UNIT 5

Since independence India has been a 'Mixed Economy'. India's large public sectors were responsible for rendering the country a 'mixed economy' feature. Indian economy is basically based in the contribution of service sector (currently provides 60% share of GDP) and near about 53% of its population is dependent on the Agriculture. As soon as the time is passing, the share of Agriculture is decreasing and share of service sector is increasing. Currently India is called a developing economy of the world.

Characteristics of the Indian Economy

The following points highlight the top thirteen characteristics of the Indian economy.

1. Low per capita income: In India, the national income and per capita income is very low and it is considered as one of the basic features of underdevelopment. As per World Bank estimates, the per capita income of India stood at only $ 720 in 2005. Keeping aside a very few countries, this per capita income figure of India is the lowest in the world and it is even lower than China and Pakistan.

2. Excessive dependence of agriculture and primary producing: Indian economy is characterized by too much dependence on agriculture and thus it is primary producing. Out of the total working population of our country, a very high proportion of it is engaged in agriculture and allied activities, which contributed a large share in the national income of our country. Nearly 58 per cent of the total working population of our country is engaged in agriculture and allied activities and was contributing about 14 per cent of the total national income. While in most of the developed countries like U.K., U.S.A. and Japan, the percentage of active population engaged in agriculture ranges between 1 to 5 per cent. Table 1.4 will clarify this position. Thus our agricultural sector is overburdened as the majority of our active population is depending on agriculture.

3. High rate of population growth: India is maintaining a very high rate of growth of population since 1950. Thus the pressure of population in our country is very heavy. This has resulted from a very high level of birth rates coupled with a falling level of death rates prevailing in our country. The prime cause behind this rapid growth of population is the steep fall in its death rate from 49 per thousand during 1911-20 to 7.1 per thousand in 2011. On the other hand, compared to its death rate, the birth rate of our population has gradually declined from 49 per thousand during 1911-20 to 21.8 per thousand in 2011. Thus whatever development that has been achieved in the country, it is being swallowed up by the increased population. Moreover, this high rate of growth of population necessitates a higher rate of economic growth just for maintaining the same standard of living.

This imposes a greater economic burden on the economy of our country as to maintain such a rapidly growing population we require food, clothing, housing, schooling, health facilities etc. in greater magnitude. Besides, this fast rate of growth of population is also responsible for rapid increase in the labor force in our country.

4. **Existence of chronic unemployment and under-employment**: Rapid growth of population coupled with inadequate growth of secondary and tertiary occupations are responsible for the occurrence of chronic unemployment and under-employment problem in our country. In India, unemployment is structural one, unlike in developed countries, which is of cyclical type. Here unemployment in India is the result of deficiency of capital. Indian industries are not getting adequate amount of capital for its necessary expansion so as to absorb the entire surplus labour force into it. Moreover, larger number of labour force is engaged in the agricultural sector of the Indian economy than what is really needed. This has reduced the marginal product of agricultural labourer either to a negligible amount or to zero or even to a negative amount.

There exists disguised unemployment in Indian agricultural sector which has resulted from too much dependence of population on land and absence of alternative occupations in the rural areas.

Moreover, in the urban areas of our country, the problem of educated unemployment has also taken a serious turn. Thus both the rural and urban area of our country has been suffering from the serious problem of unemployment and under-employment to a large extent.

5. **Poor rate of capital formation:** Capital deficiency is one of the characteristic features of the Indian economy. Both the amount of capital available per head and the present rate of capital formation in India are very low. Consumption of crude steel and energy are the two important indicators of low capital per head in the under-developed countries like India.
Moreover, this low level of capital formation in India is also due to weakness of the inducement of invest and also due to low propensity and capacity to save. As per Colin Clark’s estimate, in order to maintain the same standard of living, India requires at least 14 per cent level of gross capital formation.

To achieve a higher rate of economic growth and to improve the standard of living, a still higher rate of capital formation is very much required in India. But considering the heavy population pressure and the need for self sustained growth, the present rate of saving is inadequate and thus the enhancement of the rate of capital formation is badly needed.

6. Inequality in the distribution of wealth: Another important characteristic of the Indian economy is the mal-distribution of wealth: The report of the Reserve Bank of India reveals that nearly 20 per cent of the households owing less than Rs 1000 worth of assets possess only 0.7 per cent of the total assets. Maldistribution in income is the result of inequality in the distribution of assets in the rural areas. On the other hand, in respect of industrial front there occurs a high degree of concentration of assets in the hands of very few big business houses. This shows high degree of assets concentration in the hands of very few powerful business houses of our country.

7. Low level of technology: Prevalence of low level of technology is one of the important characteristics of an underdeveloped economy like India. The economy of our country is thus suffering from technological backwardness. Obsolete techniques of production are largely being applied in both the agricultural and industrial sectors of our country.

Sophisticated modern technology is being applied in productive units at a very limited scale as it is very much expensive. Moreover, it is very much difficult to adopt modern technology in Indian productive system with its untrained, illiterate and unskilled labour.

Thus due to the application of poor technology and lower skills, the productivity- in both the agricultural and industrial sectors of our country is very low. This has resulted in inefficient and insufficient production leading towards general poverty in our economy.

8. Under-utilisation of natural resources: In respect of natural endowments India is considered as a very rich country. Various types of natural resources, viz., land, water, minerals, forest and power resources are available in sufficient quantity in the various parts of the country.

But due to its various inherent problems like inaccessible region, primitive techniques, shortage of capital and small extent of the market such huge resources remained largely under-utilised. A huge quantity of mineral and forest resources of India still remains largely unexplored. Until recently, India was not in position to develop even 5 per cent of total hydropower potential of the country.

9. Lack of infrastructure: Lack of infrastructural facilities is one of the serious problems from which the Indian economy has been suffering till today. These infrastructural facilities include transportation and communication facilities, electricity generation and distribution, banking and credit facilities, economic organisation, health and educational institutes etc.

The two most vital sectors, i.e. agriculture and industry could not make much headway in the absence of proper infrastructural facilities in the country. Moreover, due to the absence of proper infrastructural facilities, development potential of different regions of the country largely remains under-utilized.

10. Low level of living: The standard of living of Indian people in general is considered as very low. Nearly 25 to 40 per cent of the population in India suffers from malnutrition. The average protein content in the Indian diet is about 49 grams only per day in comparison to that of more than double the level in the developed countries of the world. The present calorie level in India is just above the minimum caloric level required for sustaining life which is estimated at 2100 calories.

Moreover, a small percentage of Indian populations have access to safe drinking water and proper housing facilities.

11. Poor quality of human capital: Indian economy is suffering from its poor quality of human capital. Mass illiteracy is the root of this problem and illiteracy at the same time is retarding the process of economic growth of our country. As per 2011 census, 74.04 per cent of the total population of India is literate and the rest 25.96 per cent still remains illiterate.

In most of the developed countries like U.S.A., U.K., Canada, Australia etc. the level of illiteracy is even below 3 per cent. Moreover, the problem of illiteracy in India makes way for conservatism and this is going against the economy of the country.

12. Demographic characteristics: The demographic characteristics of India are not at all satisfactory rather these are associated with high density of population, a smaller proportion of the population in working age group of 15-60 years and a comparatively larger proportion of population in the minor age group of 0-15 years, As per 2011 census, the density of population in India was 382 per sq km. as compared with world density of population of 41 per sq km.

Even in China, the density is nearly 123 per sq km. Again, as per 2001 census, 35.6 per cent of the total population is in the age group of 0-14 years, 58.2 per cent is in the working age group of 15-60 years and about 6.3 per cent in the age group of 60 and above. All these shows that the dependency burden of our population is very high.

Moreover, lower income level, low level of living including absence of balanced diet and proper housing and medical facilities are responsible for low life expectancy of 63.9 years in India in comparison to that of 75 years in most of the developed countries of the world and high rate of infant mortality in India, i.e., about 53 per 1000 children as against only 5 to 7 per 1000 in developed countries,

13. Inadequate development of economic organization: Poor economic organization is another important characteristic of the Indian economy. For attaining economic development at a satisfactory rate certain institutions are very much essential. In India the development of financial institutions is still inadequate in the rural areas. There is the urgent need to develop certain credit agencies for advancing loan to small farmers on easy terms as well as to provide long term and medium term loan to industries.

For protecting poor tenants from the clutches of landlords, proper enforcement of tenancy legislation is very much necessary. All these require maintenance of honest and efficient administrative machinery which India is lacking very much.

Thus from the foregoing analysis it has been revealed that the Indian economy largely remains underdeveloped as the economy still exhibits the basic features of an underdeveloped economy. But considering its developmental strategy followed during last six decades of its planning and the progress attained in certain areas thereupon, Indian economy can be safely considered as a developing economy.

CONCEPT OF LPG

The economy of India had undergone significant policy shifts in the beginning of the 1990s. This new model of economic reforms is commonly known as the LPG or Liberalisation, Privatisation and Globalisation model. The primary objective of this model was to make the economy of India the fastest developing economy in the globe with capabilities that help it match up with the biggest economies of the world.

Liberalisation : Liberalisation refers to the slackening of government regulations. The economic liberalisation in India denotes the continuing financial reforms which began since July 24, 1991.

Objectives of Liberalization Policy

- To increase competition amongst domestic industries.
- To encourage foreign trade with other countries with regulated imports and exports.
- Enhancement of foreign capital and technology.
- To expand global market frontiers of the country.
- To diminish the debt burden of the country.

Privatisation: Privatization refers to the participation of private entities in businesses and services and transfer of ownership from the public sector (or government) to the private sector as well.

Forms of Privatization

- ***Denationalization or Strategic Sale***: When 100% government ownership of productive assets is transferred to the private sector players, the act is called denationalization.
- ***Partial Privatization or Partial Sale***: When private sector owns more than 50% but less than 100% ownership in a previously construed public sector company by transfer of shares, it is called partial privatization. Here the private sector owns the majority of shares. Consequently, the private sector possesses substantial control in the functioning and autonomy of the company.
- ***Deficit Privatization or Token Privatization:*** When the government disinvests its share capital to an extent of 5-10% to meet the deficit in the budget is termed as deficit privatization.

Objectives of Privatization

- Improve the financial situation of the government.
- Reduce the workload of public sector companies.
- Raise funds from disinvestment.
- Increase the efficiency of government organizations.
- Provide better and improved goods and services to the consumer.
- Create healthy competition in the society.
- Encouraging foreign direct investments (FDI) in India.

Globalisation: Globalisation stands for the consolidation of the various economies of the world.

Benefits of Liberalisation and Globalisation on Indian Economy

1. **Shift from Import-Substitution to Export-Led Growth Strategy:** The failure of import substitution strategy of industrial growth to achieve sustained growth forced India and other developing countries to pursue export-led growth strategy (which is also called outward looking strategy of development). It has been argued that by expanding exports to the other countries and getting required imports from them based on their respective comparative costs, developing countries will be able to achieve faster rate of economic growth. An important argument for trade liberalisation from the viewpoint of the developing countries is that they will gain from it as they have a comparative advantage in abundant, low-cost unskilled labor. If they specialise in the production of those goods which are labor-intensive, greater integration into global markets would increase their exports and production. This will help in generating more employment opportunities for the poor. The strategy of development focused on export promotion requires that other countries, especially developed countries should not prevent the imports to their countries through imposition of tariffs and non-tariff barriers. This is possible in the framework of a global economy with free movements of trade, capital and technology among countries. The setting up of WTO on Jan 1, 1995 was a step towards that direction. Accordingly, the entry of India in WTO in 1995 was a step to further globalize its economy.

2 **Foreign Capital Inflows:** The globalisation or integration of the Indian economy with the world economy is also beneficial because it would give a boost to foreign capital inflows in the form of portfolio investment and foreign direct investment (FDI). Portfolio investment will bring valuable foreign exchange currencies in India and free us of balance of payments difficulties. With sufficient foreign exchange reserves, balance of payments constraint on accelerating the growth process will be removed.

In the eighties due to shrinkage of foreign assistance, India had to resort to external commercial borrowings (ECB) which carried relatively higher rates of interest and increased the burden of external public debt. It may be noted that small foreign exchange reserves led to the economic crisis of 1991. The role of foreign direct investment is more important than portfolio foreign investment as it raises the rate of real investment in the economy and helps us to achieve a faster rate of economic growth. Foreign direct investment (FDI), like domestic investment, has a multiplier effect on output and employment.

3 **Globalisation and Transfer of Technology:** Another benefit flowing from globalisation of the Indian economy is that it acts as a mechanism for the transfer of technology from the developed countries. Due to financial constraints, Indian companies are in a position to invest only a small amount of funds on R & D. Therefore, it is through globalisation of its economy that we will be able to get advanced technology from the developed countries.

The technological up-gradation of the Indian industries will lead to higher productivity and help us to achieve a higher rate of industrial growth. It is worth noting that it is the multinational corporations (MNCs) that are carriers of technology to the developing countries through technological and financial collaboration with domestic enterprises. Globalisation makes faster diffusion of new ideas and advanced technologies in the world. This will make possible for the developing countries like India to catch up the developed countries more quickly.

4. Increased Market Access: An important benefit of globalisation is increased market access. Long ago Adam Smith wrote in 1776 that division of labor is limited by the size of market. Free trade accompanying globalisation widens the markets for products of industries. The larger the market in which products can be sold, the greater the benefit that will accrue as a result of economies of scale and specialisation. This will lower unit cost of production and increase the competitiveness of manufactured products. Thus globalisation will ensure greater gain from trade. In addition, the wider market increases the incentives for investing in new innovations as the potential return on investment in them will increase.

5. Faster Economic Growth and Poverty Reduction: Above all, it has been argued by some prominent economists such as Jagdish Bhagwati, T.N. Srinivasan, Arvind Panagariya, that globalisation will help in faster rate of reduction in poverty through acceleration of economic growth. To quote professor Arvind Panagariya, “Countries that have achieved significant poverty reduction are generally those that have grown rapidly and have, in turn, been open to trade. The most obvious example are the Newly Industrialized Economies (NIEs) including Hong Kong, Singapore, Republic of Korea and Taiwan that have entirely eliminated poverty according to the dollar-a-day poverty line. On the other hand, countries such as India that remained autarkic and grew at less than 1.5% in per capita terms until late seventies experienced little reduction in the trend poverty ratio. Both India and China achieved poverty reduction after they began to dismantle autarkic policies and began to grow rapidly”.

6. **Increase in employment opportunities**: As globalization increases, more and more companies are setting up businesses in other countries. This in turn increases the employment opportunities that people atone place have. People can get better jobs without having to move to other countries in search of better jobs. Today, many multinational companies such as Microsoft, Google and Toyota, facebook etc. have their offices in India and many Indians work for these companies in India. Without globalization, Indian people would not have had the opportunity to work for such companies in India.

7. **Education**: With the increase in globalization, it has become easier for people to move across borders to different parts of the world to acquire better education. This has resulted in an integration of cultures. People from underdeveloped and developing countries often move to developed countries to get better education. More and more Indian students are traveling to countries like the UK or the USA to pursue higher education. This has also opened their cultures towards the Indian culture to some extent.

8· **Increase in free trade**: An increase in free trade has opened doors for investors in developed countries to invest their money in developing countries. Big companies from developed countries have the freedom to operate in developing countries. In the 2000s, Japanese and European companies such as Kawasaki and Siemens started producing high-speed trains in China. This helped Chinese firms in gaining knowledge about the production process and now Chinese companies such as China South Locomotive & Rolling Stock Corp. are producing high-speed trains on their own.

9. **Faster flow of Information**: Information flows from one part of the world to the other immediately, resulting in the world being tied together. Vital information can be shared between individuals and corporations at a very fast rate. It has also facilitated in increasing the ease of transporting people and goods.

10. **Increase in quality of goods and services**: As a result of globalization, people have access to the best quality of goods and services throughout the world. Companies have to strive to provide better quality goods and services to the consumer and the consumer has the liberty of choosing whichever product he thinks is best suited for his needs. This allows a person in America to wear clothes made in India and Mexico while watching a football match taking place in England on a TV made in China.

11. **Decrease in prices of goods and services**: As the competition in the market has increased due to rapid globalization, producers have to price their products competitively in order to remain in the market. This has become a boon for the consumer as he can get better quality products at cheaper prices. An example is that of the car Ambassador in India. It was the only car available in India along with the Fiat before the liberalization of the Indian Economy. These cars were inefficient and expensive. Once the Indian economy was opened, other car companies started selling their cars in India at cheaper prices. This was a major benefit for the Indian consumer.

12. **Reduction in cultural barriers**: As people move from one country to another, barriers between various cultures tend to decrease.This has resulted in tolerance and openness towards other cultures. This has also facilitated communication between different cultures and hence, nations. It has also led to a reduction in wars as we are today living in one of the most peaceful periods in the history of mankind.

NATIONAL INCOME

Meaning of National Income: National Income is the total value of all final goods and services produced in a financial year in a nation.

Methods to Measure National Income

Production generate incomes which are again spent on goods and services produced. Therefore, national income can be measured by three methods:

1. Output or Production method

2. Income method, and

3. Expenditure method.

Let us discuss these methods in detail.

1. Output or Production Method: This method is also called the value-added method. This method approaches national income from the output side. Under this method, the economy is divided into different sectors such as agriculture, fishing, mining, construction, manufacturing, trade and commerce, transport, communication and other services. Then, the gross product is found out by adding up the net values of all the production that has taken place in these sectors during a given year.

In order to arrive at the net value of production of a given industry, intermediate goods purchase by the producers of this industry is deducted from the gross value of production of that industry. The aggregate or net values of production of all the industry and sectors of the economy plus the net factor income from abroad will give us the GNP. If we deduct depreciation from the GNP we get NNP at market price. NNP at market price – indirect taxes + subsidies will give us NNP at factor cost or National Income.

The output method can be used where there exists a census of production for the year. The advantage of this method is that it reveals the contributions and relative importance and of the different sectors of the economy.

2. Income Method: This method approaches national income from the distribution side. According to this method, national income is obtained by summing up of the incomes of all individuals in the country. Thus, national income is calculated by adding up the rent of land, wages and salaries of employees, interest on capital, profits of entrepreneurs and income of self-employed people.

This method of estimating national income has the great advantage of indicating the distribution of national income among different income groups such as landlords, capitalists, workers, etc.

3. Expenditure Method: This method arrives at national income by adding up all the expenditure made on goods and services during a year. Thus, the national income is found by adding up the following types of expenditure by households, private business enterprises and the government: -

(a) Expenditure on consumer goods and services by individuals and households denoted by C. This is called personal consumption expenditure denoted by C.

(b) Expenditure by private business enterprises on capital goods and on making additions to inventories or stocks in a year. This is called gross domestic private investment denoted by I.

(c) Government's expenditure on goods and services i.e. government purchases denoted by G.

(d) Expenditure made by foreigners on goods and services of the national economy over and above what this economy spends on the output of the foreign countries i.e. exports – imports denoted by

(X – M). Thus,

GDP = C + I + G + (X – M).

Various concepts of national income

1. Gross Domestic Product (GDP)

2. Gross National Product (GNP)

3. Net National Product (NNP) at Market Prices

4. Net National Product (NNP) at Factor Cost or National Income

5. Personal Income

6. Disposable Income

Let us explain these concepts of National Income in detail.

1. Gross Domestic Product (GDP): Gross Domestic Product (GDP) is the total market value of all final goods and services currently produced within the domestic territory of a country in a year.

Four things must be noted regarding this definition.

First, it measures the market value of annual output of goods and services currently produced. This implies that GDP is a monetary measure.

Secondly, for calculating GDP accurately, all goods and services produced in any given year must be counted only once so as to avoid double counting. So, GDP should include the value of only final goods and services and ignores the transactions involving intermediate goods.

Thirdly, GDP includes only currently produced goods and services in a year. Market transactions involving goods produced in the previous periods such as old houses, old cars, factories built earlier are not included in GDP of the current year.

Lastly, GDP refers to the value of goods and services produced within the domestic territory of a country by nationals or non-nationals.

2. Gross National Product (GNP): Gross National Product is the total market value of all final goods and services produced in a year. GNP includes net factor income from abroad whereas GDP does not. Therefore,

GNP = GDP + Net factor income from abroad.

Net factor income from abroad = factor income received by Indian nationals from abroad – factor income paid to foreign nationals working in India.

3. Net National Product (NNP) at Market Price: NNP is the market value of all final goods and services after providing for depreciation. That is, when charges for depreciation are deducted from the GNP we get NNP at market price. Therefore'

NNP = GNP – Depreciation

Depreciation is the consumption of fixed capital or fall in the value of fixed capital due to wear and tear.

4.Net National Product (NNP) at Factor Cost (National Income)**:** NNP at factor cost or National Income is the sum of wages, rent, interest and profits paid to factors for their contribution to the production of goods and services in a year. It may be noted that:

NNP at Factor Cost = NNP at Market Price – Indirect Taxes + Subsidies.

5. Personal Income: Personal income is the sum of all incomes actually received by all individuals or households during a given year. In National Income there are some income, which is earned but not actually received by households such as Social Security contributions, corporate income taxes and undistributed profits. On the other hand there are income (transfer payment), which is received but not currently earned such as old age pensions, unemployment doles, relief payments, etc. Thus, in moving from national income to personal income we must subtract the incomes earned but not received and add incomes received but not currently earned. Therefore,

Personal Income = National Income – Social Security contributions – corporate income taxes – undistributed corporate profits + transfer payments.

Disposable Income: From personal income if we deduct personal taxes like income taxes, personal property taxes etc. what remains is called disposable income. Thus,

Disposable Income = Personal income – personal taxes.

Disposable Income can either be consumed or saved. Therefore,

Disposable Income = consumption + saving.

Difficulties in Measuring National Income in developing Countries or in India.

In under-developed countries like India, we face some special difficulties in estimating national income. Some of these difficulties are:

1. Lack of Reliable Statistics: In under-developed countries there is a general lack of adequate statistical data. Inadequacy, non-availability and unreliability of statistics are a great handicap in measuring national income in these countries.

2. Difficulty to measure the output of non-monetized sector and subsistence sector: The difficulty also arises because of the prevalence of non-monetized transactions in such countries so that a considerable part of the output does not come into the market at all because a major portion of population is involved in barter system in villages. Agriculture still being in the nature of subsistence farming in these countries, a major part of output is consumed at the farm itself.

3. Lack of accounting habits: Because of illiteracy, most producers have no idea of the quantity and value of their output and do not keep regular accounts. This makes the task of getting reliable information very difficult.

4. Because of under-development, occupational specialization is still incomplete, so that there is lack of differentiation in economic functioning. An individual may receive income partly from farm ownership, partly from manual work in industry in the slack season, etc. This makes the task of estimating national income very difficult.

5. Unorganized Sector: Another difficulty in measuring national income in under-developed countries arises because production, both agriculture and industrial, is unorganized and scattered in these countries. In India, agriculture, household craft, and indigenous banking are the unorganized and scattered sectors. An assessment of output produced by self-employed agriculturist, small producers and owners of household enterprises in the unorganized sectors requires an element of guesswork, which makes the figure of national income unreliable.

6. Black Money: In developing countries, people also involve in illegal practices and money earned through these practices is black money which is unaccounted. Because of black money to measure national income becomes a tough task.

7. Regional Disparities: India is a sub-continent with large geographical and economic diversities. Information based on samples taken from certain districts in a particular state may or may not be valid for the whole state or the region to which these districts belong. If the required information is to be obtained through sample surveys, special care would be needed in using this technique.

INFLATION

Meaning of Inflation: Inflation is a situation where the aggregate demand of goods and services exceeds the available supply and due to this there is an increase in the price level and decrease in the value of money.

Famous economist Friedman said that Inflation is always and everywhere a monetary phenomenon and it increases due to rapid increase in the quantity of money than output.

Inflation just means a sustained or continuous increase in the general price level or a sustained or continuous fall in the value of money.

TYPES OF INFLATION-

Demand-pull Inflation

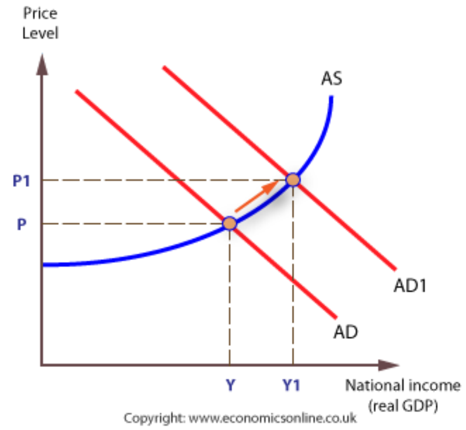
When demand of product and services exceeds the supply of the product in the economy it is known as wage or demand-pull inflation. This scarcity of goods and services pushes the general price level upward. This trend follow the common law of demand as demand increases so the prices level and situation prevail until supply adjust accordingly. In the time of emergencies like during or after wartime the affect is more severe.

Cost-push Inflation /Wage push Inflation

When the cost of production increase it has a direct affect of price incremental shift to end user, this increase in price level is called cost-push inflation. For example if the there is a rise in labor wages it will increase the unit cost and price of that product will increase. Once this price upward movement trend set forth it affects whole economy and inflation level rise. Due to increase the price raw material, cost of production can increase and resulting in Cost-push inflation.

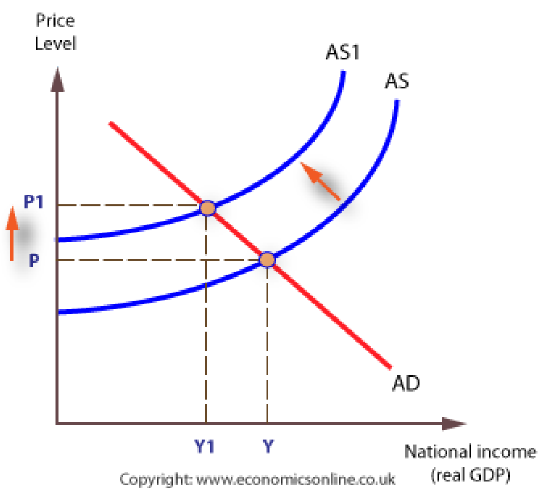
CAUSES FOR INFLATION

ON THE DEMAND SIDE: Demand side causes explain those factors which are responsible of higher demand and responsible of disturbing the equilibrium point.



1. **Increase in money supply:** Sometimes government issues new currency which comes in the market in unproductive manner and cause of higher demand while supply is not in that order which generates inequilibrium in demand and supply and result is in inflation.
2. **Increase in disposable income:** If government reduces direct taxes, it will increase disposable income which increases the demand and resulting in inflation.
3. **Increase in public expenditure:** In developing countries when development process is started, huge amount is spent on infrastructure. But these projects have long gestation period which give output after a long period. But the people involved in those projects get salaries and wages Thus they have purchasing g power and demand for goods and services but production does not increase at same rate that results inflation
4. **Increase in consumer spending:** When people start to spend large portion of their income on consumable items and save less, it increases demand for products and service that causes inflation.
5. **Cheap monetary policy:** If government makes it credit policies cheaper, it becomes easy to avail goods through credit this is why they demand for more goods and services which increase the price of goods and services.
6. **Deficit financing:** When government expenditures are higher than its income, to bridge this gap government has to issue new currency which decreases the value of money and results inflation.
7. **Black money:** because of black money, demand for goods also increases which results in high prices.

ON THE SUPPLY SIDE: Supply side causes explain those factors which are responsible of lower supply and responsible of disturbing the equilibrium point.



1. **Shortage of factors of production**: Because of shortage of production factors, production rate falls and supply of products also decreases which increases the price level.
2. **Artificial scarcity**: Sometimes producers want to earn extra profit this is why they show scarcity of products in the market which results in high price.
3. **Increase in exports**: if a product can be sold at higher price in foreign market, to earn high profits, producers export that product in foreign market which lowers the supply of that product in domestic market and results inflation.

4. **Industrial dispute**: Because of strike, lockouts and other disputes between management and employees, production process is shut down which decreases the supply of products and result in high prices.
5. **Natural calamities**: because of unfavourable monsoon, drought, earthquake, production system is interrupted and supply of products decreases which results in high prices.
6. **Reduced production**: if production level or scale is reduced, it will lower the supply and resulting inflation.
7. **International factors**: because of international instability or unfair political relations with other countries, supply of products is interrupted which increases the price of those products which are imported from other countries and results inflation.

MEASURES TO CONTROL INFLATION-

MONETARY MEASURES

1. Credit control
2. Demonetization of currency
3. Issue of new currency

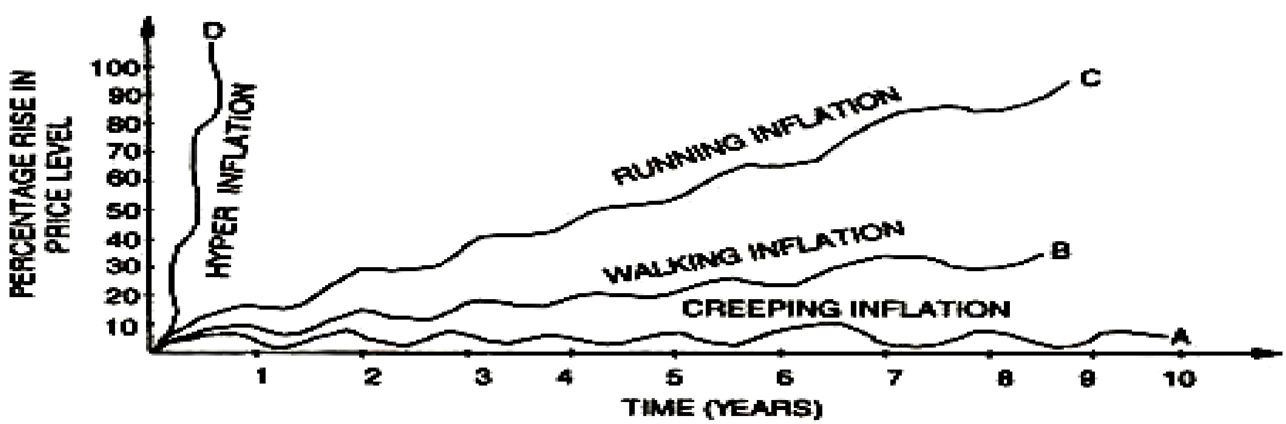
FISCAL MEASURES

1. Controlling unnecessary expenditure
2. Increase in taxes
3. Increase in savings
4. Surplus budget
5. Public debt

OTHER MEASURES

1. Increase in production
2. Rational wage policy
3. Price control
4. Rationing

Types of Inflation



BUSINESS CYCLE & ITS VARIOUS PHASES

Business cycle: The term **business cycle** (or **economic cycle**) refers to economy-wide fluctuations in production or economic activity over several months or years. These fluctuations occur around a long-term growth trend, and typically involve shifts over time between periods of relatively rapid economic growth (an expansion or boom), and periods of relative stagnation or decline (a contraction or recession)

1. Prosperity: when there is an expansion of output, income, prices and profits, there is also a rise in the standard of living. This period is termed as Prosperity Phase.

The features of prosperity are:

1. High level of output and trade
2. High level of effective demand
3. High level of income and employment
4. Rising interest rates
5. Inflation
6. Large expansion of bank credit
7. Overall business optimism
8. High level of Marginal Efficiency Of Capital and Investment

Due to full employment of resources, the level of production is Maximum and there is a rise in **GNP** (Gross National Product). Due to a high level of economic activity, it causes a rise in prices and profits. There is an upswing in the economic activity and economy reaches its **Peak**. This is also called as a **Boom Period.**

2. Recession Phase

The turning point from prosperity to depression is termed as Recession Phase. During the recession period, the economic activities slow down. When demand starts falling, the overproduction and future investment plans are also given up. There is a steady decline in the output, income, employment, prices and profits. The businessmen lose confidence and become pessimistic (Negative). It reduces investment. The banks and the people try to get greater liquidity, so credit also contracts. Expansion of business stops, stock market falls. Orders are cancelled and people start losing their jobs. The increase in unemployment causes a sharp decline in income and aggregate demand. Generally, recession lasts for a short period.

3. Depression Phase

When there is a continuous decrease of output, income, employment, prices and profits, there is a fall in the standard of living and depression sets in.

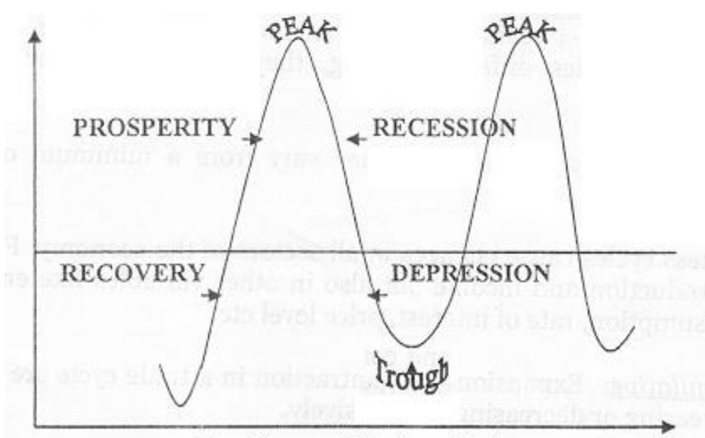
The features are:

1. Fall in volume of output and trade
2. Fall in income and rise in unemployment
3. Fall in interest rate
4. Deflation
5. Contraction of bank credit
6. Overall business pessimism
7. Fall in MEC (Marginal efficiency of capital) and investment

In depression, there is under-utilization of resources and fall in GNP (Gross National Product. The aggregate economic activity is at the lowest, causing a decline in prices and profits until the economy reaches its **Trough** low point.

4. <u>Recovery Phase</u>

The turning point from depression to expansion is termed as Recovery or **Revival** Phase. During the period of revival or recovery, there are expansions and rise in economic activities. When demand starts rising, production increases and this causes an increase in investment. There is a steady rise in output, income, employment, prices and profits. The businessmen gain confidence and become optimistic (Positive). This increases investments. The stimulation of investment brings about the revival or recovery of the economy. The banks expand credit, business expansion takes place and stock markets are activated. There is an increase in employment, production, income and aggregate demand, prices and profits start rising, and business expands. Revival slowly emerges into prosperity, and the business cycle is repeated. Thus, we see that during the expansionary or prosperity phase, ther is inflation and during the contraction or depression phase, there is a deflation.



Four Phases of Business Cycle