# Economics Class 05

**18th July, 2023 at 9:00 AM**

## REVISION OF THE PREVIOUS CLASS (9:00 AM):

- The Second Five-Year Plan(1956-1961) prioritized capital-intensive sectors over labor-intensive sectors.
- All over the world, the major sector of the economy began from the primary sector, shifted to the manufacturing sector, and later to the services sector.
- Also, the labor force participation moves in that manner.
- But in India, the services sector became the largest contributor to the GDP after the primary sector.
- More than required labor remained in the primary sector, which gave rise to disguised employment.
- The services sector( mainly Informational Technology) though contributes majorly to the GDP, but not everyone can participate in the sector.
- So we saw, and are seeing **Jobless Growth,** where the growth in GDP could not get reflected in the growth in employment.

## Employment Elasticity(EE) :

- It reflects the change in employment with respect to the change in GDP.
- EE of 1 would mean that if the GDP grows by 1 %, employment will also grow by 1%.
- In India, EE reached 0.04 (almost 0) in 2012, indicating jobless growth.

## Creative Destruction:

- It refers to the dismantling of existing economic structures-industries & jobs, due to innovation and R & D.
- It can cause economic prosperity and create new job profiles and more overall jobs in the long run.
- **For example-** the progression from bullock-cart to Pedal rickshaws to motorized autos to Ola/Uber.

## India in the 1970s:

- License Raj contributed to manufacturing companies working at sub-optimal levels.
- The agriculture sector was also not performing well because the Green Revolution was in its nascent stages.
- That era saw inflation because of **cost-push** factors.
- The government had to continue vital imports like crude oil, food, etc.
- Costlier goods(imports and domestically produced) caused high inflation.
- Higher import bills caused a higher **trade deficit.**
- The situation was worsened by the global oil crisis of the 1970s.
- The structural deficiencies along with other factors kept on compounding till we faced the economic crisis in 1991.
- The 1991 crisis compelled India to take reforms to become a more open economy.

## MAINS QUESTION DISCUSSION (9:30 AM):

- **Question 1:** How can the market economy be made more inclusive?
- **Approach:**
- We can introduce by defining market economy, then inclusive growth.
- We can first mention some reasons why the market economy has not yet been very inclusive.
- We must mention the aspect of jobless growth.
- We must then mention some ways to make the economy inclusive:
- I. Progressive taxation.
- II. Financial Inclusion.

- III. Investments in labor-intensive sectors.
- We will try to substantiate our points with relevant data.

**Question 2:** Comparison between pre-1991 and post-1991 Indian economy.

- **Approach:**
- We can introduce by briefly describing the LPG- Liberalization, Privatization & Globalization reforms done in 1991.
- We must compare the pre-1991 and post-1991 Indian economies on grounds like:
- I. Openness of the economy.
- II. Tax regimes.
- III. Dependency upon foreign investment.
- IV. Shares of primary, secondary, and tertiary sectors in the GDP.
- V. Inequality, etc.

**Question 3:** Demonetization's probable results in the 1970s

- **Approach:**
- We can start with a brief description of the demonetization done in November 2016.
- The answer must revolve around the premise that in 2016, we had more avenues to utilize/hide black money.
- We must mention tax havens, foreign investments, etc.

**Question 4:** Foreign investment is necessary for economic development, but not beyond a certain point.

- **Approach:**
- We can introduce with 1991 reforms- foreign investments became more critical for Indian growth after 1991.
- We must then mention how foreign investments increased after the 1991 reforms.
- We must then mention what benefits can be derived from foreign investments.
- Mention that augmentation of domestic capacity as soon as possible to protect ourselves from external shocks.

**Question 5:** The transition of every economy generally moves from primary to secondary and from secondary to tertiary, unlike India where there was an abrupt shift from primary to tertiary. What is the impact of this abrupt shift on the Indian economy, and what measures have to be taken by the government to strengthen the secondary sector?

- **Approach:**
- We can start with the contributions of different sectors in GDP and employment before and after the 1991 reforms.
- We must then mention the reasons behind the Indian shift from the primary to the tertiary sector.
- We must then mention how the government has tried to boost the manufacturing sectors through various reforms.

## BALANCE OF PAYMENTS (BOP) 10:00 AM:

- The balance of payments (BOP) is an accounting statement of Indian transactions with the rest of the world.
- The transactions are broadly classified into:
- **I. Current Account.**
- **II. Capital Account.**

### Current Account:

- These have no future implications.
- **The components of the Current Account are:**
- (a) Merchandize trade- Imports and exports of goods to and from a country.
- (b) Invisibles- It has three sub-components:
- (b)(1) Trade in Services-imports & Exports.

- (b) (2) Remittances/Transfers/Grants- Money sent or received during the year in the form of transfers.
- (b) (3) Earnings/Incomes- Incomes earned when some factor of production(FOP) is provided on a cross-border basis.
- **For example,** if some resident provides capital to a non-resident then the return on this capital is the earning/income.
- If capital is invested, then the earning would be in the form of profits.
- In India, the current account deficit is mainly because of the trade deficit.

### Capital Account:

- It consists of transactions between Residents(R) & Non-Residents(NR) that are settled in nature.
- These are the transactions that affect any futuristic interests or obligations.
- **Broadly there are two components:**
- **I. Loans/Borrowings:** Money borrowed from R by NR or vice versa.
- **II. Investments:**
- When either R or NR invests money(purchases ownership via some instruments) in another's country.
- Foreign investments into India are classified as FDI or FPI.

### BOP can be classified into:

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| **Current Account (**settled transactions) | **Capital Account(** unsettled transactions) |
|---|---|
| Trade in Merchandize (Goods)**-** Both Imports & Exports**-Balance of Trade** | Loans/Borrowings |
| Trade in Invisibles:<br>Trade in Services-imports & Exports.<br>Remittances/Transfers- Money sent or received during the year in the form of transfers.<br>Earnings/Incomes- Incomes earned when some factor of production(FOP) is provided on a cross-border basis. | Investments:<br>Both Indian investments abroad and foreign investments into India( FDI, FPI). |

### Twin deficit hypothesis:

- Current Account deficit leading to Fiscal deficit and fiscal deficit leading to current account deficit.
- A **fiscal deficit** is the borrowing of the government.

### LIBERALIZATION, PRIVATIZATION & GLOBALIZATION(LPG) REFORMS (10:30 AM):

- Foreign exchanges( and investments) were earlier regulated through **Foreign Exchange Regulation Act (FERA).**
- Later their regulation was done under **Foreign Exchange Management Act (FEMA).**
- FERA was more strict than FEMA.
- FERA treated foreign investment crimes as criminal offenses, while they were civil offenses under FEMA.
- FEMA was needed as India needed more foreign exchange at that time.

### First-Generation Reforms:

- All those reforms by the government were implemented after the 1991 crisis.
- They focussed on reducing fiscal deficit reducing current account deficit and liberalizing the economy.

- As part of liberalization, the government came up with a **New Industrial Policy in 1991** which liberalized the license raj era.
- The government started to move towards a market economy-implementing capitalist principles.
- Currency (rupee) values were also determined based on market fundamentals.
- Progressive liberalization of exchange rate policy.
- The government also initiated tax reforms, allowing FDI (Foreign Direct Investment) and FII (Foreign Institutional Investment) into the Indian market.

### Globalization:

- It leads to the free movement of goods, services, labor & capital with minimum restrictions.
- It also has a societal aspect- globalization in India is related to the rise in service sector jobs.
- The prominence of service sector jobs came at the cost of agricultural jobs, as the manufacturing sector was not developed enough to create mass employment.
- This further caused the prevalence of joint family structures to decrease at the cost of rising nuclear family arrangements.
- The multinational companies which entered India had to strategize keeping in mind the **price-sensitive** nature of the Indian public.
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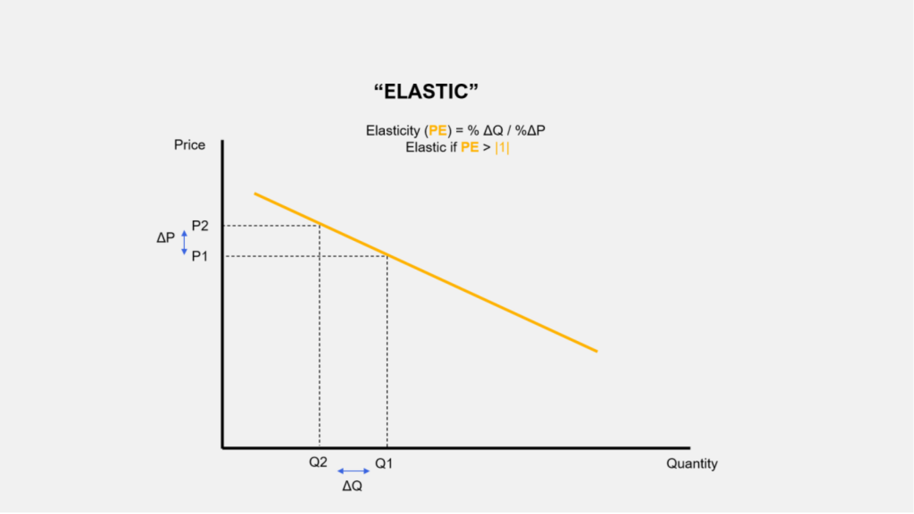
### Surrogate Advertising:

This advertisement technique is used to advertise those products whose direct advertisements are banned.

Advertisers can rope in celebrities, and build brands for the product, without actually referring to the product.

**For example-** advertising tobacco through running ads for mouth fresheners by the same company.

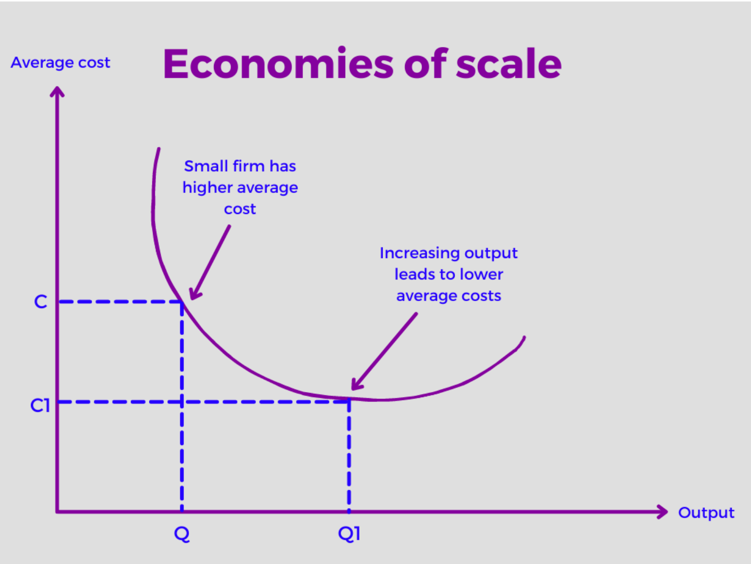
### DEMAND ELASTICITY (11:00 AM):

- The concept deals with the changes in demand for any goods & services with respect to their prices.
- 

- The Indian middle class is considered to be very price-sensitive.
- If there is an increase in prices of non-essential goods, most people will postpone/cancel buying the good, hence decreasing their immediate demand.
- **Inelastic demand** would be seen if the demand remains the same irrespective of price changes, like essential medicines.

- So to target the Indian middle class, companies try to engage in **price competitiveness-** trying to keep the prices of their products as low as possible.
- We see this in manners like giving discounts, cashback, and other related offers.
- Large corporations, who can achieve **Economies of Scale** are better suited to indulge in such competitive pricing methods than small retailers who anyways operate on low profit margins.

### Economies of Scale:

- This refers to the cost advantages achieved as a result of the more efficient productional process.
- Even the cost of raw material procurement will be cheaper.
- Simply speaking, as the scale of production will increase (more products can be produced at the same time), the cost of production of each product will be lower.
- This lower cost will increase profit margins, which will give the scope for giving discounts.
- 


### FREE TRADE (11:30 AM):

- Capitalist thinkers like **Adam Smith** promoted free trade as beneficial for all the countries involved in the trade.
- Free trade is the trade between different countries with minimum restrictions(taxes, duties, etc).
- Global trade is believed to be tilted in favor of developed countries.
- The reasons include better manufacturing capacity and other tariff & non-tariff barriers.

### Predatory Pricing:

- This simply means keeping the prices of goods/services very low so that other competitors lose the market.
- **For example-** the provision of free data & calling by Jio.

### Dumping:

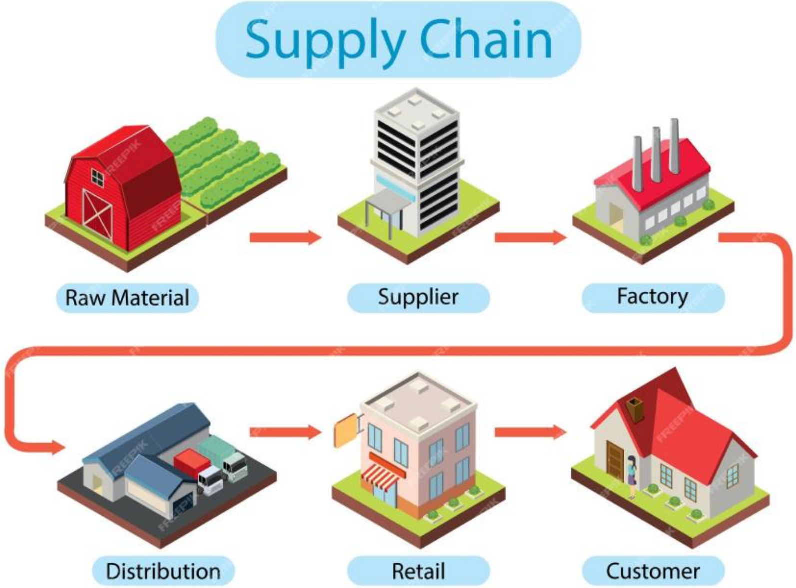
- Selling the product in a foreign economy  at a price lower than the cost of production in
- Government levies **Anti-Dumping** duty to protect the domestic market from such predatory policy.

### Elastic demand:

- Demand is more responsive to the change in price.

- **Inelastic demand:**
- Demand is less responsive to the changes in price.

- **Supply Chain:**
- Supply chain refers to the arrangement of entities indulged in processes from procurement of raw materials, processing raw materials, intermediate storages, and delivering the products to the final customers.

- 

- Efficient supply chains are essential for the least wastage and optimal resource & time utilization which will achieve the least costs for the finished products.
- Efficient supply chains will also provide convenience to the customers for accessing products with the least effort.
- In the supply chain, **backward integration** means moving toward the supplier base.
- **Forward Integration** means moving toward the final consumer.
- In the agricultural sector, the supply chain will aim to provide a "Plough to Plate" experience for both farmers and consumers.
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**The topics for the next class are Capital accounts and other basics of economics.**