE)** and **Bombay Stock Exchange (BSE)** in India. Stock market allows companies to raise capital by issuing shares to the public and investors to purchase shares of companies.

Financial markets are the organisations, systems, and venues that permit the buying and selling of financial assets like derivatives, stocks, bonds, currencies, and commodities. Financial markets' primary goal is to make it easier for money to move from savers to borrowers, giving people, businesses, and governments a way to invest and finance their endeavours. Financial markets are vital to the smooth operation of capitalist economies.

In other words, financial markets refer broadly to any marketplace where securities trading occurs, including the stock market, bond market, forex market, and derivatives market.

Thus, the key points pertaining to the financial markets are-

- Financial markets refer broadly to any marketplace *where the trading of securities occurs*.
- There are *many kinds of financial markets*, including (but not limited to) forex, money, stock, and bond markets.
- These markets *may include assets or securities* that are either listed on regulated exchanges or trade over-the-counter (OTC).
- Financial markets *trade in all types of securities* and are critical to the smooth operation of a capitalist society.
- When financial *markets fail*, economic disruption, including *recession and rising unemployment*, can result.

The term “Indian financial market” refers to the country’s system of institutions, instruments, and rules that play a key role in streamlining the exchange of money between market participants.

FUNCTIONS OF FINANCIAL MARKET:

The following are the major functions of Financial Market:

1. **Facilitating capital formation:** Financial markets allow companies to raise fresh capital from investors to finance their operations or expansion plans. This helps businesses grow and create jobs, leading to economic growth.
2. **Price discovery:** Prices of all financial instruments are determined through market forces like supply- demand dynamics in these markets. This helps buyers and sellers determine fair prices for a given security or asset class at any given time.
3. **Allocating capital efficiently:** By allowing investors to allocate their capital across different classes of assets according to their risk appetite, financial markets help ensure that resources are allocated efficiently across various sectors of the economy.
4. **Risk management tools:** These markets also offer sophisticated risk management tools such as derivatives which can be used by institutions or individual traders seeking exposure without taking on too much risk or leverage levels beyond what they can manage effectively.

Financial markets have become increasingly interconnected in recent years, allowing capital to move more quickly worldwide and making it easier for businesses to access capital when needed.

Financial markets play an indispensable role in facilitating the transfer of capital, aiding in price discovery, and managing risks.

Types of Financial Markets:



1. Capital Market

Capital markets are marketplace where buyers and sellers engage in the trade of securities like bonds, stocks, and derivatives. Capital markets channel savings and investment between suppliers of capital such as retail investors and institutional investors, and users of capital like businesses, government, and individuals.

Capital markets in India consist primarily of the stock exchanges like NSE and BSE where investors buy and sell shares, bonds, and derivatives. The main usage of capital markets is to allow Indian companies across sectors to raise long-term capital from investors across India. This capital is used to fund growth and projects for business expansion. It provides an alternative to limited bank lending. For investors, it provides an avenue to allocate savings into financial securities to build wealth over time.

- a) **Stock Market:** Stock markets allow companies to raise capital by issuing and selling shares or stock to investors.

The two main stock exchanges in India are the **National Stock Exchange (NSE)** and the **Bombay Stock Exchange (BSE)**. Companies list and trade their shares on these exchanges to access equity financing from investors across the country. Stock markets provide an avenue for companies to access capital for business purposes like investing in new projects or acquisitions. It offers an alternative to traditional bank lending. For investors, it serves as a platform to allocate savings and build wealth.

- b) **Bond market:** Bond markets are used by organisations like governments and companies raise debt financing by issuing bonds that are purchased by investors. The bond market segments in India include the government bond market, corporate bond market, and municipal/local bonds.

The Indian bond market consists of both government and corporate bonds. **Government securities**, including treasury bills and bonds issued by the Reserve Bank of India (RBI) on behalf of the Government of India, form a significant portion of the bond market. **Corporate bonds** are issued by companies to raise funds for various purposes, such as expansion, working capital, and debt refinancing. The bond market provides investors with fixed-income securities, offering regular interest payments and the return of principal upon maturity.

2. Commodity market

Commodity markets are markets that facilitate the trading of primary economic goods like agricultural products, metals, oil and natural gas. The main commodity exchanges in India are MCX and NCDEX.

For example, NCDEX allows farmers, traders, and processors to trade in agricultural commodities like wheat, rice, cotton, spices, etc. through futures contracts. This provides price risk management in agri-commodities. Similarly, on MCX traders buy and sell futures contracts on metals like gold, silver, copper, natural gas, crude oil etc. Jewellers hedge their price risk on gold inventory using gold futures.

The main usage of commodity markets in India is to provide price discovery and price risk management for producers, consumers and traders of commodities. It helps integrate localised commodity markets across India into one national market. Commodity derivatives also allow better inventory planning for companies.

- a) **Soft commodities:** Soft commodities refer to agricultural commodities that are grown, rather than mined. They include crops like wheat, rice, pulses, spices, coffee, tea, cotton, rubber, fruits and vegetables. The National Commodity and Derivatives Exchange (NCDEX) in India provides a platform for trading in various soft commodities.

For example, it allows futures trading in wheat, chana, soybean, mustard seed, cotton, cardamom, mentha oil, etc. This helps farmers, producers and exporters hedge against price risks.

The main usage of soft commodity trading in India is price discovery and risk management. It provides valuable information on demand, supply and prices to all participants. Farmers lock in future selling prices for their produce. Processors like flour mills hedge against raw material price changes. The efficient price signals lead to higher farm productivity and food security.

- b) **Hard Commodities:** Hard commodities refer to natural resources that are mined or extracted, rather than grown agriculturally. They include precious metals like gold, silver, platinum, base metals like aluminium, copper, nickel, lead, zinc and energy commodities like crude oil, natural gas and coal.

In India, hard commodities are traded on exchanges like the Multi Commodity Exchange (MCX) and National Commodity and Derivatives Exchange (NCDEX).

For example, MCX offers futures trading in gold, silver, copper, crude oil, natural gas, aluminium, nickel, mentha oil, cotton etc. This facilitates price discovery and hedging for producers, consumers and traders.

The key usage of hard commodity derivatives in India is managing price volatility and inventory risks. Mining companies hedge against fluctuations in global metal prices. Oil marketing companies lock in crude oil purchase costs in advance. Jewellers offset price risks in gold/silver inventory.

3. **Money Market:** Money markets are short-term debt markets where participants borrow and lend for durations typically up to one year. Money market instruments in India include treasury bills, commercial paper, certificates of deposit, repo and reverse repo agreements.

For example, a manufacturing company sometimes issues commercial paper with 3 month maturity to raise short-term working capital funds from investors instead of taking a bank loan. The investors purchasing this commercial paper will earn short-term returns while their money is parked for 3 months.

The main usage of money markets in India is to allow businesses, financial institutions, government and investors to borrow and lend for very short periods. It serves as an alternative to bank borrowing and provides short-term liquidity in the economy.

For businesses, it offers flexibility in managing cash flows. For investors, it provides very liquid and low-risk short-term investment options like treasury bills. An active money market is essential for the Reserve Bank of India to conduct effective monetary policy.

4. **Derivatives Market:** Derivatives markets provide instruments like futures, options, swaps etc. that derive their value from an underlying asset. They allow the transfer of risk from parties who want to hedge their risk exposure to parties more willing to bear that risk.

For example, an Indian farmer will be able to buy a futures contract to sell his crop at a future date for a predetermined price. This protects him from potential decrease in crop prices at harvest time. The speculator taking the opposite trade is bearing the price risk in exchange for a potential profit if prices rise.

The main usage of derivatives markets in India is to allow hedging and speculation on asset prices.

For producers and businesses, it provides a means to hedge against commodity price risk, interest rate risk and currency rate risks. For investors, it provides avenues to speculate and profit from movements in underlying asset prices. India has active derivatives markets in

equity, commodities and currencies. These markets impart liquidity and price discovery to the underlying cash markets.

- a) **Futures:** Futures markets provide standardised contracts that obligate the buyer to purchase an asset and the seller to sell an asset at a predetermined future date and price. The contracts are standardised by the exchanges on the quantity, quality and delivery specifications.

The main usage of futures markets in India is to allow hedging and speculation on future asset prices.

For producers like farmers, it provides price protection against potential adverse price movements. For speculators, it provides an opportunity to profit from correct bets on future price trends. India has active futures markets in equities, commodities, currencies and bonds. These provide price discovery of the underlying cash markets and improve their liquidity.

- b) **Forward:** The forward market is an over-the-counter market where two parties enter into customised contracts to buy or sell an asset at a specified price on a future date. The terms are agreed bilaterally unlike the standardised contracts traded on futures exchanges. The main usage of the forward market in India is to hedge against currency and commodity price risks.

Exporters, importers and commodity producers use forward contracts to lock in future prices and mitigate risks. Speculators provide liquidity and absorb risks in the forward market. While smaller in size compared to futures markets, the forward market provides flexibility as terms are customised as per needs.

- c) **Option:** Option markets refer to derivatives exchanges where financial securities known as options are traded.

An option is a contract that gives the buyer the right, but not the obligation, to buy or sell an underlying asset at a predetermined price on or before a specific date.

For example, on the National Stock Exchange (NSE) in India, investors are able to buy or sell Nifty options that give the right to buy or sell the Nifty 50 index at a particular price by the expiry date.

The main usage of option markets in India is to allow investors to hedge stock portfolios or speculate on market direction. Options help limit downside risk in volatile markets, making option trading a preferred method for managing financial exposure. Traders use options to bet on expected moves in the broader market or individual stocks, with option trading offering a strategic tool for both hedging and speculation purposes.

d) **Swap:** Swap markets refer to over-the-counter (OTC) markets where counterparties exchange financial instruments known as swaps. A swap is a derivative contract where two parties agree to exchange financial flows at certain intervals during the life of the swap. For example, an interest rate swap involves exchanging a fixed interest rate cash flow for a floating rate cash flow.

The main usage of swap markets in India is for corporates to hedge interest rate and currency risk on foreign borrowings. Swaps help convert floating rate loans to fixed rates or vice versa. Banks trading swaps earn fees while facilitating client hedging needs. Swaps also allow speculators to bet on the direction of interest rates and currencies.

5. **Foreign Exchange Market:** The foreign exchange market is a decentralised global market where participants trade currencies. It consists of banks, commercial companies, central banks, investment management firms, hedge funds and retail forex brokers and investors.

The Reserve Bank of India, for example, wants to intervene in the forex market to strengthen or weaken the rupee against the dollar. They will be able to do this by buying or selling rupees in the market.

Multinational corporations like Infosys use the forex market to pay overseas suppliers or staff in other countries. They need to convert their domestic currency into foreign currency through their bank.

The main usage of the foreign exchange market is to facilitate the conversion of one currency into another. It allows businesses, investors, travellers and governments to pay or receive currencies for goods, services, investments and other transactions globally.

6. **Cryptocurrency Market:** The cryptocurrency market refers to the exchanges and over-the-counter platforms where various digital currencies or crypto tokens are traded. Cryptocurrencies like Bitcoin, Ethereum, and Cardano operate on blockchain networks as peer-to-peer decentralised digital money.

In India, investors purchase cryptocurrencies like Bitcoin on exchanges like WazirX, CoinDCX, and CoinSwitch Kuber.

Retail investors buy cryptos as investments, while traders aim to profit from price fluctuations. The main usage of the cryptocurrency market is to facilitate the trading of crypto coins and tokens as an alternative digital asset class. It provides a venue for investors, traders and companies to access decentralised cryptocurrencies outside the traditional financial system. The cryptocurrency market aims to allow the transfer of digital value and enable various blockchain-based applications.

7. **Spot Market:** The spot market, also known as the cash or physical market, refers to the buying and selling of financial instruments or commodities for immediate delivery. Commodities like gold and crude oil also have active spot markets where buyers and sellers trade for immediate delivery. Gold jewellers or oil refiners sometimes use the spot market for their raw material needs.

The main usage of the spot market is to facilitate the exchange of assets at current market prices for near-term requirements. It provides immediate liquidity, unlike derivatives contracts or bonds. Companies use the spot market to fulfil business needs, traders profit from price swings, and the spot prices determine derivatives pricing.

8. Interbank Lending Market

The interbank lending market refers to the system through which banks lend and borrow short-term funds from each other. It enables banks to meet temporary shortages or excesses in liquidity. For example, Bank A has surplus funds while Bank B faces a temporary deficit. Bank B borrows overnight funds from Bank A in the interbank market to square its books. The loans are made at the prevailing interbank interest rates.

Banks in India actively use the interbank market to fine-tune liquidity. The Clearing Corporation of India facilitates interbank lending and borrowing through its collateralized lending and borrowing mechanism. The key usage of the interbank market is to allow banks to efficiently manage their short-term liquidity needs. It provides a mechanism to channel funds from banks with surpluses to those facing deficits. This ensures the stability of the banking system by preventing liquidity crunches and helps optimise the use of available funds.

OVERVIEW OF INDIAN FINANCIAL ECOSYSTEM

The financial system of an economy is a crucial element for its economic development. It facilitates the flow of funds from the households (savers) to business organisations (investors), thereby assisting in the creation of wealth for the nation.

Mainly, the financial system of a country is concerned with the following:

- (a) Allocation and mobilisation of savings.
 - (b) Provision of funds.
 - (c) Facilitating the financial transactions.
 - (d) Developing financial markets.
 - (e) Provision of legal financial structure.
 - (f) Provision of financial and advisory services.
- (a) **Allocation and mobilization of savings:** The financial system facilitates the efficient allocation of savings by directing funds from savers to borrowers. This process ensures that available

capital is channelled towards productive investments, fostering economic growth and development.

- (b) **Provision of funds:** Financial institutions such as banks, non-banking financial companies (NBFCs), and capital markets provide funds to individuals, businesses, and governments for various purposes, including consumption, investment, and infrastructure development
- (c) **Facilitating financial transactions:** The financial system enables the smooth execution of financial transactions, including payments, transfers, and settlements. It provides infrastructure, such as payment systems and electronic banking platforms, to facilitate secure and efficient transactions.
- (d) **Developing financial markets:** Financial markets, including stock markets, bond markets, and commodity markets, provide platforms for buying and selling financial assets. The financial system fosters the development of these markets, enhancing liquidity, price discovery, and access to capital for investors and issuers.
- (e) **Provision of legal financial structure:** The financial system operates within a legal framework established by regulatory authorities. This framework includes laws, regulations, and oversight mechanisms that govern financial institutions, transactions, and market participants, ensuring transparency, accountability, and investor protection.
- (f) **Provision of financial and advisory services:** Financial institutions offer a range of services, including banking, insurance, investment management, and financial advisory services. These services cater to the diverse needs of individuals, businesses, and governments, providing assistance in managing finances, mitigating risks, and achieving financial goals.

Components of Financial System

A system that allows money to be transferred between investors and borrowers is referred to as a financial system. An international, regional, or organisational level definition of a financial system is possible.

The word “system” in “Financial System” refers to a collection of intricately intertwined economic institutions, agents, processes, markets, transactions, claims, and liabilities.

The financial system is made up of five parts, which are described below:

1. Financial Institutions:

Making investors and borrowers meet guarantees the financial system runs well. With the employment of various financial instruments and the assistance of several financial service providers, they *directly or indirectly mobilise investor savings through financial markets.*

They can be divided into four groups: intermediates, non-intermediaries, regulators, and others. They provide services to businesses looking for guidance on a variety of issues, from restructuring to diversification plans. They provide a full range of services to businesses looking to raise capital from the market and manage their financial assets, such as deposits, securities, loans, etc.

2. Financial Markets:

The market where financial assets are created or moved is known as a financial market. A financial transaction entails the creation or transfer of a financial asset as opposed to a real transaction, which involves exchanging money for actual products or services.

A claim to the payment of an amount of money in the future and/or a recurring payment in the form of interest or dividend is represented by financial assets or financial instruments.

Here are the four elements of the financial market:

- I. **Money Market:** A wholesale debt market for highly liquid, short-term instruments with little risk. In this market, funds are offered for terms ranging from one day to one year. Generally speaking, the government, banks, and financial organisations control this market.
- II. **Capital Market:** The purpose of the capital market is to finance long-term investments. The duration of the transactions in this market will be longer than a year.
- III. **Foreign Exchange Market:** deals with the multicurrency needs that are satisfied through currency exchange. The transfer of funds occurs in this market based on the applicable exchange rate. One of the most advanced and integrated markets on the planet is this one.
- IV. **Credit Market:** Short, medium and long-term loans to businesses and individuals are distributed in the credit market by banks, financial institutions (FIs), and non-banking financial companies (NBFCs).

3. Financial Instruments:

Financial assets, securities, and other kinds of financial instruments are the goods that are traded on a financial market. Since the needs of investors and those looking for credit varied, there are many different securities available on the market.

They represent a claim on the future repayment of principal or the regular payment of an amount, such as interest or dividends. Examples include equity shares, bonds, and debentures.

4. Financial Services:

It is made up of products and services offered by Asset Management and Liability Management Businesses. They assist in obtaining the necessary cash and ensure that they are invested effectively. They offer their expertise up to the stage of servicing lenders and help to decide the financing combination.

They support lending and investing, making and authorising payments and settlements, buying and selling assets, managing risk exposures in financial markets, and borrowing. Leasing firms,

mutual fund companies, merchant bankers, portfolio managers, bill discounting and acceptance businesses are a few examples. Many expert services are provided by the financial services industry, including credit rating, venture capital funding, mutual funds, merchant banking, depository services, book building, etc.

5. Money:

Money is defined as anything that is accepted as payment for goods and services or as a means of repaying debt. It serves as a store of value and a means of exchange. It makes it simpler to swap various commodities and services for cash.

KEY FACETS AND GROWTH OF FINANCIAL INSTITUTIONS IN INDIA

The significant characteristics of Indian financial system are as under:

1. Plays a pivotal role in accelerating the rate and volume of savings through the provision of different financial instruments and efficient mobilisation of savings.
2. It is playing a significant role in increasing the national output by providing funds to corporate customers to expand their business operations.
3. Safeguarding the interests of the investors by ensuring smooth financial transactions through regulatory bodies like, Reserve Bank of India (RBI), Securities and Exchange Board of India (SEBI) etc.
4. Contributes substantially towards the economic development and raising the standard of living of the people.
5. Promotes development of weaker sections of the society through rural development banks and cooperative societies.

6. Assist corporate customers to *make better financial decisions* by offering effective financial and advisory services.
7. Facilitates financial deepening and broadening. *Financial deepening refers to an increase in financial assets as a percentage of GDP and financial broadening pertains to an increasing number of participants in the financial system.*

Banking Sector

The banking sector was developed during the British era.

British East India Company set up three banks: *Bank of Bengal (1809)*; *Bank of Bombay (1840)* and *Bank of Madras (1843)*. These three banks were later merged and called *Imperial Bank*, which was taken over by State Bank of India (SBI) in 1955. *The Reserve Bank of India was established in 1935*, followed by the Punjab National Bank, Bank of India, Canara Bank and Indian Bank.

July 19, 1969 was an important date in the history of Indian banking. As it is on this date that *14 major scheduled commercial banks having a deposit of more than INR 50 crore were nationalized*. The 14 banks were Central Bank of India, Bank of Maharashtra, Dena Bank, Punjab National Bank, Syndicate Bank, Canara Bank, Indian Overseas Bank, Indian Bank, Bank of Baroda, Union Bank, Allahabad Bank, United Bank of India, UCO Bank and Bank of India.

Banks are the institutional bodies that accept deposits and grant credit to the entities and play a major role in maintaining the economic stature of a country. Given their importance in the economy, banks are kept under strict regulation in most of the countries. In India, the Reserve Bank of India (RBI) is the apex banking institution that regulates the monetary policy in the country.

As per the Reserve Bank of India (RBI), India's banking sector is sufficiently capitalised and well-regulated. The financial and economic conditions in the country are far superior to any

other country in the world. Credit, market and liquidity risk studies suggest that Indian banks are generally resilient and have withstood the global downturn well.

The Indian banking industry has recently witnessed the rollout of innovative banking models like payments and small finance banks.

In recent years India has also focused on increasing its banking sector reach, through various schemes like the Pradhan Mantri Jan Dhan Yojana and Post payment banks. Schemes like these coupled with major banking sector reforms like digital payments, neo-banking, a rise of Indian NBFCs and fintech have significantly enhanced India's financial inclusion and helped fuel the credit cycle in the country.

Developments of Indian Banking Sector

The major developments of Indian banking sector is captured in the following table-

Years	Major Developments
1921	• Closed market • State-owned Imperial Bank of India was the only bank existing.
1935	• RBI was established as the central bank of country. • Quasi central banking role of Imperial Bank came to an end.
1936-1955	• Imperial Bank expanded its network to 480 branches. • In order to increase penetration in rural areas, Imperial Bank was converted into State Bank of India.
1956-2000	• Nationalisation of 14 large commercial banks in 1969 & 6 more banks in 1980. • Entry of private players such as ICICI intensifying the competition.

	• Gradual technology upgradation in PSU banks .
2000-2020	• In 2003, Kotak Mahindra Finance Ltd received a banking license from RBI and became the first NBFC to be converted in to a bank
	• In 2009, the government removed the Banking Cash Transaction Tax which had been introduced in 2005.
2020 onwards	• Mega merger of Public Sector Banks — Oriental Bank of Commerce and United Bank of India merged with Punjab National Bank — Syndicate Bank merged with Canara Bank — Allahabad Bank merged with Indian Bank — Andhra Bank and Corporation Bank with Union Bank of India • Technological innovations resulting into marked improvements in efficiency, productivity, quality, inclusion and competitiveness in extension of financial services, especially in the area of digital lending. • Conceptualization of digitalization of Agri-finance jointly by the Reserve Bank of India and Reserve Bank Innovation Hub (RBIH) to enable delivery of Kisan Credit Card (KCC) loans in a fully digital and hassle-free manner. • In November 2022, RBI launched a pilot project on Central Bank Digital Currency (CBDC) • The year 2023 was a significant year for policy reforms and regulatory changes in India's banking sector. The Reserve Bank of India (RBI) played a critical role, with a series of policy rate adjustments aimed at balancing

growth and inflation. The repo rate adjustments, which have been kept 6.5% by the Monetary Policy Committee (MPC), were carefully calibrated, reflecting the central bank's commitment to maintaining monetary stability while supporting economic recovery.

- Regulatory changes introduced in 2023 had a profound impact on banking operations. The RBI's tightened norms on Non-Performing Assets (NPAs) reflected a stringent stance on asset quality. Moreover, the introduction of new guidelines for digital lending aimed at protecting consumer interests while fostering a healthy digital finance ecosystem.

- The year 2023 also witnessed a push towards greater compliance with international banking standards, including Basel III norms. These regulatory measures were pivotal in enhancing the resilience and transparency of the banking system, ensuring a more stable financial environment.

- During 2023, the banking sector witnessed an unprecedented surge in online banking services, mobile banking apps, and digital payment solutions. Banks collaborated extensively with fintech companies, leveraging their technology to offer innovative services like instant loans, digital KYC, and AI-driven customer support.

- In July 2023, Housing Development Finance Corporation (HDFC) merged with its subsidiary HDFC Bank.

- In accordance with the Reserve Bank India (RBI) approval dated March 4, 2024, AU Small Finance Bank (AU SFB), India's largest SFB, announced the amalgamation of Fincare Small Finance Bank (Fincare SFB) with and into AU SFB, effective April 1st, 2024.

Public Sector Banks

Public sector banks are those in which the government holds more than 50% of the total stock. The government formulates all the financial guidelines for public sector banks. The public sector banks operate under the government to inspire trust in the depositors that their money is safe.

PSBs play a crucial role in fulfilling the government's objectives related to financial inclusion, economic development, and social welfare. Public sector banks offer a wide range of banking services, including savings and current accounts, loans, credit facilities, and payment services. These banks play a significant role in providing banking services to underserved and remote areas, contributing to financial inclusion and rural development.

India's biggest public sector bank is the State Bank of India. Public sector banks constantly work in the public interest by introducing schemes for customers' benefit. They also charge less for their services than private banks.

Private Sector Banks

Private sector banks are those in which a major stake or equity is held by private shareholders. All the banking rules and regulations laid down by the RBI will be applicable on private sector banks as well. While the government does not have direct ownership or control over private sector banks, they are subject to regulatory oversight by the Reserve Bank of India (RBI) and other regulatory authorities.

Private sector banks offer a wide range of banking and financial services, including savings and current accounts, loans, credit cards, wealth management, investment banking, and insurance products. Private sector banks often emphasize a customer-centric approach, focusing on delivering superior service, personalized solutions, and a seamless banking experience.

Private banks were recognized in the 1990s after the LPG policy came into existence. Amongst the oldest and most famous private banks, Axis Bank and IndusInd Bank are regarded as the

oldest private banks in India started in 1993-94 when the government allowed them to launch such banks.

INDUSTRIAL FINANCE CORPORATION OF INDIA AND SMALL INDUSTRIES DEVELOPMENT BANK OF INDIA

Industrial Finance Corporation of India

At the time of independence in 1947, the Indian Capital Markets were relatively less developed. The demand for capital was growing rapidly, however, there was a dearth of providers of capital. The commercial banks that existed were not equipped well enough to provide for long term capital needs in any significant manner.

Against this backdrop and to bridge the demand supply gap for capital needs of the economy, the Government of India established The Industrial Finance Corporation of India (IFCI) on July 1, 1948 by way of an IFC Act 1948.

IFCI was the first Development Financial Institution of India set up to propel economic growth through the development of infrastructure and industry. Since then, IFCI has contributed significantly to the economy through its incessant support to projects in all the three spheres of growth & development – manufacturing, infrastructure & services and agriculture allied sectors.

The Liberalisation of the Indian Economy in 1991 made significant changes in the Indian Capital Markets & Financial System. To aid in raising funds directly through capital markets, the constitution of IFCI was changed from a statutory corporation to a company under the Indian Companies Act, 1956. Subsequently, the name of the company was changed to 'IFCI Limited' with effect from October 1999.

IFCI has been able to maintain the financial sustainability with the consistent support and cooperation of all its stakeholders and particularly the Government of India. In addition to its core competence in long term lending to industrial and infrastructure sectors, IFCI has also developed competence in providing advisory services and has been a nodal agency for providing advisory services to various Govt. of India schemes such as Sugar Development Fund, M-SIPS, Production Linked Incentive (PLI) Scheme and Scheme for Promotion of Manufacturing of Electronic Components and Semiconductors (SPECES).

Further, IFCI also enhanced its organizational value through optimising value of core and non-core assets & investments. Over the years, IFCI has played a pivotal role in establishment of various entities (including some of its subsidiaries & associates) that are respected in their fields today, namely Stock Holding Corporation of India Ltd (SHCIL), National Stock Exchange Ltd (NSE), LIC Housing Finance Ltd, Tourism Finance Corporation of India Ltd (TFCI), ICRA Ltd, among many others. With the changes in the markets over a period of time, a few of the subsidiaries were divested.

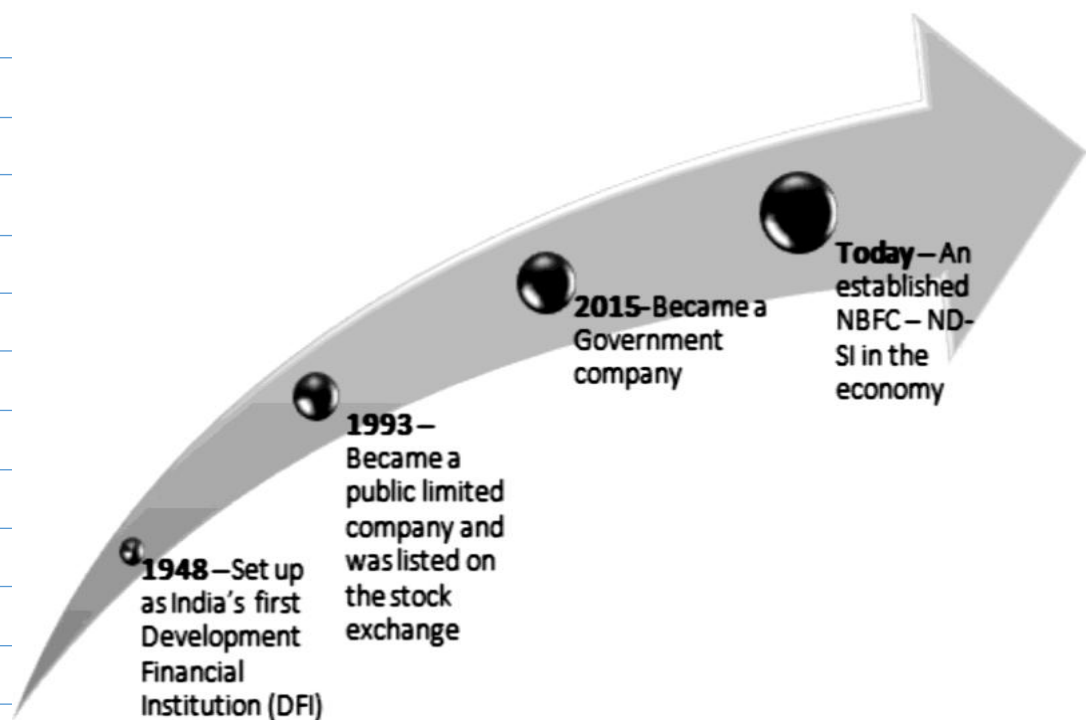
IFCI Group has the following subsidiaries-

1. Stock Holding Corporation of India Ltd,
2. IFCI Venture Capital Fund Ltd,
3. IFCI Factors Ltd,
4. IFCI Infrastructure Development Ltd,
5. IFCI Financial Services Ltd,
6. MPCON

Besides above subsidiaries, IFCI also setup up following institutions under its social sector initiatives :-

1. Management Development Institute
2. Institute of Leadership Development'

3. Rashtriya Gramin Vikas Nidhi



What is IFCI?

- *IFCI is a Systemically Important Non-Deposit taking Non-Banking Finance Company (NBFC-ND-SI) in the public sector.* Established in 1948 as a statutory corporation, IFCI is a public limited company listed on BSE and NSE. IFCI has six number of subsidiaries and one associate under its fold.
- *IFCI is having mandate to provide financial support for the diversified growth of Industries across the spectrum.* The financing activities cover various kind of projects such as airports, roads, telecom, power, real estate, manufacturing, services sector and such other allied industries.

During its 75 years of existence, mega projects like Adani Mundra Ports, GMR Goa International Airport, Salasar Highways, NRSS Transmission, Raichur Power Corporation, to name a few, have been setup with financial assistance of IFCI.

- IFCI also provides Government Advisory services and Corporate Advisory services. In Government Advisory, IFCI is appointed as a Project Management Agency (PMA) for various Production Linked Incentive (PLI) schemes launched under the aegis of “Atmanirbhar Bharat” by the Government of India.
These schemes are aimed at boosting domestic manufacturing and to attract large investment in the identified sectors. IFCI is also the Verifying & Monitoring Agency for various capital subsidy schemes. Under Corporate Advisory, IFCI is offering financial advisory, ESG advisory and other Project advisory services to the Corporate & Government sectors. IFCI is also the Nodal Agency for monitoring loans of Sugar Development Fund (SDF) since 1984.
- IFCI is also the Nodal Agency for monitoring loans of Sugar Development Fund (SDF) since 1984.
- The company has played a pivotal role in setting up various market intermediaries of repute in several niche areas like stock exchanges, entrepreneurship development organizations, consultancy organizations, educational and skill development institutes across the length and breadth of the country.
- The Govt. of India has placed a Venture Capital Fund of Rs. 200 crore for Scheduled Castes (SC) with IFCI with an aim to promote entrepreneurship among the Scheduled Castes (SC) and to provide concessional finance.
IFCI has also committed a contribution of Rs.50 crore as lead investor and Sponsor of the Fund. IFCI Venture Capital Funds Ltd., a subsidiary of IFCI Ltd., is the Investment Manager of the Fund. The Fund has been operationalized since FY 2014-15 and IVCF is continuously making efforts for meeting the stated objective of the scheme.
- Further, in March 2015, Ministry of Social Justice and Empowerment, Government of India has designated IFCI as a nodal agency for implementing the “Credit Enhancement Guarantee Scheme for Scheduled Castes” with an objective to encourage entrepreneurship amongst the Scheduled Castes, by providing Credit Enhancement Guarantee to Member Lending Institutions

viz. banks who are providing financial assistance to these entrepreneurs belonging to scheduled castes community.

Corporate Strategy of IFCI:

1. To be a *solution provider* to various financial needs of the industry.
2. To *remain competitive, competent and sensitive* to the economic growth of the country.
3. To design *customer focused solutions*.
4. To enhance the *reputation and image of IFCI*

Small Industries Development Bank of India (SIDBI)

Small Industries Development Bank of India (SIDBI) set up on 2nd April 1990 under an Act of Indian Parliament, acts as the Principal Financial Institution for Promotion, Financing and Development of the Micro, Small and Medium Enterprise (MSME) sector as well as for coordination of functions of institutions engaged in similar activities.

SIDBI's initiatives have remained aligned to the national goals of poverty alleviation, employment generation, kindling entrepreneurship and fostering competitiveness in MSME sector.

Some of SIDBI's key initiatives over more than the past 25 years of tirelessly promoting the growth of MSMEs, include-

- (i) Providing a *cumulative assistance* of around INR 5.40 lakh crore channelized into MSME segment.
- (ii) Directly *impacting over 360 lakh persons/enterprises* through its branch network of around 80 offices spread across the country as well as through the network of banks / institutions (having more than 1.25 lakh branches) across the country.

- (iii) *Extending loans, equity and quasi-equity* aggregating to INR 13,689 crore benefitting 356 lakh disadvantaged people, mostly women, through its Micro Finance operations.
- (iv) *Deepening its outreach* by nurturing and evolving more than 100 MFIs who have emerged as strong and viable financial intermediaries serving the unserved.
- (v) Supporting more than 1.16 lakh *budding and existing entrepreneurs* by infusing skills and reskilling initiatives.
- (vi) *Facilitating Institutions Building* by *adopting a SIDBI Plus approach and creating its Subsidiary and Associate Institutions* for providing impetus to the growth of MSME ecosystem.
- (vii) Developing a *passionate pool of 1000+ professionals with 22% women and 40% belonging to SC/ST and OBCs category*, for serving the needs of the dynamic and consistently evolving MSME Sector.

SIDBI's Historical Journey

Years	Developments
1990	Small Industries Development Bank of India (SIDBI) set up on April 2, 1990.
1992	Introduced (Bills Discounting) of MSME vendors
1994	Launched Micro Credit Scheme
1999	Established SIDBI Venture Capital Limited
2000	Established CGTMSE (Credit Guarantee Fund Trust for Micro and Small Enterprises)
2005	Established SMERA (now <u>Acuité</u> Ratings & Research Limited)
2008	Established ISARC (ISARC is the country's first ARC supported by a large number of public sector banks and undertakings. It will strive for speedier resolution of NPAs with a focus on MSME sector).
2010	Launched NTREES (National Trade Exchange for Electronic Securities)
2012	Launched PSIG (Poorest States Inclusive Growth (PSIG) Program)

2013	Established MUDRA (Micro Units Development & Refinance Agency Ltd.)
2016	Launched RXIL TReDS and Standupmitra Platform
2017	Launched Udyamimitra Portal
2018	Launched PSB loans in 59 minutes, MSME Pulse, CriSidEx and Swalamban
2019	Launched Microfinance Pulse
2020	Launched Fintech Pulse and Industry Spotlight
2021	Digitisation of Lending Process
2023	Launch Udyam Assist Platform (UAP) & FIT Rank

Regional Rural Banks (RRBs)

Regional Rural Banks were established under the provisions of an Ordinance passed on 26th September, 1975 and the RRB Act 1976 to provide sufficient banking and credit facility for agriculture and other rural sectors.

As a result, Five Regional Rural Banks were set up on 2nd October, 1975, Gandhi Jayanti. These were set up on the recommendations of The Narshimham committee Working Group during the tenure of Indira Gandhi's Government with a view to include rural areas into the economic mainstream since that time about 70% of the Indian Population was of Rural Orientation.

The development process of RRBs started on 2nd October, 1975, Gandhi Jayanti with the forming of the first RRB, the Prathama Bank, Head Office at Moradabad (U.P.) with an authorised capital of Rs 5 crore at its starting. As on 2nd October, 1975 Out of the remaining four RRBs in the country one was Set up at Malda in West Bengal under the name of Gour Gramin Bank, which was the first RRB in the Eastern Region of India.

The current structure of RRBs is that Central Government owns 50%, Sponsorship Bank holds 35% and State Government holds 15%.

Regional Rural Banks (RRBs) are Indian Scheduled Commercial Banks (Government Banks) operating at regional level in different States of India. They have been created with a view of serving primarily the rural areas of India with basic banking and financial services. However, RRBs may have branches set up for urban operations and their area of operation may include urban areas too.

The area of operation of RRBs is limited to the area as notified by Government of India covering one or more districts in the State. RRBs also perform a variety of different functions.

RRBs perform various functions in the following heads:

- (a) Providing banking facilities to rural and semi-urban areas.
- (b) Carrying out government operations like disbursement of wages of MGNREGA workers, distribution of pensions etc.
- (c) Providing Para-Banking facilities like locker facilities, debit and credit cards, mobile banking, internet banking, UPI etc.
- (d) Small financial banks.

India is eyeing a mega revamp of its regional rural banks (RRBs) and the plan includes consolidation of these lenders for better operational efficiencies in line with the government's big rural focus.

CO-OPERATIVE BANKS

Cooperative bank is an institution established on the cooperative basis and dealing in ordinary banking business.

Like other banks, the cooperative banks are founded by collecting funds through shares, accept deposits and grant loans.

History of Cooperative Banking in India

Cooperative movement in India was started primarily for dealing with the problem of rural credit. The history of Indian cooperative banking started with the passing of Cooperative Societies Act in 1904. The objective of this Act was to establish cooperative credit societies "to encourage thrift, self-help and cooperation among agriculturists, artisans and persons of limited means."

Many cooperative credit societies were set up under this Act. The Cooperative Societies Act, 1912 recognised the need for establishing new organisations for supervision, auditing and supply of cooperative credit.

These organisations were-

- (a) A union, consisting of primary societies;
- (b) the central banks; and
- (c) provincial banks.

Although beginning has been made in the direction of establishing cooperative societies and extending cooperative credit, but the progress remained unsatisfactory in the pre-independence period. Even after being in operation for half a century, the cooperative credit formed only 3.1 per cent of the total rural credit in 1951-52.

Types of Cooperative Bank

There are 4 types of co-operative banks in India:

I. **Central Co-Operative Banks:**

These banks are organized and operated at the district level and can be of two types:

- (a) Co-operative Banking Union
- (b) Mixed control Co-operative Bank

At the first, the members of the bank are the co-operative societies only. However, in the second, the members can be co-operative societies as well as individuals. The central co-operative banks lend money mainly to the affiliated primary societies with typical loan tenure lending between 1 to 3 years.

2. State Co-Operative Banks:

These banks are organized and operated at the district level and rest at the top of the hierarchy in the co-operative credit structure. With the help of State Co-operative Banks (SCBs), the RBI funds the co-operative institutions. These banks also get loans at an interest rate of 1% to 2% lower than the standard bank rate.

3. Primary Co-Operative Banks:

These offer credit services in urban and semi-urban regions. Thus, they are not considered as agricultural credit societies. Primary Co-Operative Banks receive concessional refinance services from RBI and IDBI from time to time for them to offer housing loans and other types of loans that can be used by small businesses.

4. Land Development Banks:

The land development banks are divided into three tiers which are primary, state, and central. These offer credit services to the farmers for developmental purposes. They used to be regulated by the RBI as well as the state governments. However, this responsibility was recently transferred to the National Bank for Agricultural and Rural Development (NABARD).

NON-BANKING FINANCIAL COMPANIES (NBFCs)

NBFCs are financial institutions that provide various financial services and products, including loans, insurance, and asset management, but do not have a banking license. Unlike banks, NBFCs do not have the authority to accept deposits from the public. However, they can accept deposits from a select group of individuals, such as directors, shareholders, and relatives.

Types of NBFCs

NBFCs are categorized:

1. in terms of the *type of liabilities* into Deposit and Non-Deposit accepting NBFCs;
2. *regulatory structure of NBFCs* under Scale Based Regulation into NBFC-Base Layer, NBFC-Middle Layer, NBFC- Upper Layer, and NBFC-Top Layer; and
3. by the *kind of activity, they conduct*.

Based on the type of activities they conduct, the different types of NBFCs are as follows:

- I. **Investment and Credit Company (ICC)**: ICC means any company which is a financial institution carrying on as its *principal business - asset finance, the providing of finance whether by making loans or advances or otherwise for any activity other than its own and the acquisition of securities*; and is not any other category of NBFCs as defined by the Reserve Bank in any of its Master Directions.
- II. **Housing Finance Company (HFC)**: HFC shall mean a company that fulfils the following conditions:
It is an NBFC whose financial assets, in the business of providing finance for housing, constitute at least 60% of its total assets (netted off by intangible assets). Out of the total assets (netted off by intangible assets), not less than 50% should be by way of housing finance for individuals .

- III. **Infrastructure Finance Company (IFC)**: IFC is a non-banking finance company which deploys at least 75 per cent of its total assets towards infrastructure lending.
- IV. **Infrastructure Debt Fund (IDF-NBFC)**: IDF-NBFC means a non-deposit taking NBFC which is permitted to:
- refinance post commencement operations date (COD) infrastructure projects that have completed at least one year of satisfactory commercial operations; and
 - finance toll operate transfer (TOT) projects as the direct lender.
- V. **Core Investment Company (CIC)**: CIC is a NBFC carrying on the business of acquisition of shares and securities which satisfies the following conditions:
- It holds not less than 90% of its net assets in the form of investment in equity shares, preference shares, debt or loans in group companies;
 - Its investments in the equity shares (including instruments compulsorily convertible into equity shares within a period not exceeding 10 years from the date of issue) in group companies and units of Infrastructure Investment Trusts (InvITs) only as sponsor constitutes not less than 60% of its net assets;
 - Provided that the exposure of such CICs towards InvITs shall be limited to their holdings as sponsors and shall not, at any point in time, exceed the minimum holding of units and tenor prescribed in this regard by SEBI (Infrastructure Investment Trusts) Regulations, 2014, as amended from time to time. It does not trade in its investments in shares, debt or loans in group companies except through block sale for the purpose of dilution or disinvestment;
 - it does not carry on any other financial activity referred to in Section 451(c) and 451(f) of the RBI act, 1934 except (i) investment in bank deposits, money market instruments, government securities, bonds or debentures issued by group companies; (ii) granting of loans to group companies; and (iii) issuing of

guarantees on behalf of group companies; (e) Its asset size is `100 crore or above; and (f) It accepts public funds

VI. **Micro Finance Institution (NBFC-MFI)**: “NBFC-MFI” means a *non-deposit taking NBFC which has a minimum of 75 percent of its total assets deployed towards “microfinance loans”* as defined under Reserve Bank of India (Regulatory Framework for Microfinance Loans) Directions, 2022.

VII. **Non-Banking Financial Company – Factors (NBFC-Factors)**: NBFC-Factor is a non-deposit taking *NBFC engaged in the principal business of factoring*. The financial assets in the factoring business should constitute at least 50 percent of its total assets and its income derived from factoring business should not be less than 50 percent of its gross income.

VIII. **Mortgage Guarantee Companies (MGC)**: MGC means a company *registered as mortgage guarantee company which primarily transacts the business of providing mortgage guarantee i.e., a guarantee for the repayment of an outstanding housing loan and interest accrued thereon up to the guaranteed amount to a creditor institution, on the occurrence of a trigger event.*

A mortgage guarantee company shall be deemed to primarily transact the business of providing mortgage guarantee *when at least 90% of the business turnover is mortgage guarantee business or at least 90% of the gross income is from mortgage guarantee business.*

IX. **Standalone Primary Dealers (SPDs)**: SPDs are primarily NBFCs which have been *granted authorisation to undertake the Primary Dealer activities in Government Securities*. SPDs may undertake a set of core and non-core activities which are clearly defined. SPDs support G- Sec market, (both primary and secondary) through various obligations like participating in primary auctions, market making in G- Secs, predominance of investment in G-Secs, achieving minimum secondary market turnover ratio, etc.

X. **Non-Operative Financial Holding Company (NOFHC):** NOFHC means a non-deposit taking NBFC referred to in the “Guidelines for Licensing of New Banks in the Private Sector” dated February 22, 2013, issued by the Reserve Bank, *which holds the shares of a banking company and the shares of all other financial services companies in its group, whether regulated by the Reserve Bank or by any other financial regulator, to the extent permissible under the applicable regulatory prescriptions.*

XI. **NBFC – Account Aggregator (NBFC-AA):** NBFC-AA means a non-banking financial company as notified under in *sub-clause (iii) of clause (f) of section 45-I of the RBI Act, that undertakes the business of an account aggregator, for a fee or otherwise.*

The “business of an account aggregator” means the business of providing under a contract, the service of, retrieving or collecting such financial information pertaining to its customer, as may be specified by the Reserve Bank from time to time; and consolidating, organizing and presenting such information to the customer or any other financial information user as may be specified by the Bank; Provided that, the financial information pertaining to the customer shall not be the property of the Account Aggregator, and not be used in any other manner.

XII. **NBFC – Peer to Peer Lending Platform (NBFC-P2P):** NBFC-P2P means a non-banking institution *which carries on the business of a Peer to Peer Lending Platform i.e., acting as intermediary providing the services of loan facilitation via online medium or otherwise, to the participants of the platform.*

Services offered by NBFCs

NBFCs offer a wide range of financial services, including:

- Personal loans
- Home loans
- Vehicle loans
- Gold loans

- Microfinance
- Leasing and hire-purchase services
- Credit card services
- Insurance services
- Investment and asset management services

Differences between NBFCs and banks

Although NBFCs lend money and make investments, just like banks do, there are a few distinct differences between them.

- NBFCs cannot accept demand deposits
- NBFCs cannot issue cheques drawn on itself
- Unlike in case of banks, deposit insurance facility of Deposit Insurance and Credit Guarantee Corporation is not available to depositors of NBFCs
- NBFCs do not form part of the payment and settlement system

BASICS OF CAPITAL MARKET

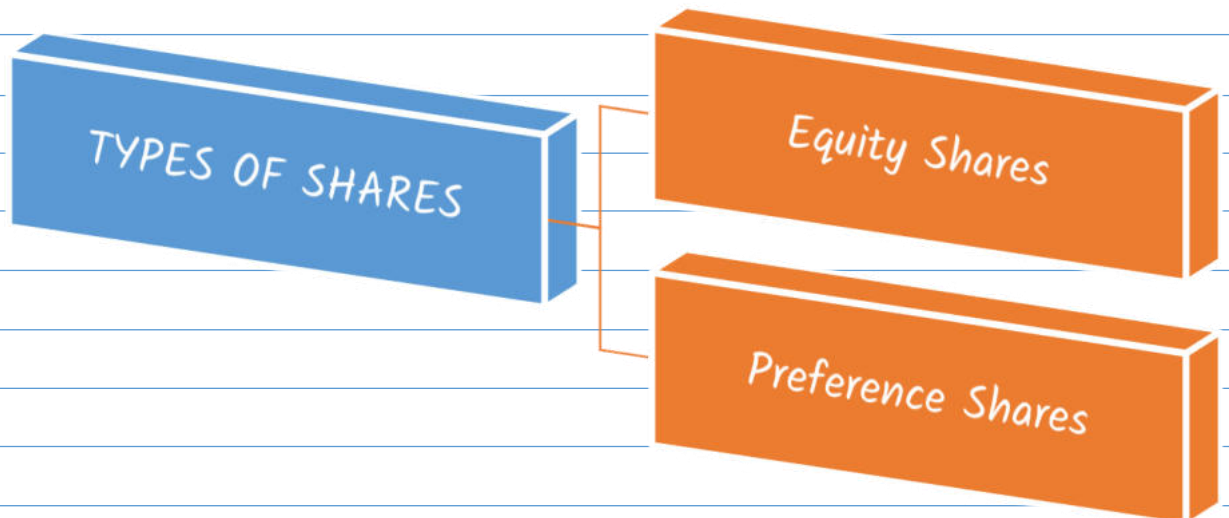
The history of the capital market in India dates back to the **eighteenth century** when **East India Company securities were traded in the country**. Until the end of the nineteenth century, securities trading was unorganized and the **main trading centres were Bombay (now Mumbai) and Calcutta (now Kolkata)**. Of the two, Bombay was the chief trading centre wherein bank shares were the major trading stock.

During the **American Civil War (1860-61)**, Bombay was an important source of supply for **cotton**. Hence, trading activities flourished during the period, resulting in a boom in share prices. **This boom, the first in the history of the Indian capital market, lasted for half a decade**. The first joint stock company was established on 1850. The bubble burst on July 1, 1865, when there was a tremendous slump in share prices.

Trading was at that time limited to a dozen brokers, their trading place was under a banyan tree in front of the Town Hall in Bombay. These stockbrokers organized an informal association in 1875-Native Shares and Stock Brokers Association, Bombay. **The stock exchanges in Calcutta and Ahmedabad, also industrial and trading centres; came up later**. The **Bombay Stock Exchange was recognized in May 1927** under the Bombay Securities Contracts Control Act, 1925.

Indian remained largely inactive till the 1970s. Partial liberalisation of the economy and pro-capital market policies during the 1980s infused some life into the markets, but **it was only the economic liberalisation of the 1990s that provided a lasting impetus**. Today, segments of India's capital markets are comparable with counterparts in many of the advanced economies in terms of efficiency (price discovery), tradability (low impact cost), resilience (co-movement of rates across product classes and yield curves), and stability.

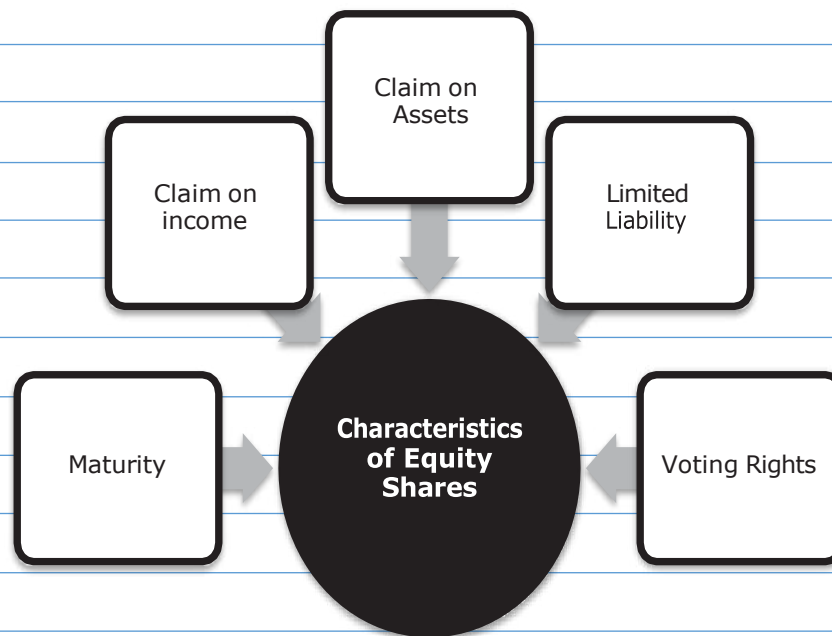
In particular, their ability to withstand several periods of stress, notably the Asian financial crisis in 1997-98, the global financial crisis in 2007-09 and the "taper tantrum" episode in 2013, is a sign of their increasing maturity.

TYPES OF SHARES AND DEBENTURES**Equity Share**

Equity shares, also known as ordinary shares or common shares represent the owners' capital in a company. The holders of these shares are the real owners of the company. They have a control over the working of the company.

The rate of dividend on these shares depends upon the profits of the company. They may be paid a higher rate of dividend if the profit of the company is high or they may not get anything if the profit of the company is not sufficient. Equity shareholders are paid dividend after paying dividend to the preference shareholders.

Characteristics of Equity Shares



An equity share carries the following characteristics:

1) **Maturity:**

Equity share capital *remains with the company as long as the company exists*, unless the shareholder chooses to sell the shares or the company undergoes winding up/liquidation.

2) **Claim on Income:**

Equity shareholders have a *residual claim on the income of a company*. They have a claim on income left after paying dividend to preference shareholders.

3) **Claim on Assets:**

Equity shareholders have a residual claim on company's assets. In the *event of liquidation of a company*, the assets are utilized first to meet the claims of creditors and preference shareholders and if there is any balance left that can be claimed by equity shareholders.

4) Voting Rights:

Equity shareholders enjoy the *benefit of voting rights in the meetings of the company* and have a control over the working of the company.

5) Limited Liability:

Although, equity shareholders are the real owners of the company but their *liability is limited to the value of shares they have purchased*.

For example if a shareholder has purchased 1,000 shares of Rs. 100 each; he is liable to pay only Rs. 1,00,000. This is another distinct feature of equity shares.

Advantages of Equity Shares

Advantages to the Company:

- Equity shares *provide permanent capital to the company* so there is no liability to return the money during the life time of company.
- The rate of dividend is not fixed on the equity shares so *there is no fixed burden of dividend*, i.e., if there are more profits the company distributes dividend at a higher rate and when there are less profits the company distributes dividend at a lower rate.
- There is *no charge of equity share capital on assets of the company* so all the assets are available for security for raising debt capital.
- Raising capital through equity shares is *convenient source of finance as compared to other sources of finance* like debentures and loans.

Advantages to the Investors:

- As the income of the company increases, the *equity shareholders get more dividends because the rate of dividend is not fixed on these shares*. Shareholders get dividend at higher rate in boom period that increases the income of shareholders.
- The equity shareholders have a *right of management and control of the company*. They use their voting right and elect directors of their choice to manage the affairs of the company.

- The market price of equity shares of the company increases with the increase in profits of the company and result in capital gain to the investors if they sell their shares in the market.
- The equity shareholders are the owners of the company, so they take interest in company's activities.

Disadvantages of Equity Shares

Disadvantages to the Company:

- Equity dividends are paid to the shareholders out of after-tax profits, these dividends are not tax deductible.
- The equity share capital has the highest specific cost of capital among all the sources.
- The new issue of equity capital may reduce the earning per share because of increase in the number of equity share, and thus may have an adverse effect on the price of the equity share.
- The equity shareholders have right to vote it limits the power of the directors of the company.
- If the company gets its whole capital through equity shares then the equity shareholders are not able to get advantage of trading on equity.
- Equity shares are irredeemable, if a company facing the situation of over-capitalization it is difficult to remove it because it is not possible to decrease the number of equity shares while in case of preference shares, they can be redeemed.

Disadvantages to the Investors:

- The rate of dividend is not fixed on the equity shares. If there is less profit, fewer dividends will be given to the shareholders. Sometimes they get no dividend if the company is having no profit.
- The income of equity shareholders is not only irregular but also uncertain. If the company has profit, it is not necessary that the company should announce dividend and then distribute it to the shareholders. The management of company can decide not to distribute any dividend and keep the profits invested in the company.
- In times of recession, the prices of equity shares fall, hence resulting in capital loss to the investors.

- At the time of *liquidation* the *equity shareholders* are *paid at the last* if there is any balance remains after payment of loans, liabilities and payment of preference shareholders. If nothing is left, they get nothing.

PREFERENCE SHARES

A preference share is a share which carries preferential rights as to the payment of dividend at a fixed rate either free or subject to income tax and as to the payment of capital at the time of liquidation prior to equity shareholders.

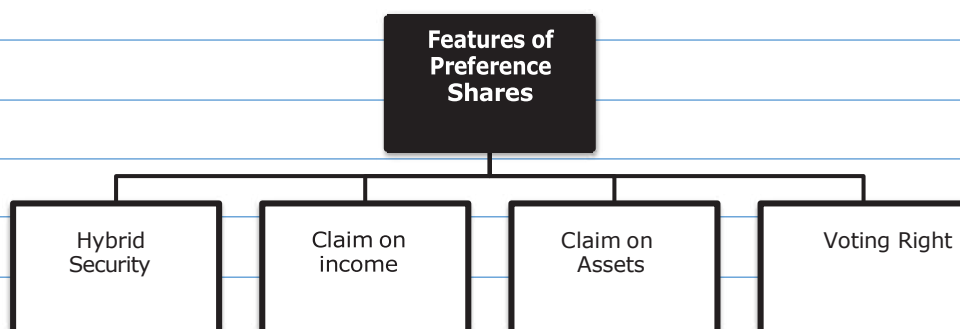
Preference shares have certain preferences as compared to other types of shares.

These preferences are given below:

- 1) The first preference is for *payment of dividend*.
- 2) The second preference for these shares is the *repayment of capital at the time of liquidation* of the company.

A company can issue preference shares of varying dividend rates at a time viz. 10% Preference Shares, 12% Preference Shares etc. these % are showing the fixed rate of dividend which is payable to the preference shareholders.

Features of Preferences Shares



Preferences shares carry four characteristics / features:

1) Hybrid Security:

Preference share is *hybrid kind of security, possessing some characteristics of debt and some of equity*. Legally, it is part of a company's equity base and preference dividend is not a tax-deductible expense. Preference shares carry a *fixed dividend rate* and this fixed rate plus the preferred prior claims to income and assets, make it resemble to debt.

2) Claim on Income:

A *fixed rate of dividend* is payable on preference shares. Preference shareholders have *prior claim on income (dividend) over equity shareholders*. Whenever the company has distributable profits, the dividend is first paid on preference share capital.

After paying the fixed rate of dividend they have *no right to share extra income*. But, if the preference shares are participating shares, then the preference shareholders are entitled to participate in the balance of profits in agreed proportion along with equity shareholders after paying them a reasonable dividend.

3) Claim of Assets:

Generally, the preference shareholders have *no right in the surplus assets of the company*. However, a company may issue participating preference shares which entitle its holders a right to participate even in the surplus assets of the company at the time of liquidation in agreed ratio.

4) Voting right:

Preference shareholders *do not have the voting rights to participate in the management of the company* like equity shareholders. However they have been given right to vote on resolutions which directly affect the rights attached to preference shares.

Advantages of Preference Shares

Advantage to the company

- Preference shares required *no collateral or mortgage* as in the case of debt.
- Preference shares provide a *long-term capital* for the company.
- The *cost of capital* of preference shares is *less than that of equity shares*.
- *Redeemable preference shares* have the *added advantage of repayment of capital* whenever there are surplus funds with the company.
- As a fixed rate of dividend is payable on preference shares, so the *company has fixed financial commitment*.
- Preference shares *do not carry voting rights* as described in section 87 under normal circumstances and hence there is no dilution of control.

Advantage to the Investors:

- Investors receive *regular fixed income* in the form of dividend.
- It is a *superior security over equity shares in repayment of capital* at the time of winding up of the company.
- It provides *preferential rights* in regard to payment of dividends.
- Although preference shares carry no voting rights, the *holders of such shares can vote on matters directly* affecting their rights as well as on all resolutions if the dividend due on their shares is remaining unpaid.

Disadvantages of Preference Shares

Disadvantages to the Company

- It is an *expensive source of finance* as compared to debt.
- If the company is *earning return less* than the cost of preference share capital, then it will *decrease the earning per share* of the equity shareholders.
- Although there is no legal obligation of a company to pay dividend on preference shares, yet *frequent delays or non-payment adversely affects the market position of the company* and may reduce the market price of the share.

- Preference share dividend is not a deductible expense while calculating tax, interest is a deductible expense. Thus, there is a tax disadvantage to the company.

Disadvantages to the Investors

- As the preference shareholders, ordinarily, do not have any voting rights.
- The rate of dividend on preference shares is usually lower as compared to the equity shares.
- Preference shareholders do not have any charge on the assets of the company while debentures, usually, provide a charge on all the assets of the company.
- In case of winding up of a company, the preference shareholders only get the invested value of their capital. They cannot participate in the surplus.

Types of Preference Shares:

Cumulative and Non-cumulative

- **Cumulative Preference Shares:** the dividends are accumulated and therefore paid before anything paid to equity shares.
- **Non-Cumulative Preference Shares:** if company does not pay dividend in current year, claim of preference shareholder is lost to that extent.

Convertible and Non-Convertible

- **Convertible Preference Shares** possess an option or right whereby they can be converted into an ordinary equity share at some agreed terms and conditions.
- **Non-Convertible Preference Shares** do not have the option to convert but has all other normal characteristic of a preference share.

Participating and Non-participating

- **Participating Preferences Share** has an additional benefit of participating in 'surplus profits or 'surplus assets' of the company apart from preferential dividend.
- **Non-participating Preference Share** are those which are not entitled to participate in the 'surplus profits' or surplus assets' of the company. They are entitled to only a fixed rate of dividend.

Redeemable and Non-Redeemable

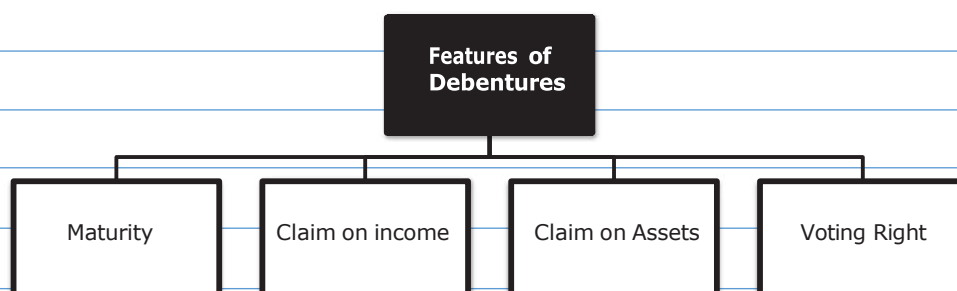
- **Redeemable Preference Share** has a maturity date on which date the company will repay the capital amount to the preference shareholders. The paying back of capital is called redemption dividend. Preferences share shall be redeemed within a period not exceeding 20 years (however infrastructure companies can issue preferences shares redeemable within a period not exceeding 30 years).
- **Irredeemable Preference Share** do not have any maturity date and are repayable only at the time of winding up of the company. However, as per section 55 of the Companies Act, 2013 no company can issue irredeemable preference shares.

DEBENTURE

The word 'debenture' has been derived from a Latin word 'debere' which means to borrow. Section 2(30) of the Companies Act, 2013 define "debenture" which includes debenture stock, bonds or any other instrument of a company evidencing a debt, whether constituting a charge on the assets of the company or not.

A debenture holder is a creditor of the company. A fixed rate of interest is paid on debentures. The interest due on debentures is a charge on the profit and loss account of the company. The debentures are generally given a floating charge over the assets of the company.

Features of Debentures



The debenture carries the following features:

1) **Maturity:**

Although debentures provide long-term funds to a company, *they mature after a specific period*. Generally, the debentures are to be repaid at a definite time as stipulated in the issue.

The *company must pay back the principal amount on these debentures* on the given date otherwise the debentures holders may force winding up of the company as creditors.

2) **Claim on Income:**

A fixed rate of interest is payable on debentures. Unlike shares, a company has a legal obligation to pay the interest on due dates irrespective of its level of earnings.

Even if a company makes no earnings or incurs loss, it is under an obligation to pay interest to its debenture holders. The default in payment of interest may cause forfeiture of assets or winding up of the company.

3) **Claim on Assets:**

Even in respect of claim on assets, *debenture holders have priority of claim on assets of the company*. They have to be paid first before making any payment to the preference or equity shareholders in the event of liquidation of the company.

However, they have a claim for the principal amount and interest due only and *do not have any share in the surplus assets* of the company, if any.

4) **Voting Rights:**

Since debenture holders are creditors of the company and not its owners, *they do not have any control over the management of the company*. They do not have any voting right to elect the directors of the company nor any other matters.

Advantages of Debentures

Advantages to the Company

- The rate of interest payable on debentures is, usually, *lower than the rate of dividend paid on share.*
- The *interest on debentures is a tax-deductible expense* and hence the effective cost of debentures (debt-capital) is lower as compared to ownership securities where dividend is not a tax-deductible expense.
- Debentures have *no voting rights* so there can be no dilution of control.
- A company can *trade on equity by mixing debentures in its capital structure* and thereby increase its earnings per share.
- Debentures *provide a hedge against the inflation* because the interest payment as well as the principal repayment is fixed in monetary terms.

Advantages to the Investors:

- Debentures are the *safest source of income for an investor* because it provides a fixed, regular and stable income to the debenture holder.
- Debentures are *issued against the security*, so they are safe.
- The *payment date of debentures is fixed* at the time of issue of debentures, because of a definite maturity period investors like debentures more than shares.
- The *interest of debenture holders is protected by various provisions* of the debenture trust deed and the guidelines issued by the Securities and Exchange board of India in this regard.

Disadvantage of Debenture

From the Company's Point of View:

- The *fixed interest charges and repayment of principal amount on maturity* are legal obligations of the company.
- Debenture finance *reduces the credit standing of the company*. Banks and other financial institutions show an unfavorable attitude towards a company whose capital structure is loaded with debentures.

- The use of *debt financing usually increases the risk perception of investors* in the firm. This enhanced financial risk increases the cost of equity capital.
- *Cost of raising finance through debenture is also high because of high stamp duty.*

From the Investors Point of View:

- Debentures *do not carry any voting rights* and hence its holders do not have any controlling power over the management of the company.
- Debenture holders *do not have any right to claim on the surplus assets and profits* of the company beyond the fixed interest and their principal amount.
- The *prices of debentures in the market fluctuate* with the changes in the interest rates.
- *Uncertainty about redemption* also restricts certain investors from investing in such securities.

Types of Debentures

On the basis of Convertibility

- Non-Convertible Debentures (NCD):** These instruments retain the debt character for the whole of the tenure and *cannot be converted into equity shares* or any other form of security.
- Partly Convertible Debentures (PCD):** Partly convertible debentures, as the name suggests, a certain portion of these debentures are *partially converted into equity shares* upon exhaustion of the specified duration.
- Fully convertible Debentures (FCD):** These are *fully convertible into Equity shares* or any other form of security at the issuer's notice.
- Optionally Convertible Debentures (OCD):** The investor has the option to *either convert these debentures into shares* at price decided by the issuer/agreed upon at the time of issue.

On the basis of Security

- Secured Debentures:** Debentures that are *issued against a security* are called *secured debentures*. In other words, a charge is made against the assets of the issuing company.

- (b) **Unsecured Debentures:** Debentures which are *issued without any charge* against the issuing company's assets are called unsecured debentures.

On the basis of Tenure

- (a) **Redeemable Debentures:** Redeemable debentures *clearly spell out the exact terms and date* by which the issuer of the bond must repay their debt in full.
- (b) **Irredeemable Debentures:** An irredeemable debenture is a type of debenture in which *there is not fixed time for the issuer to repay the amount*. The debenture holder cannot demand payment as long as the company is a going concern and does not make default in making payment of the interest.

On the basis of Registration

- (a) **Registered Debentures:** Registered debentures are *made out in the name of a particular person, whose name appears on the debenture certificate* and who is registered by the company as holder on the Register of debenture holders
- (b) **Bearer debentures:** Bearer debentures on the other hand, *are made out to bearer*, and are negotiable instruments, and so transferable by mere delivery like share warrants.

MICRO, SMALL AND MEDIUM ENTERPRISES (MSMES)

Introduction

The Micro, Small and Medium Enterprises (MSME) sector has emerged as a highly vibrant and dynamic sector of the Indian economy contributing around 30% of India's GDP, over 45% of India's exports. It contributes significantly to the economy and social development of the country by fostering entrepreneurship, innovation and generating large employment opportunities at comparatively lower capital cost, next only to agriculture.

MSME are complementary to large industries as ancillary units. This sector contributes significantly to inclusive industrial development of the country. By fostering entrepreneurship, generating employment and promoting inclusive development, MSMEs continue to drive economic transformation at the grassroots level.

Globally, MSMEs represent the most dominant segment of the business ecosystem, accounting for nearly 90% of enterprises and over 50% of total employment. In India, they hold a similar significance, emerging as the second-largest employer after agriculture.

Classification of MSME

MSMEs are governed by the Micro, Small, and Medium Enterprises Development Act, 2006, the classification criteria have evolved over time to better accommodate modern business realities. Micro, Small, and Medium Enterprises are characterised by specific thresholds of investment in equipment and annual turnover. They operate across manufacturing, services, and trade sectors.

Classification	Micro	Small	Medium
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Micro Enterprise	Investment in Plant	Investment in Plant	Investment in Plant and
Small Enterprise	and Machinery or	and Machinery	Machinery or Equipment:
Medium	Equipment: Not more	or Equipment:	Not more than Rs. 125
Enterprise	than Rs. 2.5 crore and	Not more than Rs.	crore and Annual Turnover
	Annual Turnover not	25 crore and Annual	not more than Rs. 500
	more than Rs. 10	Turnover not more	crores
	crores	than Rs. 100 crores	

Udyam Registration Portal

Launched on July 1, 2020, the Udyam Registration Portal serves as a pivotal platform for facilitating the registration of enterprises across India. The portal encourages enterprises previously registered under the Udyog Aadhaar Memorandum and Entrepreneurship Memorandum-II to migrate to this new system. It offers a free, paperless, and self-declaration-based registration process, eliminating the need for document uploads, thus simplifying the formalization of businesses.

In a significant step towards integrating informal micro-enterprises into the formal economy, the Government introduced the Udyam Assist Platform on November 11, 2023. This initiative aims to bring these micro-enterprises under the formal sector, enabling them to access benefits such as Priority Sector Lending, which is essential for their growth and sustainability.

Government Initiatives for MSMEs

These initiatives range from financial support and procurement policies to capacity building and market integration. Key initiatives include the Udyam Registration Portal, PM Vishwakarma scheme, PMEGP, SFURTI, and the Public Procurement Policy for MSEs, all aimed at fostering entrepreneurship, enhancing employment, and integrating informal sectors into the formal economy. These initiatives reflect the government's commitment to supporting MSMEs and driving inclusive economic growth nationwide.

The 'PM Vishwakarma' scheme, launched by the Government of India, aims to enhance the quality and reach of products and services by artisans and craftspeople, integrating them into domestic and global value chains. Announced in the 2023-24 Budget and launched on September 17, 2023, this scheme seeks to provide comprehensive support to Vishwakarmas, improving their socio-economic status and quality of life.

Prime Minister's Employment Generation Programme (PMEGP) is a credit linked subsidy scheme for providing employment opportunities through establishment of micro-enterprises in the non-farm sector. Under the Scheme, Margin Money (Subsidy) is provided to beneficiaries availing loan from banks for setting up new enterprises. The maximum project cost admissible for setting up of new project is Rs. 50 lakhs in manufacturing sector and Rs. 20 lakhs in Service Sector.

Public Procurement Policy for MSMEs

The Ministry of MSME, Government of India, notified the Public Procurement Policy for Micro and Small Enterprises (MSEs) in 2012. This policy mandates that 25% of annual procurement by Central Ministries, Departments, and Central Public Sector Enterprises (CPSEs) must be sourced from MSEs.

Within this 25%, 4% is reserved for MSEs owned by Scheduled Castes/Scheduled Tribes (SC/ST), and 3% is reserved for MSEs owned by women entrepreneurs. Additionally, 358 items are exclusively reserved for procurement from MSEs.

Designing Policy for Medium Enterprises

NITI Aayog in May 2025 released a report titled "Designing a Policy for Medium Enterprises", offering a comprehensive roadmap for transforming medium enterprises into future growth engines of India's economy.

The report underscores key challenges faced by medium enterprises, including constrained access to tailored financial products, limited adoption of advanced technologies, inadequate R&D

support, lack of sectoral testing infrastructure, and a mismatch between training programmes and enterprise needs. These limitations hinder their ability to scale and innovate.

To address these issues, the report outlines a comprehensive policy framework with targeted interventions across six priority areas:

- **Tailored Financial Solutions:** Introduction of a working capital financing scheme linked to enterprise turnover; a Rs.5 crore credit card facility at market rates; and expedited fund disbursement mechanisms through retail banks, overseen by the Ministry of MSME.
- **Technology Integration and Industry 4.0:** Upgradation of existing Technology Centers into sector-specific and regionally customized India SME 4.0 Competence Centers to promote the adoption of Industry 4.0 solutions.
- **R&D Promotion Mechanism:** Establishment of a dedicated R&D cell within the Ministry of MSME, leveraging the Self-Reliant India Fund for cluster-based projects of national significance.
- **Cluster-Based Testing Infrastructure:** Development of sector-focused testing and certification facilities to ease compliance and enhance product quality.
- **Custom Skill Development:** Alignment of skilling programmes with enterprise-specific needs by region and sector, and integration of medium enterprise-centric modules into existing Entrepreneurship and Skill Development Programmes (ESDP).
- **Centralized Digital Portal:** Creation of a dedicated sub-portal within the Udyam platform featuring scheme discovery tools, compliance support, and AI-based assistance to help enterprises navigate resources effectively.

The report emphasizes that unlocking the potential of medium enterprises requires a shift toward inclusive policy design and collaborative governance. With strategic support in finance, technology, infrastructure, skilling, and information access, medium enterprises can emerge as the drivers of innovation, employment, and export growth. This transformation is pivotal to realizing the vision of Viksit Bharat @2047.

CHAPTER 5 INDIAN ECONOMY

INTRODUCTION



The Indian economy is one of the *largest and fastest-growing economies* in the world, characterized by its diverse sectors, significant population, and ongoing economic reforms.

India has *transitioned from being a primarily agrarian economy to a more diversified one*, with significant contributions from sectors such as services, industry, and manufacturing. India has undertaken significant economic reforms since the early 1990s to liberalize its economy, promote private sector participation, attract foreign investment, and enhance competitiveness.

Key reforms include the *dismantling of the license raj, reduction of trade barriers, privatization of state-owned enterprises, deregulation of industries, and simplification of tax and regulatory frameworks*.

A sector is an area of the economy in which businesses share the same or related business activity, product, or service. We can divide the economy into the following three sectors:

- **Primary sector** companies are directly engaged in activities utilizing natural resources, such as mining and agriculture.
- **Secondary sector** companies produce goods derived from the products within the primary sector and include manufacturing.
- **Tertiary and quaternary sectors** represent the services and knowledge-based economy and include retail and information technology.

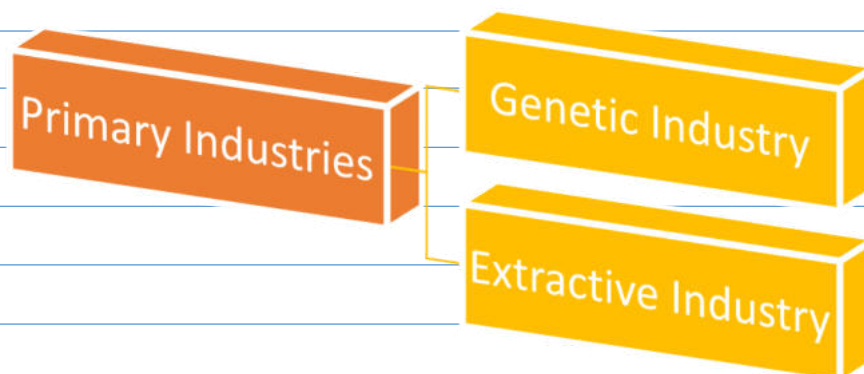
PRIMARY (AGRICULTURE AND ALLIED ACTIVITIES)



The **primary sector** is that which is involved in obtaining raw materials or natural resources from the planet. The kind of economic activities that can exist in a location depend on its characteristics.

Utilising the Earth's natural resources, like water, minerals, vegetation, etc., it is able to carry out its economic activities. *Despite its declining share in GDP, agriculture remains a vital sector, employing a significant portion of the population and contributing to food security and rural livelihoods.*

There are two categories of primary industries:



GENETIC INDUSTRY

This industry *involved the extraction or gathering of raw materials, which can then be enhanced through labour-intensive manufacture.* Agriculture, forestry, fisheries, and livestock management are a few examples of the primary sector's genetic industry. These industries are susceptible to advances in renewable resource technology and science.

EXTRACTIVE INDUSTRY

This category includes the *extraction or manufacture of finite raw materials that cannot be replaced or replenished by agriculture*. In the extractive industries, stone is quarried, mineral fuels are extracted, and mineral ores are mined.

Primary Sector Classifications

Primary industries include the following:

Farming: Farmers cultivate plants and raise animals that may be utilised to produce food or other items on their property. *Agriculture is a primary-sector industry*. It is the ability to make raw food using agricultural methods.

Rough materials and textiles are separated from food and fuel to form *four distinct product groups*. The food category includes egg yolks, milk, vegetables, meats, and oils. Cotton is a raw material used in agriculture to produce clothes.

Mining: The *extraction of raw materials from the ground, such as rock, sand, metals, clay, gemstones, and minerals, is known as mining*. A mining company's most valuable assets are its reserves and resources. Ore resources are located, the profit potential is assessed, and precious metals are extracted.

Mining is also a significant source of raw materials for the secondary sector, used to manufacture and create various imported goods. Natural gas, petrol, and water are examples of non-renewable resources included in the concept of mining.

Fishing: *Fishing is one of the world's most critical primary businesses*. You'll be responsible for everything from shipping and promoting fish goods to preserving them and processing them. *Industrial fish farming is the fastest-growing food production technology globally*, and fish farms presently provide about half of the world's seafood.

Forestry: For various sectors, forestry is a crucial supplier of raw materials. All forms of forest sector goods help address some of the needs of contemporary civilization while also improving worldwide human well-being.

However, Indian forests are facing a silent crisis. Rising temperatures, erratic rainfall and deforestation are weakening their ability to absorb carbon dioxide (CO₂), a vital role in combating global warming. This poses a major threat to the country's ambitious climate goal of creating "an additional carbon sink of 2.5-3 billion tonnes of CO₂ equivalent through additional forest and tree cover by 2030", as per its Nationally Determined Contributions, updated in August 2022.

Difference between Primary, Secondary and Tertiary Sectors

Primary	Secondary	Tertiary
The agricultural and allied sector services are known as the Primary Sector.	The manufacturing sector is known as the Secondary Sector.	The service sector is known as the Tertiary Sector.
Raw materials for goods and services are provided for the Primary Sector.	Secondary sector changes one goods into another by building more from it	This sector provides services to both the primary and secondary sector
The primary sector uses traditional techniques and is mostly unorganised.	The secondary sector uses more reliable methods of production and is organised.	This sector uses modern-day logistics methods to execute its functions and is well organised.
This sector consists of forestry, agriculture and mining activities.	It involves manufacturing units, large firms, small scale units and multinational organisations.	Insurance trade, Banking and communications come under this sector.

In comparison to other developed nations, India has a large workforce employed.	The employment rate is in balance, as a specific set of skills is needed to find a workforce in this sector	This sector's employment share has developed in the ensuing years.
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CURRENT SCENARIO OF AGRICULTURE AND ALLIED ACTIVITIES IN INDIA

Agriculture Has Been Considered As The 1st Engine Of Development In The Union Budget 2025-2026

- **Prime Minister Dhan-Dhaanya Krishi Yojana** - Developing Agri Districts Programme: The programme to be launched in partnership with the states, covering 100 districts with low productivity, moderate crop intensity and below-average credit parameters, to benefit 1.7 crore farmers.
- **Building Rural Prosperity and Resilience:** A comprehensive multi-sectoral programme to be launched in partnership with states to address under-employment in agriculture through skilling, investment, technology, and invigorating the rural economy. Phase-I to cover 100 developing agri-districts.
- **Aatmanirbharta in Pulses:** Government to launch a 6-year "Mission for Aatmanirbharta in Pulses" with focus on Tur, Urad and Masoor. NAFED and NCCF to procure these pulses from farmers during the next 4 years.
- **Comprehensive Programme for Vegetables & Fruits:** A comprehensive programme to promote production, efficient supplies, processing, and remunerative prices for farmers to be launched in partnership with states.

- **Makhana Board in Bihar:** A Makhana Board to be established to improve production, processing, value addition, and marketing of makhana.
 - **National Mission on High Yielding Seeds:** A National Mission on High Yielding Seeds to be launched aiming at strengthening the research ecosystem, targeted development and propagation of seeds with high yield, and commercial availability of more than 100 seed varieties.
 - **Fisheries:** Government to bring a framework for sustainable harnessing of fisheries from Indian Exclusive Economic Zone and High Seas, with a special focus on the Andaman & Nicobar and Lakshadweep Islands.
 - **Mission for Cotton Productivity:** A 5-year mission announced to facilitate significant improvements in productivity and sustainability of cotton farming, and promote extra-long staple cotton varieties.
 - **Enhanced Credit through KCC:** The loan limit under the Modified Interest Subvention Scheme to be enhanced from ` 3 lakh to ` 5 lakh for loans taken through the KCC.
 - **Urea Plant in Assam:** A plant with annual capacity of 12.7 lakh metric tons to be set up at Namrup, Assam.
- Indian food industry has come a long way since the time of Independence in 1947. From a ship to mouth existence, India has emerged as a food basket for the world.
 - Today, India is the largest country in terms of food production, processing, supply, and consumption.
 - India's food market is ranked 6th in the world, with 70% of sales and 5th in production, consumption, and export.

- India is today the *largest producer of F&V, milk, sugar, pulses, spices, oilseeds* etc. During the last two decades, the food consumption pattern has significantly changed and that had led to the growth of a gigantic size food processing industry. Today *the size of Indian food retail market is valued over \$800 billion with a growth rate of 11% AGCR.*
- With the rapid growth of the Indian economy, a *shift is also being seen in the consumption pattern* of the country, *from cereals to more varied and nutritious diet* of fruits and vegetables, milk, fish, meat and poultry products.
- The Indian *food processing industry accounts for 32 per cent of the country's total food market*, one of the largest industries in India. It *contributes around 14 per cent of manufacturing Gross Domestic Product (GDP)*, 13 per cent of India's exports and six per cent of total industrial investment.
- *India's Food Processing sector is identified as sunrise sector with projected size \$535 billion by 2025-26.* India's food ecosystem offers huge opportunities for investments with stimulating growth in the food retail sector, favorable economic policies, and attractive fiscal incentives.
- The organic food segment in India is expected to grow at a CAGR of *10% during 2015-25 and was estimated to reach Rs. 75,000 crore (US\$ 10.73 billion) by 2025* from Rs. 2,700 crore (US\$ 386.32 million) in 2015.
- The processed food market in India was forecasted to grow to Rs. 3,451,352.5 crore (US\$ 470 billion) by 2025, from Rs. 1,931,288.7 crore (US\$ 263 billion) in FY20 on the back of government initiatives such as planned infrastructure worth US\$ 1 trillion and Pradhan Mantri Kisan Sampada Yojna. The food processing industry employs about 1.77 million people. The sector allows 100% FDI under the automatic route.

SECONDARY (MANUFACTURING)



The **secondary sector** consists of processing, manufacturing, and construction companies. The secondary sector produces goods from the natural products within the primary sector.

Types of secondary sector industries:

- a) **Heavy industry:** Involves *large-scale production with heavy machinery*, such as steel and automobiles manufacturing.
- b) **Light industry:** Typically involves *less capital-intensive, consumer-oriented manufacturing*, like clothing and small electronics.
- c) **Craft industry:** *Small-scale production* focusing on handmade goods.
- d) **Processing industry:** Converts *raw materials into a finished product*, like oil refining or food processing.

The secondary sector includes the following business activities:

1. **Automotive Manufacturing:** This industry *involves the production of automobiles*, including cars, trucks, and other vehicles. It encompasses various processes such as assembly, painting, and quality control.

2. **Electronics Manufacturing:** Electronics manufacturing involves the production of electronic components and devices such as semiconductors, consumer electronics, and communication equipment. This industry often requires precision engineering and advanced technology.
3. **Metalworking and Metallurgy:** Metalworking encompasses a range of activities, including metal fabrication, forging, casting, and machining. Metallurgy involves the study of metals and their properties, as well as the production of alloys and metallic materials.
4. **Construction and Infrastructure:** The construction industry involves the development of buildings, infrastructure, and other physical structures. This sector includes activities such as residential and commercial construction, civil engineering, and infrastructure projects like roads, bridges, and utilities.
5. **Food Processing and Packaging:** Food processing involves the transformation of raw agricultural products into food products suitable for consumption. This includes activities such as sorting, cleaning, processing, and packaging of food items.
6. **Chemical Manufacturing:** Apart from chemical engineering, chemical manufacturing involves the production of a wide range of chemicals, including industrial chemicals, pharmaceuticals, fertilizers, and specialty chemicals for various applications.
7. **Machinery and Equipment Manufacturing:** This sector involves the production of machinery and equipment used in various industries, such as agricultural machinery, construction equipment, industrial machinery, and manufacturing tools.
8. **Paper and Pulp Industry:** The paper and pulp industry involves the production of paper, cardboard, and other paper-based products. It includes processes such as pulping, papermaking, and paper finishing.

9. **Plastics and Rubber Manufacturing:** Plastics and rubber manufacturing involve the production of plastic and rubber products for various applications, including packaging, automotive parts, consumer goods, and industrial components.
10. **Textile Machinery Manufacturing:** While textiles are already mentioned, textile machinery manufacturing is a crucial industry that produces machinery and equipment used in textile production processes such as spinning, weaving, knitting, dyeing, and finishing.

Major Investments

With the help of **Make in India** drive, India is on the path of becoming the hub for hi-tech manufacturing as global giants such as GE, Siemens, HTC, Toshiba, and Boeing have either set up or are in process of setting up manufacturing plants in India, attracted by India's market of more than a billion consumers and increasing purchasing power.

India has become one of the most attractive destinations for investments in the manufacturing sector.

Some of the major investments and developments in this sector in the recent past are:

- MSMEs have been considered as the **2nd Engine of Development** in the Union Budget 2025 – 2026
- **Revision in classification criteria for MSMEs:** The investment and turnover limits for classification of all MSMEs to be enhanced to 2.5 and 2 times respectively.
- **Credit Cards for Micro Enterprises:** Customized Credit Cards with ₹ 5 lakh limit for micro enterprises registered on Udyam portal, 10 lakh cards to be issued in the first year.

- **Fund of Funds for Startups:** A new Fund of Funds, with *expanded scope and a fresh contribution* of ` 10,000 crore to be set up.
- **Scheme for First-time Entrepreneurs:** A new scheme for *5 lakh women, Scheduled Castes and Scheduled Tribes first-time entrepreneurs* to provide term-loans upto ` 2 crore in the next 5 years announced.
- **Focus Product Scheme for Footwear & Leather Sectors:** To *enhance the productivity, quality and competitiveness of India's footwear and leather sector*, a focus product scheme announced to facilitate employment for 22 lakh persons, generate turnover of ` 4 lakh crore and exports of over ` 1.1 lakh crore.
- **Measures for the Toy Sector:** A scheme to create *high-quality, unique, innovative, and sustainable toys*, making India a global hub for toys announced.
- **Support for Food Processing:** A National Institute of Food Technology, Entrepreneurship and Management to be set up in *Bihar*.
- **Manufacturing Mission - Furthering "Make in India":** A National Manufacturing Mission covering *small, medium and large industries* for furthering "Make in India" announced.

Major Government Initiatives

The recent major government initiatives announced are as under:

1. Transforming India's agricultural and dairy sectors:

On March 19, 2025, the Union Cabinet took two key decisions to further the development of agriculture, dairying and animal husbandry in India. Agriculture, animal husbandry, and dairying are the cornerstone of India's economy. The Union Cabinet approved the Revised National Program for Dairy Development (NPDD), a Central Sector Scheme, with an additional budget

of `1,000 crore, bringing the total to `2,790 crore for the 15th Finance Commission period (2021-22 to 2025-26).

Key Objectives of the Revised NPDD:

- Improved milk procurement, processing capacity, and quality control.
- Enhanced market access for farmers and better pricing through value addition.
- Strengthening of the dairy supply chain to increase rural income and development.

Components of the Revised NPDD:

- a) Component A: Focuses on improving dairy infrastructure.
- b) Component B: Dairying through Cooperatives (DTC) in partnership with Japan International Cooperation Agency (JICA).

Expected Outcomes of Revised NPDD:

- Establishment of 10,000 new Dairy Cooperative Societies.
- Additional 3.2 lakh employment opportunities, 70% benefiting women.

2. The Union Cabinet has also approved the [Revised Rashtriya Gokul Mission \(RGM\)](#) to boost the livestock sector, with an additional outlay of `1,000 crore, bringing the total budget to `3,400 crore for the 15th Finance Commission period (2021-22 to 2025-26).

Key Additions to the Revised RGM:

- a) **Heifer Rearing Centres:** One-time assistance of 35% of capital cost for setting up 30 housing facilities for 15,000 heifers.
- b) **Support for High Genetic Merit (HGM) Heifers:** 3% interest subvention on loans taken by farmers to purchase HGM IVF heifers from milk unions/financial institutions.

3. Government Scales Up PLI Budget to Accelerate Manufacturing

India's manufacturing sector is undergoing a transformative shift, driven by visionary policies aimed at redefining its global standing. At the heart of this transformation is the Production

Linked Incentive (PLI) Scheme, a cornerstone of the government's strategy to establish India as a global manufacturing powerhouse while promoting innovation, efficiency, and competitiveness across key industries.

In a strong push to accelerate industrial growth, the Government has significantly increased budget allocations for key sectors under the PLI Scheme in 2025-26, reaffirming its commitment to strengthening domestic manufacturing. Several sectors have witnessed substantial hikes, with allocations for Electronics and IT Hardware soaring from `5,777 crore (revised estimate for 2024-25) to `9,000 crore, and Automobiles and Auto Components seeing a remarkable jump from `346.87 crore to `2,818.85 crore. The Textile sector has also received a major boost, with its allocation surging from `45 crore to `1,148 crore.

Launched in 2020, the PLI Scheme is more than just a policy; it is a strategic leap toward self-reliance. By targeting industries like electronics, textiles, pharmaceuticals, and automobiles, the initiative offers financial incentives tied directly to measurable outcomes such as higher production and incremental sales. This performance-driven approach not only attracts investments from domestic and global players but also encourages businesses to embrace cutting-edge technologies and achieve economies of scale.

Mobile Manufacturing and Specified Electronic Components

Critical Key Starting Materials/Drug Intermediaries & Active Pharmaceutical Ingredients

Manufacturing of Medical Devices

Automobiles and Auto Components

Pharmaceutical Drugs

Specialty Steel

Telecom & Networking Products

Electronic/Technology Products

White Goods (Air Conditioners and LEDs)

Food Products

Textile Products: MMF Segment and Technical Textiles

High Efficiency Solar PV Modules

Advanced Chemistry Cell (ACC) Battery

Drones and Drone Components

TERTIARY (SERVICES)



Tertiary Sector, also known as the service sector, is one of the three sectors of the economy. The tertiary sector of the economy is responsible for providing services to both businesses and final consumers.

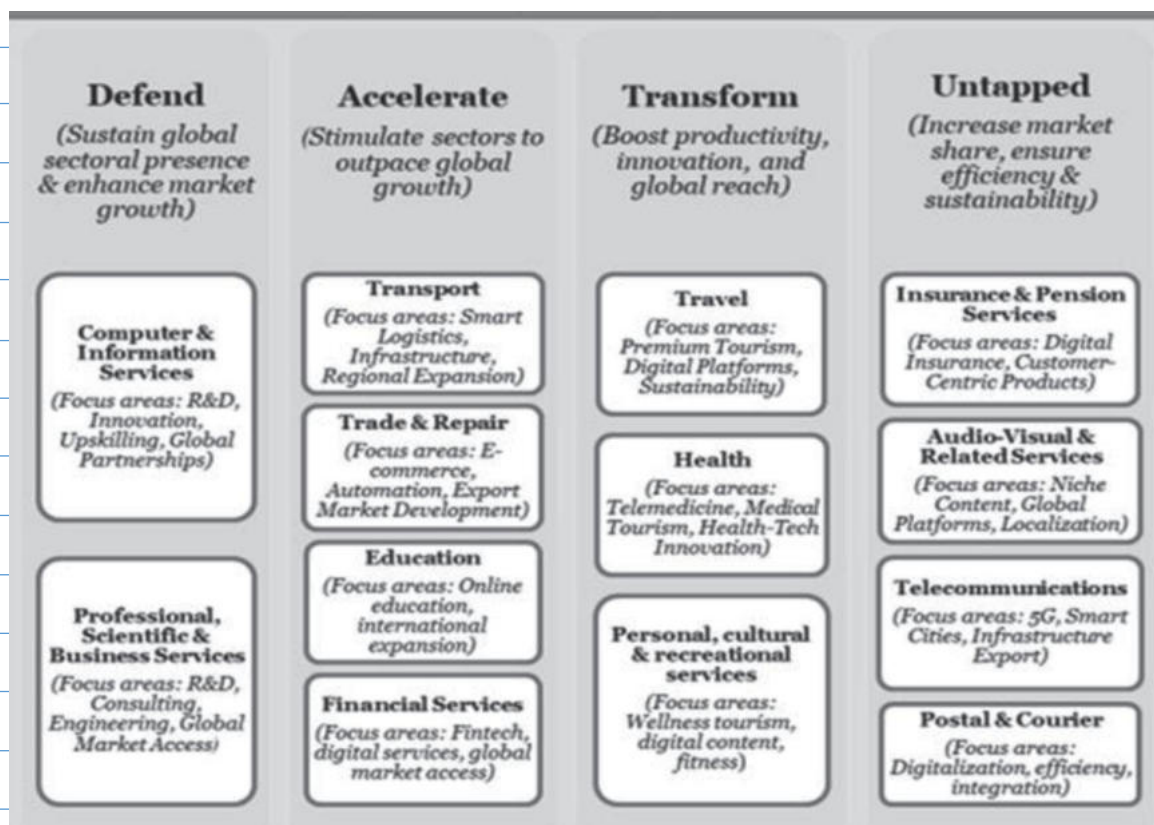
Service sector includes transportation, distribution, and sale of commodities from a producer to a customer, as in wholesaling and retailing, or providing of a service.

Market of Services Sector

- To enhance India's commercial services exports, share in the global services market from 3.3% and permit a multi-fold expansion in the GDP, the government is also making significant efforts in this direction. *India's IT and business services market is projected to reach US\$ 19.93 billion by 2025.*
- The share of the services sector accounted for 57% of the total GVA in FY24 (April-September) as per advance estimates. *The services category ranked first in FDI inflows*, as per data released by the Department for Promotion of Industry and Internal Trade (DPIIT).
- The sector has the potential to open up a multi-trillion- dollar opportunity that might stimulate symbiotic growth for all nations. Service providers in India continued to signal positive demand trends in June, which underpinned a stronger increase in new business volumes and further job creation.
- India's service exports stood at US\$ 163.94 billion, whereas imports stood at US\$ 88.89 billion in (April- September) 2023-24. The services trade surplus for 2023-24 (April-September) was expected to be US\$ 75.05 billion.

CURRENT SCENARIO OF SERVICE SECTOR IN INDIA

- The **HSBC India Services Purchasing Managers' Index (PMI)**, compiled by S&P Global, rose to **59.0 from 56.5 in January**, which had marked its lowest level in over two years. The service PMI report published on March 5, 2023, **attributes this resurgence to a sharp rise in new business orders, both domestically and internationally**, driving increased output and a significant boost in employment.
- India's central government has made a note of its service sector's positive performance. As of January 2023, the sector **contributes over 50 percent to India's gross value added (GVA)**, amounting to approximately **US\$1.4 trillion in FY2022-23**. This share is projected to increase to 56 percent by 2047, driven by continued investment in technology, infrastructure, and skill development.
- India's think tank agency, NITI Aayog, has said that the **country's services sector is shifting toward high-tech digital solutions**, including e-commerce, fintech, cloud computing, and AI-driven services. This surge in adoption of high-tech digital solutions can be attributed to the rise in establishment of global capability centers (GCC), which provide outsourced technology and business functions.
- NITI Aayog working paper on **"Identifying Potential Service Sub-Sectors: Insights from GVA, Exports, and Employment Data"** studies the potential of services in transforming the Indian economy from various dimensions such as the contribution to output /value added, employment and exports. Based on the analysis of the performance of the various service sub-sectors on these key dimensions, the Survey classifies services into four categories, each with its own set of policy recommendations: defend, accelerate, transform, and untapped.



- According to *Goldman Sachs*, the potential for India's share of global insurance and financial services is likely to rise by 2030. Indian states are registering record GVA growth in sectors like computer, transport, and professional services, with Maharashtra, Karnataka, and Tamil Nadu leading the way.
- The central government-backed AI and digital infrastructure initiatives, such as the INR 5 billion (US\$57.2 million) investment in AI Centers of Excellence and the National Geospatial Mission, are also reportedly influencing India's position as a leader in digital services.
- India's services sector continues to attract strong foreign investments, solidifying its position as a key driver of economic growth. According to the Department for Promotion of Industry and Internal Trade (DPIIT), FDI equity inflows reached US\$40.67 billion in FY2024-25 (April-December), with the services sector accounting for US\$7.22 billion of the total.

- From April 2000 to December 2024, India's total FDI amounted to US\$719.65 billion, of which the service sector contributed US\$116.72 billion, approximately 16 percent of the overall FDI inflow in the country. This significant investment underscores the growing confidence of foreign investors in India's economic potential and the increasing importance of the service sector in driving growth.
- To further attract foreign investments into India's service sector, the Union Budget FY2025-26 introduced a key reform in the insurance sector, raising the FDI cap from 74 percent to 100 percent. This policy change makes market entry easier for global players and enhances capital inflows into the sector.
- India's share in global services exports has been steadily rising for the last two decades. This has helped compensate the impact of oscillation in the share of merchandise exports in global merchandise exports to some extent. India ranks seventh globally, representing a 4.3% share in the global services export.
- India's Global Capability Centres (GCCs) are emerging as strategic hubs reshaping the Indian corporate landscape while influencing global business dynamics. The number of GCCs in India has grown from approximately 1430 in FY19 to over 1700 in FY24. As of FY24, GCCs in India employ nearly 1.9 million professionals.
- India's telecom sector is expanding with the smart phone boom, surging data consumption, and the advent of technologies like 5G. India stands as the second largest telecommunications market, with over 1.18 billion telephone subscribers, an overall teledensity of 84%, and 941 million broadband users as of 31st October, 2024. The country also leads in mobile data consumption per subscriber and offers the world's most affordable data rates. The average monthly wireless data usage per user in FY24 grew to 19.3 GB, up from 12.1 GB in FY21.
- As per annual survey of unincorporated sector enterprises 2022-23, the number of estimated enterprises belonging to the unincorporated sector stands at 6.5 crore. 72.6% of these enterprises operate in the service sector. These enterprises, though contributing to the overall

development of the economy in terms of employment and income, are losing out on benefits normally offered by incorporation, the Survey says.

Challenges to be addressed in Service Sector

Despite the positive growth of India's service sector over the past decade, several challenges hinder its full potential. One of the concerns is the *workforce skill gap in the country, where a disconnect between industry demands and the availability of skilled professionals in IT, artificial intelligence (AI), and financial services poses a constraint on growth.*

Another significant challenge is *regulatory complexity*, as frequent policy changes and varying taxation and compliance requirements across states create uncertainties for businesses. These regulatory inconsistencies can slow investment and expansion efforts.

Additionally, *infrastructure bottlenecks remain a key issue*, particularly in major business hubs such as Bengaluru. Urban congestion, inadequate digital infrastructure and limited resources can hamper business operations and restrict scalability.

One may note that the sector also faces *global market risks, with a high dependence on outsourcing and exports*, making it vulnerable to geopolitical disruptions and protectionist policies in major markets.

STRATEGIC RECOMMENDATIONS FOR BUSINESSES

1. Indian companies must evaluate the possibility of expanding digital service exports beyond traditional markets such as the U.S. and Europe. *Tapping into emerging economies in Southeast Asia, Africa, and Latin America can unlock new opportunities.* Additionally, fostering global partnerships in AI, fintech, and IT-enabled services will drive innovation and enhance competitiveness.
2. The *private sector* must invest in workforce development in the country by *aligning corporate training programs with government-led STEM education initiatives.* This includes providing training to employees with future-ready skills through advanced learning platforms, including AI-driven training modules.
3. Leveraging public-private collaboration is also essential. *Strong partnerships between businesses and central and state government agencies* in sectors such as transport, education, and healthcare *can accelerate business growth.* Investments in infrastructure and smart-city projects will integrate digital and physical services more effectively.
4. Furthermore, businesses must *expand beyond metro-cities to capitalize on emerging opportunities in Tier 2 and Tier 3 cities.* With central government initiatives like BharatNet and rural connectivity programs, expanding operations into these regions can unlock new markets and foster inclusive economic development.

GOVERNMENT INITIATIVES

- Centre has formulated an 'Action Plan for Champion Sectors in Services' to give focused attention to 12 identified Champion Services Sectors.
- India's tourism and hospitality sector may earn US\$ 50.9 billion as visitor exports by 2028.
- As per University Grants Commission (UGC) statistics of 2023, there are a total of 1,074 universities in the country, including 460 state universities, 128 deemed to be universities (a status of autonomy granted to high-performing institutes and universities by the Department of Higher Education), 56 central universities (established by the Department of Higher Education), and 430 private universities.
- The Government of India has adopted a few initiatives in the recent past, some of these are as follows: As of November 9, 2022, the number of bank accounts opened under the government's 'Pradhan Mantri Jan Dhan Yojana (PMJDY)' scheme reached 47.39 crore and deposits in Jan Dhan bank accounts totalled Rs. 1.76 lakh crore (US\$ 21.59 billion).
- In October 2021, the government launched a production-linked incentive (PLI) scheme to boost manufacturing of telecom and networking products in India. The scheme is expected to attract an investment of ~Rs. 3,345 crore (US\$ 446.22 million) over the next four years and generate additional employment for >40,000 individuals.
- In October 2021, the government launched phase II of the Mahatma Gandhi National Fellowship to empower students and boost skill development. The Mahatma Gandhi National Fellowship (MGNF) is an opportunity for young, dynamic individuals to contribute to enhancing skill development and promote economic development.

The two-year Fellowship seeks to combine classroom sessions (Academic Module) at host IIMs with an intensive field immersion at the district level (District Immersion) to create credible

plans and identify barriers in raising employment and economic output, and promoting livelihoods in rural areas.

MGNF is a Certificate Programme in Public Policy and Management offered by IIMs. It has been designed at the initiative of the Ministry of Skill Development and Entrepreneurship (MSDE), Government of India (GoI), and implemented in collaboration with State Skill Development Missions (SSDMs).

- In October 2021, the **PM Ayushman Bharat Health Infrastructure Mission (PM-ABHIM)** was launched by the government, to strengthen the critical healthcare network across India in the next four to five years. More than 1.64 lakh Ayushman Arogya Mandirs operationalised under NHM (National Health Mission).

PM-Ayushman Bharat Health Infrastructure Mission (PM-ABHIM) was launched by Hon'ble Prime Minister of India with an outlay of Rs.64,180 crore. The measures under the PM-ABHIM focus on developing capacities of health systems and institutions across the continuum of care at all levels, primary, secondary and tertiary, to prepare health systems in responding effectively to the current and future pandemics /disasters. Under PM-ABHIM provision have been made for construction and strengthening of 730 Integrated Public Health Labs (IPHLs), 3382 Block Public Health Units (BPHU) and 602 Critical Care Blocks (CCBs) during the scheme period.

- **Tourism for employment-led growth:** Top 50 tourist destination sites in the country to be developed in partnership with states through a challenge mode.
- **Research, Development and Innovation:** `20,000 crore to be allocated to implement private sector driven Research, Development and Innovation initiative announced in the July Budget.
- **Deep Tech Fund of Funds:** Deep Tech Fund of Funds to be explored to catalyze the next generation startups.

- **PM Research Fellowship:** 10,000 fellowships for technological research in IITs and IISc with enhanced financial support.
- **Gene Bank for Crops Germplasm:** 2nd Gene Bank with 10 lakh germplasm lines to be set up for future food and nutritional security.
- **FDI in Insurance Sector:** The FDI limit for the insurance sector to be raised from 74 to 100 per cent, for those companies which invest the entire premium in India.
- **Credit Enhancement Facility by NaBFID:** NaBFID to set up a 'Partial Credit Enhancement Facility' for corporate bonds for infrastructure.
- **Grameen Credit Score:** Public Sector Banks to develop 'Grameen Credit Score' framework to serve the credit needs of SHG members and people in rural areas.
- **Pension Sector:** A forum for regulatory coordination and development of pension products to be set up.
- **High Level Committee for Regulatory Reforms:** A High-Level Committee for Regulatory Reforms to be set up for a review of all non-financial sector regulations, certifications, licenses, and permissions.
- **Investment Friendliness Index of States:** An Investment Friendliness Index of States to be launched in 2025 to further the spirit of competitive cooperative federalism announced.
- **Jan Vishwas Bill 2.0:** The Jan Vishwas Bill 2.0 to decriminalize more than 100 provisions in various laws.

Agricultural and Industrial Policies of India



Agricultural Policies

Agricultural policy of a country is mostly designed by the Government for raising agricultural production and productivity and also for raising the level of income and standard of living of farmers within a definite time frame. This policy is formulated for all round and comprehensive development of the agricultural sector.

In India, the main objectives of agricultural policy are to remove the major problems of agricultural sector related to improper and inefficient uses of natural resources, predominance of low-value agriculture, poor cost-benefit ratio of the sectoral activities and insignificant progress of cooperative farming and other self-help institutions.

The agricultural development policies during five-year plans are as under:

(1) Five-year plan (1951-56):

The highest priority was accorded to increase of agricultural production. Nearly one third or 31 per cent of total plan funds were allocated to agriculture sector. River valley projects were taken up. Irrigational facilities and fertilizer plants were established. Consequently, production of food- grains increased by 36 per cent in a short span of five years.

(2) Second five-year plan (1956-61):

It focused on industrial growth and only 20 per cent of plan allocation was devoted to agriculture. Still food-grains production exceeded the target due to extension of irrigation facilities and use of chemical fertilizers.

(3) Third Five Years Plan (1961-66):

The priorities were on self-sufficiency in food grains, meeting the raw material needs of industries and increase in ex-ports. During this period, *Green Revolution programme was started on a small scale*. But this plan failed to meet the target due to Chinese aggression (1962), Indo-Pak war (1965) and severe and prolonged drought during 1965-66.

(4) Fourth Five Years Plan (1969-74):

It *aimed at 5 per cent annual growth in food grains*. High Yielding Variety (HYV) of seeds, fertilizer use, new agriculture techniques and irrigation facilities provided to expand area of Green Revolution. The production of wheat increased sharply but growth in rice, oilseeds and coarse grains were nominal resulting in *only 3 per cent annual growth against the target of 5 per cent*.

(5) Fifth Five Years Plan (1974-79):

It emphasised on *self-sufficiency in food production and poverty eradication*. Stress was laid on the extension of irrigation, expansion in cultivated area under HYV seeds and grant of loans and subsidies to farmers. *Dry farming was propagated*. This plan achieved its target successfully with 4.6 per cent growth. Almost all food grains except pulses witnessed increase in production.

(6) Sixth Five Years Plan (1980-85):

It emphasised on *land reforms, use of HYV seeds, chemical fertilisers and groundwater resources and improving post harvest technology* as well as marketing and storage facilities. The annual growth rate was 6 per cent, highest ever during plan periods. The food-grain production reached 152 million tonnes.

(7) Seventh Five Year Plan (1985-90):

During this period, the *highest growth in foodgrain, pulses and coarse cereals was recorded* showing over all annual growth rate of *4 per cent*. The areas of Green Revolution were expanded during the period.

(8) Eight Five Year Plan (1992-97):

This witnessed a *tendency of stagnation in foodgrain* production while oilseed registered a rapid growth.

(9) Ninth Five Year Plan (1997-02):

The ninth five year plan witnessed a *mixed success*. There were fluctuations in the foodgrain production. During this plan period *National Agricultural Policy, 2000*, was framed and several measures were announced including, watershed management, development of horticulture, agricultural credits and insurance scheme for crops.

(10) Tenth Five Year Plan (2002-07):

In the Tenth Plan (2002-2007) focus was placed on

- (i) sustainable management of water and land resources,
- (ii) development of rural infrastructure to support agriculture,
- (iii) dissemination of agriculture technology,
- (iv) credit flow to agriculture sector, and
- (v) agricultural marketing reforms.

The *New Agricultural Policy* the Government of India has announced (28th July 2000) a new National Agricultural policy, 2000, in the light of changes arising out of economic liberalization and globalization.

(11) Eleventh Five Year Plan (2007-12):

The 11th Five Year Plan (2007-12) emphasised '*Inclusive growth*' to achieve a target growth of 4 per cent per annum in GDP from agriculture and allied services.

(12) Twelfth Five Year Plan (2012-17)

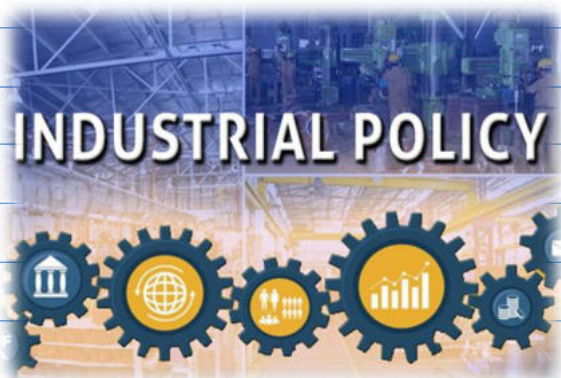
Agriculture sector grew by an *average 1.6 percent per annum in first four years* as against the targeted 4 percent annual growth due to lower production. However, *Government of India took several steps for increasing investment in agriculture* sector such as enhanced institutional credit to farmers, promotion of scientific warehousing infrastructure for increasing shelf life of

agriculture produce, setting up of agri- tech infrastructure fund for making farming competitive and profitable, developing commercial organic farming.

However, *it was realized that action is required on numerous fronts* including provision of basic support services such as technology and irrigation infrastructure, access to credit, good and reliable seeds and improved post-harvest technology. The latter is particularly important since the bulk of the acceleration in growth will come from diversification towards horticulture, animal husbandry and fisheries.

The *greatest potential for improving productivity was identified in the rain-fed areas, which accounted for 55 per cent of net sown area and where most of the poor live*. Land productivity was low in these areas, but a combination of effective water management combined with better seeds, promotion of soil health and critical on farm investments combined with public sector efforts to improve infrastructure was expected to make a big difference.

Industrial Policies



Industrial Policy is a statement of objectives to be achieved in the area of industrial development and the measures to be adopted towards achieving these objectives. The industrial policy thus formally indicates the spheres of activity of the public and the private sectors.

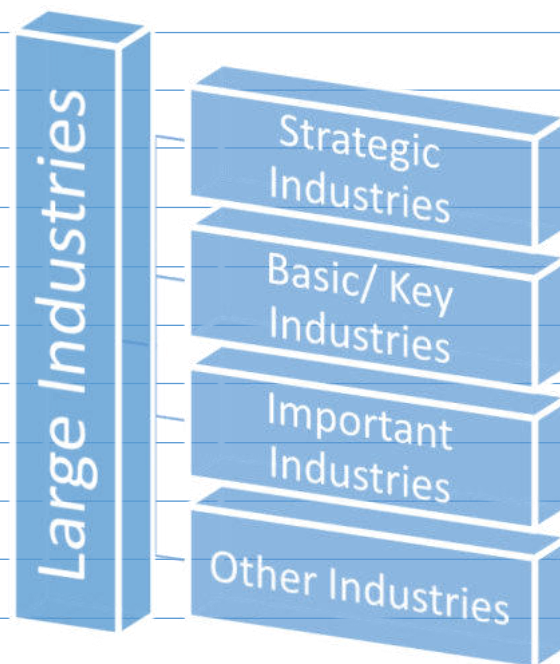
It lays down rules and procedures that would govern the growth and pattern of industrial activity.

(1) **INDUSTRIAL POLICY RESOLUTION 1948**

After having attained independence, the Government of India declared its *first Industrial Policy on 6th April, 1948*.

Salient Features of Industrial Policy, 1948

Under this policy, the large industries were classified in four categories viz. Strategic Industries, Basic / Key industries, Important Industries and other industries which respectively referred to Public Sector; Public-cum-Private Sector; Controlled Private Sector and Private & Cooperative sector.



(i) Strategic Industries (Public Sector):

This category included *three industries in which Central Government had monopoly*. These included Arms and ammunitions; Atomic energy and Rail transport.

(ii) Basic / Key Industries (Public-cum-Private Sector):

Six industries viz. coal, Iron and Steel, Aircraft manufacturing, Ship-building, Manufacture of telephone, telegraph and wireless apparatus, and Mineral oil were designated as “Key Industries” or “Basic Industries”. It was decided that the *new industries in this category will henceforth only beset-up by the Central Government*. However, the *existing private sector enterprises were allowed to continue*.

(iii) Important Industries (Controlled Private Sector):

Eighteen industries were kept in the “Important Industries” category. Such important industries included heavy chemicals, sugar, cotton textile and woollen industry, cement, paper, salt, machine tools, fertiliser, rubber, air and sea transport, motor, tractor, electricity etc. These industries will *continue to remain under private sector* however, the central government, in consultation with the state government, will have general control over them.

(iv) Other Industries (Private and Co-operative Sector):

All other *industries which were not included in the above mentioned three categories* were left open for the private sector. However, government could impose controls on these industries also if any of them was not working satisfactorily.

(2) THE INDUSTRIES (DEVELOPMENT AND REGULATION) ACT, 1951

Industries (Development and Regulation) Act, 1951 was passed by parliament in Oct, 1991 to control and regulate industrial development in the country.

Its objectives were:

- The *regulation of industrial investment and production* according to planned priorities and targets
- The *protection of small entrepreneurs* against the competition from larger industries
- *Prevention of monopoly* and concentration of ownership industries
- *Balanced regional development* with the view to reduce the disparity level of development of different regions of the country

Provisions of the Act:

Restrictive Provisions: Under this category, all the measures were designed to curb the unfair practices adopted by industries

- Registration and licensing of industrial undertakings
- Enquiry of listed industries
- Cancellation of registration license

Reformative Provisions:

- Direct regulation and control by government
- Control on price, distribution and supply
- Constructive measures

(3) INDUSTRY POLICY RESOLUTION (IPR), 1956

Industrial Policy Resolution, 1956 replaced the IPR, 1948.

It stressed on:

- Speeding up the pace of industrialization, particularly heavy industries.
- Expansion of public sector and growth of co-operative sector.
- State to take up the responsibility of setting up new industrial set up and development of transport facilities.
- Prevent private monopolies and concentration of economic process in hands of few number of individuals.

(4) INDUSTRIAL POLICY OF INDIA, 1991

The new Industrial Policy was announced in July, 1991 in the midst of severe economic instability in the country. The objective of the policy was to raise efficiency and accelerate economic growth.

Features of Industrial Policy 1991:

1. Strengthening of Private Sector
2. Dismantling of controls
3. Dispersing Industries
4. Limiting role of public sector
5. Liberalization of foreign investments
6. Foreign technology had been made easy by allowing automatic approvals for technology related agreements
7. Promotion of Small Scale Industries (SSI)

8. Domestic Regulatory Reforms
9. Abolition of Industrial Licensing:

Industry-1 (NITI Aayog):

The Industry-1 Vertical focuses on the continuous growth of trade and industry by developing new policies. The Vertical envisages holistic development of the industrial and mineral sector in India, encouraging optimum mineral exploitation, decreasing the import of various minerals, and strengthening the supply chain by means of value addition.

The Vertical also plays a crucial role in enabling active engagement of the States and relevant stakeholders in achieving milestones for the industrial and economic development of India. It aims to bring together innovation, technology, and efficient management at the core of policy formulation and implementation

Core functions of Industry-1

- The Vertical deals with policies related to revenue, commerce, corporate affairs, industry and internal trade, and mines and minerals.
- It actively engages with DPIIT, Department of Commerce, Department of Revenue, Ministry of Mines, and Ministry of Corporate Affairs for effective policy formulation.
- The Vertical collaborates with research organisations and development partners for studies and development initiatives in the areas of industry, trade and commerce, revenue, corporate affairs and mines and minerals.
- Analyzing and providing comments on the schemes and proposals of various Ministries/ Departments of the Government of India on matters related to industry, trade and commerce, corporate affairs, revenue, and mines and minerals.
- Providing suitable policy suggestions/inputs to various government Departments/Ministries for promoting the overall agenda of industrial growth.

BALANCE OF PAYMENTS

The **Balance of Payments (BOP)** is the method countries use to monitor all international monetary transactions at a specific period. Usually, the BOP is calculated every quarter and every calendar year.

All trades conducted by both the private and public sectors are accounted for in the BOP to determine how much money is going in and out of a country. If a country has received money, this is known as a **credit**, and if a country has paid or given money, the transaction is counted as a **debit**.

Theoretically, the BOP should be zero, meaning that assets (credits) and liabilities (debits) should balance, but in practice, this is rarely the case. Thus, the BOP can tell the observer if a country has a deficit or a surplus and from which part of the economy the discrepancies are stemming.

A country's trade balance equals the value of its exports minus its imports.

The formula is

$$X - M = TB,$$

where:

X = Exports M = Imports

TB = Trade Balance

Structure of Balance of Payments

There are three main components that form the basis of the structure of balance of payments. The **financial account, capital account, and current account**.

Current Account

The **current account** is useful for monitoring inflow and outflow of goods and services. Thus, this account covers all the payments and receipts that are made with respect to manufactured

goods and raw materials. Furthermore, it also includes receipts from tourism, engineering, business services, transportation, etc.

Capital Account

The capital transactions that occur between the countries are monitored under the capital account. Thus, capital transactions include the sale and purchase of assets like properties. Furthermore, the capital account also includes the flow of taxes, sales and purchases of fixed assets for a migrant moving in or out of the country. The three major elements of the capital account are investments, foreign exchange reserves, and loans and borrowings.

Financial Account

The flow of funds to and from foreign countries via various investments in real estate, FDI, business ventures, etc. are monitored through the financial account. Also, this account measures the variation in foreign ownership. When you analyze this, you can understand whether a country is acquiring more or selling more.

Favorable and Unfavorable Balance of Trade

1. Favourable Balance of Trade:

When there is an excess of exports over imports, it is called favourable balance of trade. In 1976-77 in India the imports were of value of INR 5073 crore while exports were of value of INR 5142 crore. Thus, balance of trade was +INR 69 crore. Further, it assists in strengthening the economy of a country.

2. Unfavourable Balance of Trade:

When there is excess of imports over exports, it is called an unfavourable balance of trade. Generally, in India balance of trade remains unfavourable. Further, it creates problems for an economy.

Union Budget 2025-2026: Measures to strengthen International Trade



1. **Tax Benefits and the Production-Linked Incentive (PLI) Schemes:** The Union Budget 2025-26 introduced a series of incentives and structural reforms aimed at enhancing India's role in global trade. With a strong emphasis on export-oriented growth, the government is prioritizing domestic manufacturing to reduce import dependency while simultaneously strengthening export incentives through tax benefits, subsidies and the Production-Linked Incentive (PLI) schemes. A key focus of the budget is on expanding Free Trade Agreements (FTAs) with major trade partners to boost market access for Indian exporters.

To support this agenda, the government has allocated ₹2,250 crore under the Export Promotion Mission to facilitate Indian businesses in international markets.

Additionally, ₹1,615 crore has been earmarked for the pharmaceutical industry to enhance India's global standing in the sector, while ₹2,300 crore has been directed towards the Biotechnology Research, Innovation and Entrepreneurship Development (Bio-RIDE) program, aimed at fostering biotech exports. These measures are expected to strengthen India's global trade competitiveness and accelerate its transition into a leading export-driven economy.

2. **Strategy to Balance Exports and Imports:** In line with its export-driven strategy, the budget also places a strong emphasis on reducing the trade deficit by strategically managing imports while boosting exports in high-value sectors such as pharmaceuticals, automobiles and information technology. To control the outflow of foreign exchange, the government has increased import duties on luxury goods and select raw materials, discouraging non-essential imports.

Simultaneously, the budget expands support for Micro, Small and Medium Enterprises (MSMEs) to strengthen their participation in global markets. Several key sectors, including engineering goods, textiles, electronics, semiconductors, pharmaceuticals and processed food products, are expected to benefit from export-friendly incentives and subsidies.

On the import front, the government is actively reducing reliance on foreign goods by encouraging domestic manufacturing and improving supply chain infrastructure, ensuring that India moves towards a more self-reliant and resilient trade ecosystem. These measures collectively strengthen India's global trade positioning, making it a more competitive and sustainable player in the international market.

3. **Infrastructure Investments:** A strong trade infrastructure is essential for reducing logistics costs and improving export efficiency. Recognizing this, the budget has allocated ₹1.70 lakh crore to the National Highways Authority of India (NHAI) to improve road connectivity to ports, ensuring faster transportation of export goods.

Additionally, ₹31,239 crore has been allocated for metro projects, enhancing urban trade logistics and connectivity to industrial zones. A further ₹5,649 crore has been set aside for border infrastructure and connectivity projects, aimed at facilitating smoother trade with neighboring countries.

The expansion of port infrastructure and logistics parks is expected to lower export costs, streamline trade operations and improve supply chain efficiency, making Indian goods more competitive in international markets.

4. **Export Growth through Small Businesses:** Recognizing the vital role of Micro, Small, and Medium Enterprises (MSMEs) in India's export ecosystem, the budget introduces measures to support their growth and global expansion. ₹9,000 crore has been allocated to the Guarantee Emergency Credit Line (GECL), ensuring working capital support for export-driven MSMEs.

Additionally, the Prime Minister Employment Generation Programme (PMEGP) will receive ₹2,954 crore to help small businesses enter global markets, while ₹1,500 crore has been allocated under the Raising and Accelerating MSME Performance (RAMP) program to digitize trade operations and improve market access. These initiatives will enhance MSMEs' competitiveness, enabling them to participate more actively in global trade.

5. **Expanding Global Partnerships:** Free Trade Agreements (FTAs) for Market Access: The budget underscores India's commitment to strengthening bilateral and multilateral trade agreements. India is currently negotiating or implementing Free Trade Agreements (FTAs) with the European Union, the United Kingdom, the United Arab Emirates and Australia, aiming to open new market opportunities for Indian exporters.

The key benefits of these FTAs include lower tariffs on Indian exports, easier access to foreign markets and increased foreign direct investment (FDI) in key industries. Sectors such as textiles, information technology, and pharmaceuticals are expected to benefit the most, as these agreements will reduce trade barriers and make Indian goods more cost-competitive on the global stage.

6. **Driving India's Global Trade Renaissance:** The Union Budget 2025-26 sets the stage for a bold transformation in India's global trade strategy. By harmonizing policy reforms, financial incentives and infrastructure development, the government is crafting a dynamic and resilient trade ecosystem that aligns with evolving global economic realities. With targeted customs duty adjustments, expansion of PLI schemes and strategic investments in trade logistics, India is not just reacting to global trends but actively reshaping its role in international commerce.

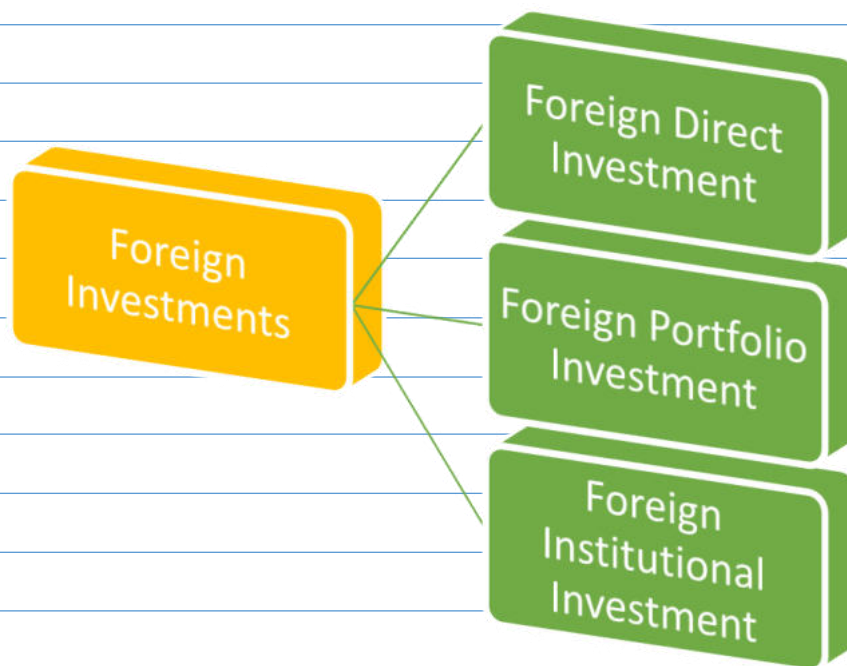
Foreign Investments in India: Types and Flows

Any investment that is made in India with the source of funding that is from outside of India is a foreign investment. By this definition, the investments that are made by Foreign Corporates, Foreign Nationals, as well as Non- Resident Indians would fall into the category of Foreign Investment.

Major Types of Foreign Investments

Funds from foreign country could be invested in shares, properties, ownership / management or collaboration.

Based on this, Foreign Investments are classified as below:



Foreign Direct Investment (FDI)

Foreign Direct Investment (FDI) is an investment made by a company or individual who us an entity in one country, in the form of controlling ownership in business interests in another country.

FDI could be in the form of either establishing business operations or by entering into joint ventures by mergers and acquisitions, building new facilities etc. A major monetary source, Foreign Direct Investment (FDI) in India is a key driver of the country's economic growth.

Since the economic liberalization of 1991, foreign investments into the country has improved considerably. FDI norms and policies have been regularly eased over the years in order to attract and promote FDI in India. India is a favourable investment destination for foreign investors given its relatively lower wages and special investment privileges in the form of tax exemptions etc.

FDI offers advantages to both the investor and the foreign host country.

Benefits for businesses:

- Market diversification
- Tax incentives
- Lower labor costs
- Preferential tariffs
- Subsidies

Benefits for the host country:

- Economic stimulation
- Development of human capital
- Increase in employment.
- Access to management expertise, skills, and technology

Foreign Portfolio Investment (FPI)

Foreign Portfolio Investment (FPI) is an investment by foreign entities and non-residents in Indian securities including shares, government bonds, corporate bonds, convertible securities, infrastructure securities etc.

The intention is to *ensure a controlling interest in India at an investment that is lower than FDI, with flexibility for entry and exit*. FPIs generally participate through the stock markets and gets in and out of a particular stock at much faster frequencies. Short term view is associated often with lower stake in companies.

Foreign Institutional Investment (FII)

Foreign Institutional Investment (FII) is an investment by foreign entities in securities, real property and other investment assets. Investors include mutual fund companies, hedge fund companies etc.

The intention is *not to take controlling interest, but to diversify portfolio ensuring hedging and to gain high returns with quick entry and exit*. As defined by the European Union Foreign Institutional Investment is an investment in a foreign stock market by the specialized financial intermediaries managing savings collectively on behalf of investors, especially small investors, towards specific objectives in term of risk, return and maturity of claims.

FII is an institution like a mutual fund, insurance company, pension fund etc. According to SEBI, *“an FII is an institution established or incorporated outside India which proposes to make investments in India in securities”*. FII is an institution who is registered under the Securities and Exchange Board of India (Foreign Institutional Investors) Regulations, 1995. FIIs comprised of a pension fund, a mutual fund, investment trust, insurance company or a reinsurance company.

Following are the few types of FIIs investing in India:

- Hedge Funds
- Foreign Mutual Funds
- Sovereign Wealth Funds
- Pension Funds
- Trusts
- Asset management Companies
- Endowments, University Funds, etc.

Differences between FDI and FII

Basis for Comparison	FDI	FII
Meaning	When a company situated in one country makes an investment in a company situated abroad, it is known as FDI.	FII is when foreign companies make investments in the stock market of a country.
Entry and Exit	Difficult	Easy
What it brings?	Long term capital	Long/Short term capital
Transfer of	Funds, resources, technology, strategies, know-how etc.	Funds only.
Economic Growth	Yes	No
Consequences	Increase in country's Gross Domestic Product (GDP).	Increase in capital of the country.
Target	Specific Company	No such target, investment flows into the financial market.
Control over a company	Yes	No

Difference between FDI and FPI

<i>Basis for Comparison</i>	<i>FDI</i>	<i>FPI</i>
<i>Meaning</i>	<i>FDI refers to the investment made by the foreign investors to obtain a substantial interest in the enterprise located in a different country.</i>	<i>When an international investor, invests in the passive holdings of an enterprise of another country, i.e. investment in the financial asset, it is known as FPI.</i>
<i>Role of investors</i>	<i>Active</i>	<i>Passive</i>
<i>Degree of control</i>	<i>High</i>	<i>Very less</i>
<i>Term</i>	<i>Long term</i>	<i>Short term</i>
<i>Management of Projects</i>	<i>Efficient</i>	<i>Comparatively less efficient.</i>
<i>Investment in</i>	<i>Physical assets/intangible assets</i>	<i>Financial assets</i>
<i>Entry and exit</i>	<i>Difficult</i>	<i>Relatively easy.</i>
<i>Results in</i>	<i>Transfer of funds, technology and other resources.</i>	<i>Capital inflows</i>

INTERNATIONAL FINANCIAL SERVICES CENTRE AUTHORITY (IFSCA) – GENESIS, GROWTH AND GOVERNANCE

Genesis

In the year 2007, the *Percy Mistry Committee Report* had explored the idea of setting up an IFSC in India and had suggested the setting up of an International Financial Centre. The report recommended for the reform of the Indian financial system and suggested that India had the enormous potential as a cost-efficient, competitive producer of International Financial Services (IFS).

It found a gap between the present capabilities of Indian financial firms and the requirements of the world IFS market. However, the plan was subsequently abandoned due to the 2008 global financial crisis.

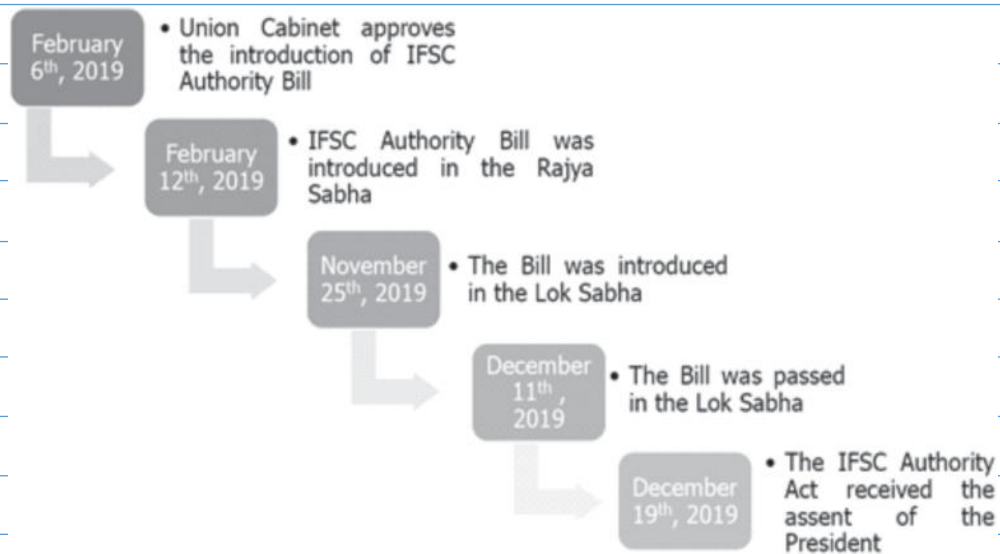
Further, a concept paper on the establishment of finance SEZs, submitted by the National Institute of Public Finance and Policy to the Ministry of Finance, also recognized that the existing financial and taxation regimes are the main reasons which have caused the global business to shift from India to countries like Singapore and Dubai, which provide a beneficial business environment.

In order to combat this, it advocated on the establishment of a new financial regulatory framework either through enacting and enforcing a 'Finance SEZ Act', or an IFSC. In Budget 2015, the establishment of the GIFT City was announced by the Union Minister of Finance in his budget speech (2015-2016).

The relevant extract of the speech is as under:

"While India produces some of the finest financial minds, including in international finance, they have few avenues in India to fully exhibit and exploit their strength to the country's advantage. GIFT in Gujarat was envisaged as International Finance Centre that would actually become as good an International Finance Centre as Singapore or Dubai, which, incidentally, are largely manned by Indians. The proposal has languished for years. I am glad to announce that the first phase of GIFT will soon become a reality."

Timelines



SEZ Framework and IFSCA

Special Economic Zones (SEZs) aim to attract Foreign Direct Investment (FDI) and improve the economy by exporting products and services and finding market globally. They are specifically defined areas where units may be set up for specified purposes of manufacturing or trading or rendering services or providing warehousing facility for export. SEZs are treated as a foreign territory for the purposes of trade operations, duties and tariffs, i.e., goods and services going into SEZ are treated as exports and goods and services coming from the SEZ as imports. SEZs provide easy access to global trading hubs that facilitates the flow of capital, movement of goods and economies of scale, all of which are critical for success of an SEZ.

To attract FDI and overcome the shortcomings experienced in terms of governance, infrastructure, etc., in the year 2000, Ministry of Commerce and Industries announced the SEZ policy. After this, in year 2005, the Government passed the SEZ Act, 2005 supported by SEZ Rules, 2006.

GIFT is conceptualized as a global Financial and IT Services hub, a first of its kind in India, designed to be at or above par with globally benchmarked financial centers such as Shinjuku, Tokyo, Lujiazui, Shanghai, La Defense, Paris, London Dockyards etc. GIFT Master Plan facilitates

Multi Services SEZ with IFSC (International Financial Services Centre) status, Domestic Finance Centre and associated social infrastructure.

“GIFT SEZ Limited” has been formed for development of Multi Services SEZ at Gandhinagar with the prime focus on development of IFSC and allied activities in SEZ. It is pertinent to note that the primary focus of the Multi Services SEZ will be on financial services.

The core objectives of developing IFSC in GIFT Multi Services SEZ are as under:

- To realize the vision of the Government of India to emerge as a major economic power by facilitating development of strong base of International Financial Services in the country.
- Facilitate the implementation of the Government's strategy for the development of a financial hub in the South Asian sub-continent.
- Position the IFSC as a world-class zone for the long-term provision of office/service accommodation and high technological, economical and commercial infrastructure.

The Government of India operationalized International Financial Services Centre (IFSC) at GIFT Multi Services SEZ in April 2015. The Union Budget 2016 provided competitive tax regime for the International Financial Services Centre at GIFT SEZ. It is the vision of the Hon'ble Prime Minister that GIFT SEZ International Financial Services Centre emerges as a hub for international financial services activities.

As per Section 2(q) of SEZ Act, 2005, “International Financial Services Centres” means an International Financial Services Centre which has been approved by the Central Government under sub-section (1) of Section 18 of SEZ Act, 2005.

Section 18(1) of SEZ Act, 2005 states that the Central Government may approve the setting up of an International Financial Service Centre in a Special Economic Zone and may prescribe the requirements for setting up and operation of such centre. However, the Central Government shall approve only one International Financial Services Centre in a Special Economic Zone.

Further, **Section 18 (2)** of SEZ Act, 2005 states that the Central Government may, subject to such guidelines as may be framed by the Reserve Bank, the Securities and Exchange Board of India, the Insurance Regulatory and Development Authority and such other concerned authorities, as it deems fit, prescribe the requirements for setting up and the terms and conditions of the operation of Units in an International Financial Services Centre.

About International Financial Services Centre Authority (IFSCA)

The first International Financial Services Centres Authority (IFSCA) has been established on April 27, 2020 under the International Financial Services Centres Authority Act, 2019 at GIFT City, Gandhinagar in Gujarat.

The Government of India implemented a major financial sector reform by establishing and operationalizing India's maiden International Financial Services Centre (IFSC) in Gujarat International Financial Tech City (GIFT City), Gujarat.

The vision of the Government is to develop GIFT IFSC as a leading internationally recognized financial centre with trusted business regulations, competitive tax structure, and ease of doing business. The IFSC has been designated as a special international financial jurisdiction, which is treated as a non-resident zone under Foreign Exchange Management (FEM) Regulations, thereby facilitating transactions in any freely convertible foreign currency.

The IFSCA is a unified authority for the development and regulation of financial products, financial services and financial institutions in the International Financial Services Centre (IFSC) in India. At present, the GIFT IFSC is the maiden international financial services centre in India. Prior to the establishment of IFSCA, the domestic financial regulators, namely, RBI, SEBI, PFRDA and IRDAI regulated the business in IFSC.

As the dynamic nature of business in the IFSCs requires a high degree of inter-regulatory coordination within the financial sector, the IFSCA has been established as a unified regulator with a holistic vision in order to promote ease of doing business in IFSC and provide world class regulatory environment.

The main objective of the IFSCA is to develop a strong global connect and focus on the needs of the Indian economy as well as to serve as an international financial platform for the entire region and the global economy as a whole.

The GIFT IFSC in Gujarat, according to the latest Global Financial Centers Index report (October 2025), ranks 43rd globally and placed among 15 centers globally expected to gain significance in the next two-three years. Operating as a special financial zone, it falls under offshore territory classification within Indian foreign exchange regulations, offering world-class financial services in various foreign currencies to both residents and non-residents. This pioneering IFSC in India presents diverse business opportunities spanning Banking, Capital Markets, Fund Management, Aircraft Leasing, Insurance, and more, rapidly becoming a preferred conduit for capital flows into and out of India.

Goals and Objectives

The main objective of IFSCA is to develop and regulate financial services in the International Financial Services Centres (IFSCs) established in India, with a mandate to create a world-class financial ecosystem based on ease of doing business and to provide best in class regulatory system to make IFSCs in India a preferred global destination for international financial services.

As a unified financial regulator, having power to regulate banking, capital market, insurance and pension funds, which in domestic India are being regulated by RBI, SEBI, IRDAI and PFRDA respectively, and other related activities in IFSC, IFSCA adopts a holistic vision towards the development and regulation of financial products, financial services, and financial institutions in IFSCs in India.

At present, the GIFT IFSC is the maiden International Financial Services Centre in India. **The objectives of IFSCA include the following:**

- To facilitate the development of a strong base of international financial services in the country
- To promote IFSCs as a dominant gateway for international capital flows into and out of India
- To emerge as a regional and global hub for international financial services
- To provide a state-of-the-art unified regulatory framework, with robust regulation and supervisory technology aligned with international best practices
- To develop a strong global connect with leading international financial jurisdictions.

Business Advantage

GIFT IFSC aims to emerge as a global hub for a plethora of cross border financial services including banking, capital markets, fund management, insurance etc. It offers best-in-class regulatory and business environment that is benchmarked with global financial centres like Singapore, Hong Kong, London, New York etc.

GIFT IFSC is poised to emerge as one of the fastest growing IFSCs in the world and is also set to become one of the most preferred gateways for inbound and outbound financial services relating to India.

GIFT IFSC has several unique features that gives it a competitive edge. These include a unified financial regulator, attractive tax regime, availability of state-of the art infrastructure, access to large hinterland Indian economy, low cost of operations and the availability of skilled talent pool in India.

GIFT IFSC, therefore is well positioned to act as a catalyst to attract global capital that can fuel the growth and development of the Indian economy and has the potential to emerge as a cornerstone in India's strategic roadmap to achieve the Viksit Bharat Mission 2047.

INDIA'S ECONOMIC TRANSFORMATION IN THE 21ST CENTURY

- India is the world's fourth-largest economy and the fastest-growing major economy.
- By 2030, India is projected to become the third-largest economy with a GDP of \$7.3 trillion.
- Growth estimates for 2025–26: 6.3% to 6.8%, leading the world among major economies.

Key drivers of growth:

- Decisive governance and visionary reforms.
- Stronger engagement with global markets.
- Robust domestic demand.
- Young and dynamic demographic profile.
- Sustained structural reforms in multiple sectors.

Aatmanirbhar Bharat (Self-Reliant India) vision:

- Promotes innovation, entrepreneurship, and technological sovereignty.
- Initiatives like PLI schemes, revitalisation of MSMEs, and digital infrastructure expansion support high- growth opportunities.

Focus on inclusive and equitable growth:

- Job creation and financial empowerment.
- Public investment to ensure benefits reach all sections of society.

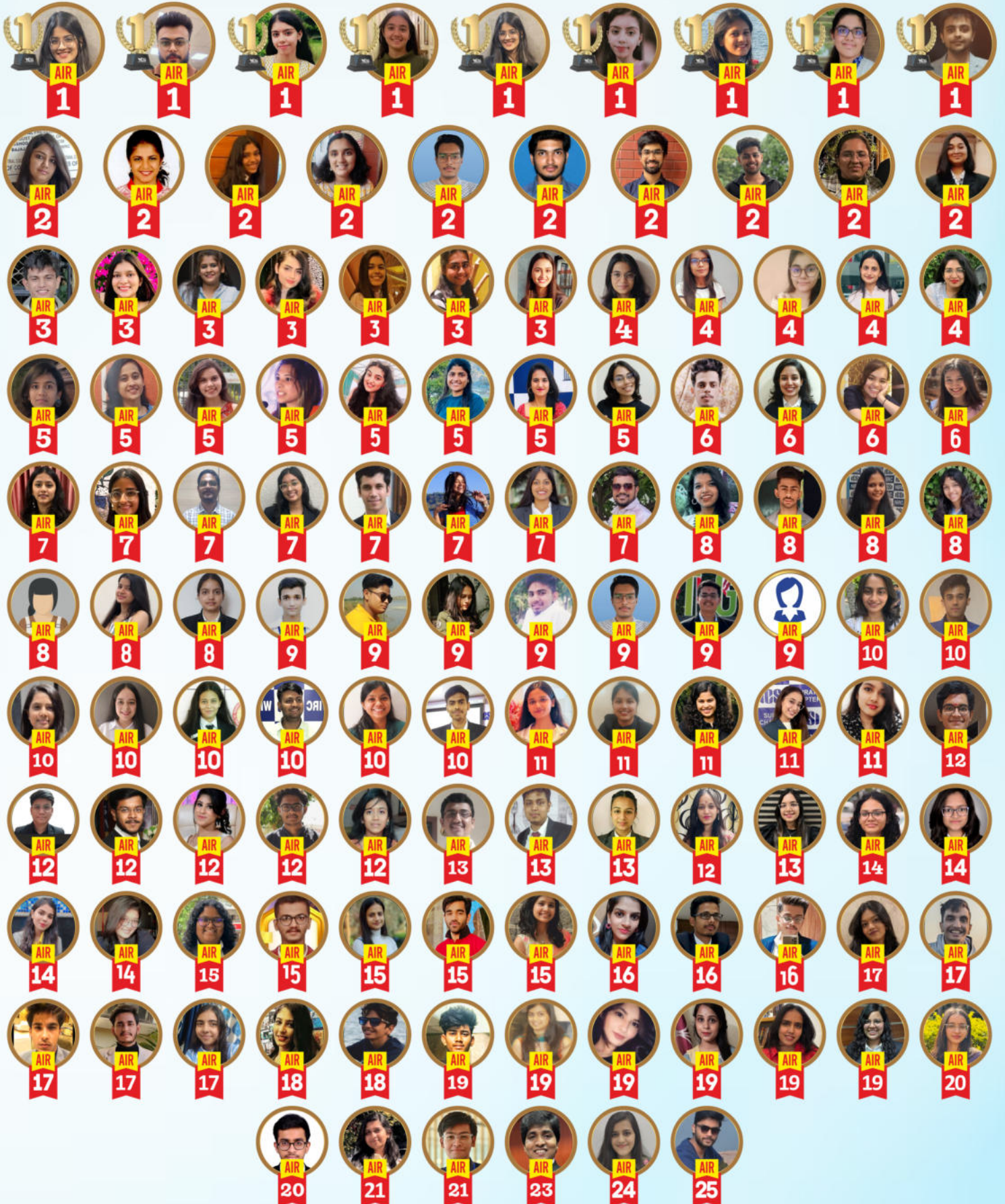
India is now digital, green, aspirational, and future-ready, moving steadily towards global leadership.

CPSEs: Catalysts of India's Economic Transformation

Central Public Sector Enterprises (CPSEs) play a critical role in India's economic and industrial development. As strategic national assets, they are not merely commercial entities but *pillars of national growth, providing essential infrastructure, manufacturing capabilities, and services across a wide spectrum* — from everyday household products like salt, tea, and paper to heavy machinery, electric vehicles, and components used in the construction of national infrastructure.

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She's known for employing innovative teaching methods to engage students in active learning and cultivating their interest in and passion for the subjects.

