CHAPTER

1

INTRODUCTION

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*Economics is the study of how goods and services are produced, distributed and consumed. As resources are always in short supply, the British economist Lionel Robbins in 1935 described the discipline as 'the science of scarcity'.**

* *See David Orrel and Borin Van Loon,* ***Introducing Economics: A Graphic Guide****, Faber & Faber, London, 2011, p. 3*

ECONOMICS—THE DISCIPLINE

The study of every discipline starts with the process of defining it. Economics is no exception to this. But the challenge of articulating an over-arching definition of any discipline has never been an easy task, and at the end one has to be satisfied with a partial definition. Different economists have seen the discipline with differing perspectives and have been coming up with differing definitions—at times a large number of such definitions became either narrow or incomprehensible. But it is quite necessary to come out with a working definition of the subject one intends to study.

Before coming out with our own working definition of the subject, we may cite here two highly acclaimed and internationally established attempts in this direction:

1. Economics is the study of how societies use scarce resources to produce valuable commodities and distribute them among different people.[1]

As per the definition there are two key ideas in economics—that goods are scarce and that society must use its resources efficiently. Indeed, economics is an important subject because of the fact of scarcity and the desire for efficiency.

Over the last half-century, the study of economics has included such varied topics that the subject serves different purposes to different students of economics. Some study it to make money (basically, most of its students in the developed world do study economics to enrich themselves. But the same is not correct in the case of the developing world. The truth is that in the developing world economics has only been read and taught, not applied—if we do a sweeping generalisation). Others study economics to know about poverty, unemployment, human development, shares and debentures, banking norms, prices and their movements, e-commerce, etc. Still others might be studying the discipline to enhance their knowledge of economics.

2. Economics studies how individuals, firms, government, and other organisations within our society make choices and how these choices determine society's use of its resources.[2]

Human life depends on consumption of various materials which are made up of the resources available on earth. As there is no limit to human wants, we need infinite resources to gratify our needs and wants. But the resources are limited! Now it is upto the individual and humanity at large as to how they try to satisfy their competing needs to get fulfilled by the limited resources. It means we need to make some choices before we utilise the scarce resources by prioritising some of our needs. In this process, some needs might never get fulfilled. At the same time, there might be some needs which may be fulfilled again and again with the available resources.

Economics is the discipline which studies how individual, society and the government make their prioritised choices in the process of using the scarce resources to gratify the various needs and wants of life. Making such choices is an art as well as a science. As time changes the choices change. As space changes human needs change and so modify the choices. After studying and surveying the various choices made by humanity at large in differing time and space, there developed the discipline of economics. As economics is an exercise in the *space-time continuum* and it deals with living human beings it is a very dynamic subject and should only be read in this perspective to have the real feel.

1. Samuelson, P.A and Nordhaus, W.D., ***Economics***, Tata McGraw-Hill Pub. Company Ltd., N. Delhi, 2005, p.4.
2. Stiglitz, J.E and Walsh, C.E., ***Economics,*** W.W. Norton & Company, New York, 2006, p.6.

A Working Definition

It is essential to feel the subject one intends to study. The fundamental way of doing this is starting with the definition of the subject. But the definition, at times or better say most of the times, becomes very abstract, jargon-laden and technical. Such a definition might not give a proper feel and understanding of the subject to a person who does not belong to economics. Most of the students of economics face difficulty in making out a complete meaning of the definition. That is why a very *general* and *layman's* definition is needed.

Human beings in their day-to-day lives are busy doing so many things. There are different activities we are involved in throughout our lives. These activities fall under different categories.

Economics studies the economic activities of mankind. Similarly, political, social and administrative activities of mankind are studied by Political Science, Sociology and Public Administration, respectively. That is why these disciplines are broadly categorised as **humanities** as all of them study human activities. There are many more specialised human activities which are studied under many more disciplines.

Which activities of mankind are ***economic activities?*** The activities which involve profit, loss, livelihood, occupation, wage, employment, etc., are economic activities. Economics studies all these activities. Today, economics has many branches and studies highly diverse subject matters, right at the global, macro and micro levels.

Why some people go for fuel-efficient cars while others go for fuel-guzzling sports cars? Why the poor are poor? Is capitalism doomed to intensify economic inequality? Will the process of globalisation be able to bridge the poor–rich divide and have a universal homogenising impact on the world? Such varied and many more questions fall under the domain of economics. These days we also can see information technology giving a typically new dimension to economics.

Economics and The Economy

The relation between economics and the economy, simply saying, is that of theory and practice. While the former is a discipline studying economic behaviour of human beings, the latter is a still-frame picture of it. Economics will come out with theories of market, employment, etc., and an economy is the real picture of the things which emerge after the application to the same theories in certain areas.

Economy is economics at play in a certain region. This region is best defined today as a country, a nation—the Indian Economy, the Russian Economy, the French Economy, etc. Economy as such means nothing. It gets meaning once it is preceded by the name of a country, a region, a block, etc. When we say developed economies, we mean economies of developed countries.

Countries of the world might be facing some common economic challenges. At the same time, they might be facing some highly specific challenges. Economists, during the period of evolution of economics, have suggested some fixed number of theories and methods of solving those economic challenges. Now it depends upon the choice of the countries as to which set of principles and theories they select for solving their economic challenges. Further, many countries selecting same remedy and tools to fight the same problems might have similar or dissimilar results during a given period. At the same time, two economies selecting different tools to solve the same economic problems might experience the same results or completely different results. Why is this so?

Basically, economic theories are expectations of human behaviour about their economic activities and as human behaviour depends greatly on many internal and external factors, the results are likely to show diversities. The level and quality of natural resources, the quantity and quality of human resources, the socio-political milieu, the historical background, the psychic make of the human resource, etc., are some of the factors which individually as well as collectively impact an economy while carrying out economic activities. These things make it highly difficult for economists to say and forecast the kind of impact a particular economic policy will have on a particular economic setting. Ultimately, implementation and delivery systems, also play a highly vital role in solving economic challenges in a country, which economists started studying after the 1960s. Therefore, it is correct to say that economics has less diversity than the economies. There will not be any exaggeration if we say that no two economies of the world are exactly the same, though we might classify them into broader terms like developed and developing, agrarian and industrial, etc.

This diversity makes economics a highly interesting discipline. And via the diverse faces of the economies, the economists have been able to modify and remodify their ideas on the subject of economics. The evolutionary history of economics is nothing but modifications in the past theories on the basis of contemporary results and experiences of the economies. It is right to say that economics has developed out of real life practices and especially from practice to theory. As practices will be having newer dimensions, the theories of economics will also have newer and more imaginative dimensions.

FOCUS OF ECONOMICS

What is the real purpose of studying economics? What ultimately economists have been trying to articulate? And what has been the focus of economics and the economists since the birth of the discipline?

Though economics today studies a wide range of issues and topics, if we take an overall picture, its essence has been very simple—the betterment of human life on earth. Improving living conditions of the humanity at large has been the real and the ultimate goal of the discipline. In this process, economists have been articulating a number of theories and propositions as to how an economy may maximise its economic potential and worth. The first and the most famous work in this direction was by the Scottish philosopher-economist, Adam Smith in *The Wealth of Nations* (1776). We trace the origin of the classical school to this work. Similarly, in the following years and centuries many masterpieces were produced by a great many economists who were trying to improvise better ways of maximising the fruits of economic activities. Economics and the economists have common goals, searching for possible alternatives for the betterment of human life.

CHALLENGE OF THE ECONOMIES

The main challenge of any economy is to fulfil the needs of its population. Every population needs to be supplied with some **goods** and **services** for its survival and well-being. These goods might include basic needs such as food, shelter, garments, etc., while it might also consist of refrigerators, air conditioners, cars, medicines, computers, etc. Similarly, the services people need may range from healthcare, drinking water supply, education to advanced and highly sophisticated services like banking, insurance, airways, telephones, internet, etc. As an economy moves on the ladder of development, the process of fulfilling the needs of the population becomes a never-ending phenomenon. As an economy achieves success in supplying one set of goods and services to its population, the population starts demanding another set of goods and services which are of a higher order. And thus goes on the struggle of the economy—solving one challenge and focusing on another. Standard of living of one set of population varies from another depending upon the attempts and the successes of the concerned economies as to which comparative extent they have been able to fulfil the needs of their population.

There are two aspects of this challenge. First, the availability of the goods and services required by the population and second, the presence of the supply network. Every economy has to, at first, guarantee the required level of goods and services out of its production process. For this, proper level of production capacity should be built which requires a particular level of capital formation or investment. From where the investible funds will be managed is altogether a separate question. Whether the investment will come from the government, the domestic private sector or the foreigners? Once these details are cleared and selected as per the socio-economic condition of the economy, a proper distribution network for goods and services produced is assured.

Distribution Network Models

In the arena of ***distribution network***, we have three historically existing models—**state**, **market** and **state–market mix**. In the first type of distribution system, the state (i.e., the government) takes the sole responsibility of supplying goods and services required by the population with no payments being done by the consumer—the former Soviet Union and Communist China being the best examples. In the second category comes the market mode of distribution which functions on the basis of price mechanism. In this system, goods and services are made available in the market and on the basis of their demand and supply, their prices are determined in the open market and finally they get distributed to the population. This was the distribution system of the capitalist economies—the whole of Euro-America till the 1930s. The third and the most prevalent mode of distribution, the state-market mix, developed out of the experiences of the former two systems. This distribution system has certain goods and services which might be made available to the population freely or at the subsidised prices by the state and some might be supplied by the market for which consumers need to pay. Almost all economies of the world today follow one or the other kinds of distribution system. As the socio-economic composition of the population of an economy changes the mixture of the goods and services to be supplied by the state and the market get redefined in the economies from time to time.

ORGANISING AN ECONOMY

Any one issue which has affected civilised history of mankind the most and has been a contentious issue is the way the production process in an economy should be organised. Whether the production should be the sole responsibility of the state/government or should it be left altogether to the private sector? Again, will it be better to carry on production with a joint effort—a mixture of state and private enterprises?

Depending upon the dominant view of the time in a particular country, different forms of production patterns evolved and different economic systems finally came up, providing alternative ways of organising an economy. The three models of economic systems which we see coming up are basically the different stages in the evolutionary process of our experiments which define a better way of organising our economy. We must have a concise overview of this evolutionary process:

1. Capitalistic Economy

The capitalistic form of economy has its origin in the famous work of Adam Smith—*Wealth* *of Nations* (1776). Adam Smith (1723–1790), the Scottish philosopher-economist professor at University of Glasgow whose writings formed the basis of classical economics had stressed certain fine ideas which were to take fancy among some of the western countries and finally capitalism took birth. He raised his voice against the heavy-handed government regulation of commerce and industry of the time which did not allow the economy to tap its full economic worth and reach the level of well-being. Stressing 'division of labour', an environment of 'laissez faire' (non-interference by the government), he proposed that the 'invisible hand' of 'market forces' (price mechanism) will bring a state of equilibrium in the economy and a general well-being to the countrymen. For such an economy to function for public well-being, he has acknowledged the need of *competition* in the *market*.

Once the USA attained Independence the ideas of Adam Smith were made part of its public policy—just one year after *Wealth of Nations* was published. From here the idea spread to other parts of Euro-America—by 1800 the economic system called 'capitalism' was established which was later known by different names—Private Enterprise System, Free Enterprise System, Market Economy.

The decisions of what to produce, how much to produce and at what price to sell are taken by the market, by the private enterprises in this system, with the state having no economic role.

2. State Economy

Rooted in the ideas of historical change proposed by the German philosopher Karl Marx (1818–1883) more specifically, this kind of economic system first came up in the erstwhile USSR after the Bolshevik Revolution (1917) and got its ideal shape in the People's Republic of China (1949). This form of economic system also spread to other countries in Eastern Europe. Here we see two versions of the state economy—in erstwhile USSR known as the *socialist economy* and in pre-1985 China as the *communist economy*. While socialistic economy emphasised the collective ownership of the means of production (property and assets) and it also ascribed a large role to the state in running the economy, communist economy advocated state ownership of all properties including labour and absolute power to state in running the economy. Though for Marx, Socialism was a transitional stage to communism, it never did happen in reality.

Basically, this form of economy came in reaction to the prevalent popular economic system of capitalism and proposed just the opposite. The decisions related to production, supply and prices were all suggested to be taken by the state only. Such economies were also known as Centralised Economy, Centrally Planned Economy, Non-market Economy.

The socialist and communist economies used to criticise capitalistic economics of being based on exploitation. In response, the capitalist economies called them the practioners of 'state capitalism', where the states were the sole exploitators. The communist and anti-communist propagandas resulted in serious intellectual discussions almost upto the mid-1980s.

3. Mixed Economy

The belief in the self-correcting quality of the market and the 'invisible hand' of Adam Smith got a major setback in early 20th century during the Great Depression (1929). The impact of the depression spread from the USA to other economies of Western Europe escalating large scale unemployment, downfall in demand and economic activities and lockouts in industrial enterprises. The prevailing Smithonian macro ideas failed to check the crisis. A new approach was needed which came in the famous work, *The General Theory of Employment, Interest and Money*

(1936) by the English economist at Cambridge University, John Maynard Keynes (1883–1946).

Keynes questioned the very principles of 'laissez-faire' and the nature of the 'invisible hand'. He even opined that the invisible hand brings equilibirium to the economy but by 'strangulating the poor'. He suggested that prices and wages are not flexible enough to provide employment to all. It means there will be some people unemployed when the economy will be at its full potential. Ultimately, a fall in demand will be imminent resulting in recession and if unchecked, in depression which happened in 1929. Questioning the limitations of the market mechanism, Keynes suggested *strong government intervention* in the economy. To get the economy out of the depression, he suggested an increase in government expenditures, discretionary fiscal policy (fiscal deficit, lower interest rates, cheap money supply, etc.) to boost the demand of goods and services as this was the reason behind the depression. As Keynesian policies were followed, the concerned economies were successfully pulled out of the Great Depression.

While Keynes was inquiring into the causes and cures of the Great Depression he questioned the capitalist economic system being practised throughout Euro-America. He suggested the capitalistic order to assimilate the goals of the socialistic economy (economic ideals of the socialists, i.e., the ex-USSR). In the capitalist economies of the time, all the basic goods and services were part of the market mechanism, i.e., being produced and supplied by the private sector. It meant that almost everything the people required was supplied by the private enterprises via the market which was ultimately an undimensional movement of money and wealth (from the mass of people to the few who controlled the production and supply chain) and the masses were going through the process of pauperisation every day, thereby weakening their purchasing power. In the end, it affected overall demand and culminated in the Great Depression.

As a follow up to the Keynesian advices, many trendsetting economic policies were initiated throughout the capitalist economies. One very important initiative which came out was the government's active role in the economy. The governments started producing and supplying some basic goods and services which are known as 'public goods'. These goods basically intended to guarantee minimum level of nutrition to all, healthcare, sanitation, education, social security, etc. The expenditure on public goods were incurred on the public exchequer even if it required deficit financing. Starting from 1930s upto 1950s, almost 50 per cent of the GDP in the Euro-America was spent by the governments on public goods which also become popular as the ***social sector.*** The essential goods and services which were till date being purchased by the people as 'private goods', were soon made available by the state 'free-of-cost' giving people more spare money to create demand for the goods and services which were part of the market.

The above instance has been cited here to just show the process as to how capitalism redefined itself by including some useful traits of the non-market economy, i.e., the state economy. The ***mixed economy*** arrived in this way and the classical capitalistic economy was challenged by it.

On the margins of the developments given above, it is interesting to note the developments in the state economies of the time. It was **Prof. Oscar Lange (1904–65),** the Polish philosopher, who in 1950s suggested the same thing for the socialist economy as Keynes had for the capitalist. Prof. Lange praised the state economy for many of its good things, but also suggested inclusion of some of the good things of the capitalistic economy.[3] He advised the *state economies* to

3. J.K. Galbraith, ***A History of Economics***, Penguin Books, London, 1991, p. 188–89.

adopt 'market socialism' (the term was coined by him). His suggestions were outrightly rejected by the state economies as such compromises in the socialistic economic order were blasphemous at that time (this was ultimately a suggestion towards democracy from dictatorship).

As Keynes has suggested that the capitalist economy should move few steps towards socialistic economy, Prof. Lange was suggesting just the same in the case of the state economies. Democracies are flexible thus they were able to go for an experiment which paid them in coming times. But as the socialist and communist political systems had been stubborn by nature, they did not go for any experiment and thus started moving towards their economic decay.

It was in the communist China, under the leadership of Mao Tse Tung, where the first opinion came against the total state economic control. And the ultimate example of the state economy (i.e., China) started its preparation towards a limited market economy under the political design of dictatorship. In 1985, China announced its 'open door policy', the first experiment in 'market socialism'—Prof. Lange had the last laugh. Other state economies, though caught unprepared, followed the Chinese experiment towards market socialism. However, the switch over to market socialism has not been smooth for most of the state economies. The efforts towards market socialism in the Soviet Union, fuelled by the lofty ideas of 'glasnost' (openness) and 'prestroika' (restructuring), resulted in the very *disintegration* of the nation-state. The experts consider it 'a political fallout of an economic mismanagement'. The other state economies experienced major economic breakdowns in their transition phases to market socialism. Basically, for smooth transition to market socialism some prerequisites were required to be put in place aforehand. China was well ahead doing this homework since Mao's time (specially since 1975 onwards) which emerged as a real winner—the ideal type example of state economy getting smoothly metamorphosed into a giant market economy.

These two events spanning many decades were nothing but timely and rational selections of economic traits from each other's economic systems and experiences. The world by the late 1980s was having neither a pure example of capitalistic economy nor a pure example of state economy.

There were many states of the world that opted for a mixed economy in the post-Second World War period after coming out of the colonial rule, such as India, Malaysia, Indonesia, etc., to name a few. The leadership of these countries could be considered visionaries which was to be proved by the mid-1990.

Though at a practical level, the world looked flat for the mixed economy, a formal opinion on the goodness, immediacy and the ultimate viability of the mixed economy was yet to emerge. The first such authoritative opinion, in this direction, came from the World Bank which accepted the goodness and the need of 'state intervention' in the economy.[4] This was a turning point in the world economic thinking as the World Bank (WB) and the International Monetary Fund (IMF) were ardent votaries of the virtues of the free market economy.

The concluding consensus emerged with the publication of the World Development Report (1999) titled *Entering the 21st Century* in which the WB said, "Governments play a vital role in development, but there is no simple set of rules that tells them what to do." The WB went on to suggest in this important document that every country should determine the **areas** and the **extent** of the market and the state intervention, depending upon its own stage of economic

4. ***The East Asian Miracle,*** W.B. Study, 1993.

development, socio-political and other historical factors.

The last WB document had basically rejected both the historically existing economic orders, namely the free-market economy, and the state economy—which meant Adam Smith and Karl Marx were cancelled and rejected outrightly, that too on the basis of the historical experiences of both the worlds. Rather, the document advocates for a 'mixture' of both the economic orders, i.e., the mixed economy. The long-standing ideological dilemma as to whether the market economy or the state economy was the better or the best way of organising the economy was solved for all times to come. The document pin-pointed good things of both the systems and concluded that they don't have the relationship of dichotomy but that of complimentarity. The real issue is not whether to have market or the state but having both of them together makes more sense. Market economy might suit one economy while it might not suit another—due to the different socio-economic conditions of the economies in reference. Similarly, the state economy model might serve one economy but might not serve the other.

The real answer seems going for neither the market nor the state but a judicious combination of both. As the state-market mix depends upon the socio-economic and political conditions of an economy, there can never be a mechanical prototype of the mixed economy, which could be applied upon every economy universally. Every economy needs to explore its own mixture of market and state. Again, the same state might need to redefine composition of the state-market mix in the coming times according to its changed socio-eco-political scenario.

The process of economic reforms in India started in 1991. It was infact the search for a new 'state-market mix', while India had been a mixed economy since Independence.

After Independence, India opted for the mixed economy when the state-market dilemma was at its peak in the world. In the process of organising the economy, some basic and important infrastructural economic responsibilities were taken up by the state/governments (centre and state) and rest of the economic activities were left to private enterprise, i.e., the market. The kind of state-market mix for which India went was thought to be fit for the socio-economic and political conditions of the time. Once the country started the process of economic reforms in early 1990s, the prevailing state-market mix was redefined and a new form of mixed economy began to be practised. As the socio-economic conditions had changed, the state-market mix also changed. The redefined mixed economy for India had a declared favour for the market economy. Many economic roles which were under complete government monopolies were now opened for participation by the private sector. Examples are many—telecommunication, power, roads, oil and natural gas, etc. At the same time, the responsibilities which were till date being shouldered by the state alone and which could be taken up by the state only were given extra emphasis. In this category comes the whole social sector—education, healthcare, drinking water, sanitation, nutrition, social security, etc.

The economic system of India was a mixed economy in the pre-1991 years as it is in the post-1991 years, but the composition of state-market mix has gone for a change. In future, as the socio-economic and political factors will be changing, India will be redefining its mixed economy, accordingly.

The emergence and evolution of the mixed economy was thus able to settle the long-standing debate as to what was the best way to organise an economy. Starting in 1776 with the *Wealth of Nations* of Adam Smith, it continued till we had the *World Development Report* of 1999 by the WB.[5] The dilemma continued for almost two and a quarter centuries (1776–2000). Today, once the World Trade Organization (WTO) has taken over the world economy, the brand of the mixed economy it advocates, is more inclined towards the free market economy. However, it does not propagate to make the state an economic non-entity, i.e., it leaves scope for greater state intervention in required areas if needed.

ROLE OF THE STATE IN AN ECONOMY

The dilemma of searching the ideal way of organising an economy, as it evolved, was also going to solve another riddle. This riddle was the role of the state in an economy.[6] If we look back into the economic history of the world, we see *three* possible roles for the state/government in the economy:

(i) As a **regulator** of the economic system (where the state takes important economic decisions, announces the required kind of economic policies, takes the sole responsibility to get them implemented and controlling and punishing those who don't oblige to those economic decisions).

(ii) As a producer and/or supplier of **'private goods and services'** (these include all those goods and services which constitute the part of market and which will be distributed among the needy according to the principles of market mechanism. Here the state earns profit as a private enterprise).

(iii) As a producer and/or supplier of **'public goods'** or **'social goods'** (these include goods and services which look essential from the perspective of social justice and well-being for the people. Education, healthcare, sanitation, drinking water, nutrition, caring for the handicapped and old, etc., come under this category. These goods which are generally distributed free of cost at times might reach the beneficiaries at subsidised prices. The loss incurred by the state in this way is paid out of the public exchequer which means that the whole economy pays for the cause of a few people).

As different economies select different roles for the state according to their socio-political ideologies, the world had differing ways of organising the economy and had resulted in the different economic systems in the past.

On the issue of regulating the economy there has been no debate, as we see all economic systems being regulated by the state only. But the selection of other two functions of the state in an economy made the real difference. The economy which selected both the roles (ii and iii) for the state under monopoly we called them the state economies. This category of economy had two variants in the socialist economy at least the labour was not owned and exploited by the state unlike the other—the communist economy where labour used to be under complete state control. These economies had almost no market.

The economic system which left both the roles (ii and iii) as the sole responsibilities of the private sector was called the capitalistic economic system. Here the state had almost no economic role but played a passive role as the regulator.

Mixed economies had at least kept one economic role fixed for them (i.e., iii) while they played the sole role of supplying public goods to the needy people. In some of the mixed economies the state went on to take some of the roles of

5. World Bank, ***World Development Report,*** 1999.
6. A highly concise and to-the-point idea on the issue comes from Joseph. E. Stiglits, **The Role of Government in Economic Development,** the keynote address at the Annual World Bank Conference on Development Economics, 1996.

supplying the private goods (i.e., ii) even by carrying heavy burdens of subsidies.

The WB document—the *World Development Report*, 1999 was a judgement on the possible and suitable roles of the state in the economy, which suggested a timely shuffling of state's role in the economy as per the socio-economic and political needs of the economy. We may understand the moot question via Keynes for whom the political problem of mankind is to combine three things:

(i) economic efficiency,
(ii) social justice, and
(iii) individual liberty

In the process of realising the above-mentioned three objectives, an economy cannot go for either allowing only state's role in the economy or only the market's role in the economy. These challenges could only be faced properly once the state and the market both are given a balanced role in an economy—the balance to be defined by its present condition and the direction of future goal of the economy. Striking the right balance between the role of the state and the market in the economies came to be known as the process of economic reforms in the post-WTO world.

If we analyse the need of an economy, we see some compulsory roles for the state in it:

(i) If the regulation and control of an economy is left to the private individuals or groups (i.e., firms) they will be using the regulatory powers to maximise their profits and returns at the cost of others. That is why this role must rest with the state. It looks more logical in the democratic political set-ups, wherein the interest of the largest numbers is being represented in the regulatory provisions.
(ii) The responsibility of producing and distributing private goods to the people could be well handled by the private sector as this is a profit-fetching area. The state should not burden itself with this responsibility as this could be well taken up by the private sector. But in the absence of the proper presence of the private sector in an economy, many countries in the world gave this responsibility also to the state; India being one among them. But as the private sector became capable, in some countries this responsibility was given up by the state in favour of the private sector and better development has been possible in those economies. In this sense, India delayed this process while in Indonesia, Malaysia, Thailand and South Korea the state did give up this responsibility allowing the entry of the private sector.
(iii) The responsibility of producing and supplying the social/public goods to the needy people cannot be left to the private sector as this is a loss-making exercise. It means, the state will have to take the sole responsibility or may need to expand its role in such areas—as we see in post-reform India.

As the private sector becomes capable of playing the proper role in producing and supplying the private goods, state saves its important human and economic resources which is transferred to take care of the production and distribution of public goods.

Basically, the WB study, the *East Asian Miracle* (1993) recognises the above-given shift of one kind of mixed economy to the another kind of mixed economy—in the cases of the Malaysian, Thai and South Korean economies—taking place since the mid-1960s. Experts believe that this shift could not take place in time in India. And once it started (1991–92) it was too late and this choice was not voluntary but obligatory. The East Asian economies had gone for the same kind of reform process but by their choice.

WASHINGTON CONCENSUS

The term 'Washington Consensus' was coined by the US economist John Williamson[7] (in 1989) under which he had suggested *a set of policy reforms* which most of the official in Washington (i.e. International Monetary Fund and World Bank) thought would be good for the crisis-driven Latin American countries of the time. The policy reforms included **ten** propositions:

(i) Fiscal discipline
(ii) A redirection of public expenditure priorities toward fields offering both high economic returns and the potential to improve income distribution, such as primary health care, primary education, and infrastructure.
(iii) Tax reform (to lower marginal rates and broaden the tax base)
(iv) Interest rate liberalisation
(v) A competitive exchange rate
(vi) Trade liberalisation
(vii) Liberalisation of FDI inflows
(viii) Privatisation
(ix) Deregulation (in the sense of abolishing barriers to entry and exit)
(x) Secure property rights

However, in coming times, the term got used synonymous to *neo-liberalism* (in Latin America), *market fundamentalism* (as George Soros told in 1998) and even *globalisation* across the world. It has often been used to describe an extreme and dogmatic commitment to the belief that **markets can handle everything**.

But the reality has been different—these *set of polices* were already being recommended by the IMF (International Monetary Fund) and the WB (World Bank) together with the US Treasury, especially during the period of the eighties and early nineties.[8] The prescriptions were originally intended to address the very real problems occurring in Latin America at the time, and their use later to handle a wide array of other situations has been criticized even by original proponents of the points. The name of the Washington Consensus has often been mentioned as being somewhat unfortunate, especially by its creator. John Williamson[9], says that audiences the world over seem to believe that this signifies a set of neo-liberal policies that have been imposed on hapless countries by the Washington-based international financial institutions and have led them to crisis and misery—there are people who cannot utter the term without foaming at the mouth. He further adds that many people feel that it gives the impression the points outlined represent a set of rules imposed on developing nations by the United States. Instead, Williamson always felt that the prescriptions represented a consensus precisely because they were so universal. Many proponents of the plan do not feel that it represents the hard-line *neo-liberal* agenda that anti-free-trade activists say it does, instead presenting it as a relatively conservative assessment of what policies can help bring a country to economic stability.

7. John Williamson, **What Washington Means by Policy Reform**, Chapter 2 in *Latin American Adjustment: How Much Has Happened?*, John Williamson (ed.), 1990; Institute for International Economics and John Williamson, **What Should the Bank Think About the Washington Consensus**, Background Paper to the World Bank's *World Development Report 2000*, Washington DC, July 1999.

8. J. E. Stiglitz, **Initiative for Policy Dialogue**, a paper presented at the conference *From the Washington Consensus towards a new Global Governance*, Barcelona, September 2004. The conference was sponsored by the Ford Foundation, the MacArthur Foundation, and the Mott Foundation.

9. J. Williamson, **Did the Washington Consensus Fail?**, Institute for International Economics, Washington DC, 2002.

But the policy prescriptions led to the processes which are known as Liberalisation, Privatisation, Globalisation, cutting down the role of the State in the economy, etc.—across the world—more so in the nations who got developmental funding from the WB or went to the IMF in times of the Balance of Payment crises (as in the case of India which commenced its reform process in 1991 under the 'conditions' of the IMF). It was as if the Adam Smith's prescription of 'free market' (liberalism) has taken its rebirth (in neo-liberalism).

Many scholars believe today that the recent financial crises of the US and the European nations are somehow born out of the ideas rooted in the Consensus. In the aftermath of the Great Recession (after the 'US sub-prime' crisis) in the Western economies, it is believed that dependence on market to correct the growth and development may not sustain any longer – and the world might agree a bit in favour of a *development state* as in the case of the East Asian nations who never went for the Consensus for their robust growth. The Keynesian idea of 'interventionist state' seems the ultimate alternative in the present times, as is suggested by the US Nobel economist Paul Krugman and being followed by the Japanese Prime Minister, Shinzo Abe (the *Three Arrows of Abenomics*).

SECTORS OF AN ECONOMY

Every economy tries to maximise the returns of economic activities in which it is involved. Whatever be the organising principles of an economy, the economic activities are broadly classified into three broad categories which are known as the three sectors[10] of the economy.

1. Primary Sector

This sector includes all those economic activities where there is the direct use of natural resources as agriculture, forestry, fishing, fuels, metals, minerals, etc. In some of the economies, mining activities are considered a part of the secondary sector, though we see direct use of natural resources here. Broadly, such economies term their agricultural sector as the primary sector. This is the case in India.

2. Secondary Sector

This sector is rightly called the manufacturing sector which uses the produce of the primary sector as its raw materials. Since manufacturing is done by the industries, this sector is also called the industrial sector—bread and biscuits, cakes, automobiles, textiles, etc.

3. Tertiary Sector

This sector includes all those economic activities where different 'services' are produced such as education, banking, insurance, transportation, tourism, etc. This sector is also known as the services sector.

TYPES OF ECONOMIES

Depending upon the shares of the particular sectors in the total production of an economy and the ratio of the dependent population on them for their livelihood, economies are given different names, such as:

1. Agrarian Economy

An economy is called agrarian if the share of its primary sector is 50 per cent or more in the total output (the GDP) of the economy. At the time of Independence, India was such an economy. But now it shows the typical symptom of a service economy with the primary sector's contribution falling to almost 18 per cent of its total produce, while almost 60 per cent of their population

10. Michael P. Todaro and Stephen C. Smith, ***Economic Development***, Pearson Education, 8th Ed., N. Delhi, p. 440.

depends on the primary sector for its livelihood. Thus, in *monetary terms* India is no more an agrarian economy, the dependency ratio makes it so—India being the first such example in the economic history of the world.

2. Industrial Economy

If the secondary sector contributes 50 per cent or more to the total produce value of an economy, it is an industrial economy. Higher the contribution, higher is the level of industrialisation. The western economies who went for early industrialisation earning faster income and developing early known as developed economies. Most of these economies have crossed this phase once the process of industrialisation saturated.

3. Service Economy

An economy whose 50 per cent or more produce value comes from the tertiary sector is known as the service economy. First lot of such economies in the world were the early industrialised economies. The tertiary sector provides livelihood to the largest number of people in such economies. In the last decade (2003–04 to 2012–13), growth has increasingly come from the services sector,[11] whose contribution to overall growth of the economy has been 65 per cent, while that of the industrial and agricultural sectors has been 27 per cent and 8 per cent respectively.

By the end of the 19th century it was a well-established fact, at least in the western world, that industrial activities were a faster way to earn income in comparison to agrarian activities. The Second World War had established the fact for the whole world—and almost every country started their preparation for the process of industrialisation. As country after country successfully industrialised, a pattern of population shift occured from one to another sector of the economy, which was known as the ***stages of growth*** of an economy.[12] With the intensification of industrialisation, dependency on the primary sector for livelihood decreased and dependency on the secondary sector increased consistently. Similarly, such economies saw a population shift from the secondary to the tertiary sector—and these were known as the 'post-industrial' societies or the services societies. Almost the whole Euro-America falls under this category—these economies are having over 50 per cent of their total produce value being contributed by their tertiary sector and over half of the population depend on this sector for their livelihood. Many other countries which started the process of industrialisation in the post-war period did show abberations in this shift of the population and the income—India being one among them.

THE IDEA OF NATIONAL INCOME

Income is probably the most frequently used term in economics, used by experts and lay men. Income level is the most commonly used tool to determine the well-being and happiness of nations and their citizens. This remains true even today, Even if we know that 'income' is not an exhaustive idea to know about the well-being of the society. There has been some reason for such a perception about the concept of income. Basically, when the idea of 'human development' came into being by the early 1990s, the concept of the 'human development index' ultimately was heavily dependent on the level of 'income' of an individual in a country. Education and life expectancy can only be enhanced once the required amount of 'investment' (expenditure on them) could be

11. Ministry of Finance, **Economic Survey 2012-13**, Government of India, New Delhi, 2013, p. 30
12. Walt W. Rostow, ***The Stages of Economic Growth: A Non-Communist Manifesto,*** Cambridge University Press, London, 1960, pp. 1–5.

mobilised. Thus, somehow, income came to be established as the 'focal point' of 'development/ human dvelopment'.

As income of a single person can be measured, it can be measured for a nation and the whole world, although the method of calculating may be a little bit complex in the latter's case. In due course, *four ideas/ways* to calculate the income of a nation[13] developed, which are the subject matter of the 'national income accounting'—an area to which the disciplines Commerce and Statistics are closely associated. These four ways to look upon 'income' of an economy, although different from each other in some ways, are the concepts of GDP, NDP, GNP and NNP. All are a form of the national income, but are different from one another. They all say a different story about the income of a nation in their own specific way. Here, we will objectively discuss each one of them.

GDP

Gross Domestic Product (GDP) is the value of the all *final* goods and services produced within the boundary of a nation during one year period. For India, this calendar year is from 1st April to 31st March.

It will be better to understand the terms used in the concept, *'gross'* means same thing to Economics and Commerce as 'total' means to Mathematics; *'domestic'* means all economic activities done inside the boundary of a nation/ country and by its own capital; *'product'* is used to define 'goods and services' together; and *'final'* means the stage of a product after which there is no known chance of value addition in it.

The ***different uses*** of the concept of GDP are as given below:

(i) Per annum percentage change in it is the 'growth rate' of an economy. For example, if a country has a GDP of Rs. 107 which is 7 rupees higher than the last year, it has a growth rate of 7 per cent. When we use the term 'a growing' economy, it means that the economy is adding up its income, i.e., in quantitative terms.

(ii) It is a 'quantitative' concept and its volume/size indicates the 'internal' strength of the economy. But it does not say anything about the 'qualitative' aspects of the produced goods and services.

(iii) It is used by the IMF/WB in the comaparative analyses of its member nations.

NDP

Net Domestic Product (NDP) is the GDP calculated after adjusting the weight of the value of 'depreciation'. This is, basically, *net form* of the GDP, i.e., GDP minus the total value of the 'wear and tear' (depreciation) that happened in the assets while the goods and services were being produced. Every asset (except human beings) go for depreciation in the process of their uses, which means they 'wear and tear'. The governments of the economies decide and announce the rates by which assets depreciate (done in India by the Ministry of Commerce and Industry) and a list is published, which is used by the different sections of the economy to determine the real levels of depreciations in different assets. For example, a residential house in India has a rate of 1 per cent per annum depreciation, an electric fan has 10 per cent per annum, etc., calculated in terms of the asset's price. This is ***one way*** how depreciation is used in economics. The ***other way*** it is used in the external sector while the domestic currency floats freely in front of the foreign currencies, If the value of the domestic currency falls following

13. The discussion on National Income Accounting is based on several textbooks of economics and the documents released by the ***International Monetary Fund (IMF)*** and the ***World Bank (WB)*** in the areas of ***Comparative Economics*** and ***International Economics.***

market mechanism in front of a foreign currency, it is the situation of 'depreciation' in the domestic currency, calculated in terms of loss in value of the domestic currency.

Thus, *NDP = GDP – Depreciation.*

This way, NDP of an economy has to be always lower than its GDP for the same year, since there is no way to cut the depreciation to zero. But mankind has achieved too much in this area through developments, such as 'ball-bearing', 'lubricants', etc., all innovated to minimise the levels of depreciation.

The **different uses** of the concept of NDP are as given below:

(a) For domestic use only: to understand the historical situation of the loss due to depreciation to the economy. Also used to understand and analyse the sectoral situation of depreciation in industry and trade in comparative periods.

(b) To show the achievements of the economy in the area of research and development, which have tried cutting the levels of depreciation in a historical time period.

However, NDP is not used in comparative economics, i.e., to compare the economies of the world. Why this is so? This is due to different rates of depreciation which is set by the different economies of the world. Rates of depreciation may be based on logic (as it is in the case of houses in India—the cement, bricks, sand and iron rods which are used to build houses in India can sustain it for the coming 100 years, thus the rate of depreciation is fixed at 1 per cent per annum). But it may not be based on logic all the time, for example, upto February 2000 the rate of depreciation for heavy vehicles (vehicles with 6-wheels and above) was 20 per cent while it was raised to 40 per cent afterwards—to boost the sales of heavy vehicles in the country. There was no logic in doubling the rate. Basically, depreciation and its rates are also used by modern governments as a tool of economic policymaking, which is the ***third way*** how depreciation is used in economics.

GNP

Gross National Product (GNP) is the GDP of a country added with its 'income from abroad'. Here, the trans-boundary economic activities of an economy is also taken into account. The items which are counted in the segment 'Income from Abroad' are:

(i) *Trade Balance:* the net outcome at the year end of the total exports and imports of a country may be positive or negative accordingly added with the GDP (in India's case it has always been negative except the three consecutive years 2000-03 when it was positive, due to high levels of 'services sector' export during the years, courtsey the booming BPO industry).

(ii) *Interest of External Loans:* the net outcome on the front of the interest payments, i.e., balance of the inflow (on the money lend out by the economy) and the outflow (on the money borrowed by the economy) of the external interests. In India's case it has always been negative as the economy has been a 'net borrower' from the world economies.

(iii) *Private Remittances:* the net outcome of the money which inflows and outflows on account of the 'private transfers' by Indian nationals working outside India (to India) and the foreign nationals working in India (to their home countries). On this front India has been always a gainer-till the early 1990s from the Gulf region (which fell down afterwards in the wake of the heavy country-bound movements of Indians working there due to the Gulf War) and afterwards from the USA and other European nations. Today, India is the highest recipient of private remittances in the world—as per the World Bank projected at \$71 billion in 2014 (in 2013 it was \$70 billion, the year's highest). China falls second (\$ 64 billion) in 2014.

Ultimately, the balance of all the three components of the 'Income from Abroad' segment may turn out to be positive or negative. In India's case it has always been negative (due to heavy outflows on account of trade deficits and interest payments on the foreign loans). It means, the 'Income from Abroad' is subtracted from India's GDP to calculate its GNP.

The normal formula is *GNP = GDP + Income from Abroad*. But it becomes GNP = GDP + (– Income from Abroad) = GDP – Income from Abroad, in the case of India. This means that India's GNP is always lower than its GDP.

The **different uses** of the concept GNP are as given below:

(i) This is the 'national income' according to which the IMF ranks the nations of the world in terms of the volumes—at Purchasing Power Parity (at PPP). For a detailed discussion on PPP readers may *search for it alphabetically* in *Chapter 24*. India is ranked as the ***4th largest economy*** of the world (after the USA, China and Japan), while as per the nominal/ prevailing exchange rate of rupee, India is the ***11th largest economy***.

(ii) It is the more exhaustive concept of national income than the GDP as it indicates towards the *'quantitative'* as well as the *'qualitative'* aspects of the economy, i.e., the *'internal'* as well as the *'external'* strength of the economy.

(iii) It enables us to learn several facts about the production behaviour and pattern of an economy, such as, how much the outside world is dependent on its product and how much it depends on the world for the same (numerically shown by the size and net flow of its 'balance of trade'); what is the standard of its human resource in international parlance (shown by the size and the net flow of its 'private remittances'); what position it holds regarding financial support from and to the world economies (shown by the net flow of 'interests' on external lending/ borrowing).

NNP

Net National Product (NNP) of an economy is the GNP after deducting the loss due to 'depreciation'. The formula to derive it may be written like:

NNP = GNP – Depreciation

or,

NNP = GDP + Income from Abroad – Depreciation.

The **different uses** of the concept of NNP are as given below:

(i) This is the **'National Income' (NI)** of an economy. Though, the GDP, NDP and GNP, all are 'national income' they are not written with capitalised 'N' and 'I'.

(ii) This is the *purest form* of the income of a nation.

(iii) When we divide NNP by the total population of a nation we get the ***'per capita income'*** (PCI) of that nation, i.e., 'income per head per year'. A very basic point should be noted here that this is the point where the rates of dipreciation followed by different nations make a difference. Higher the rates of depreciation lower the PCI of the nation (whatever be the reason for it logical or artificial as in the case of depreciation being used as a tool of policymaking). Though, economies are free to fix any rate of depreciation for different assets, the rates fixed by them make difference when the NI of the nations are compared by the international financial institutions like the IMF, WB, ADB, etc.

The 'Base Year' together with the 'Methodology' for calculating the National Accounts were revised by the Central Statistics Office (CSO) in January 2015, which is given in the forthcoming pages. So that readers are able to understand the 'main differences' in the accounting process, the literature related to the 'old methodology' is left unchanged in this edition. We may expect questions on their comparative aspects in the futre examinations.

Cost and Price of National Income

While calculating national income the issues related to 'cost' and 'price' also needs to be decided. Basically, there are two sets of costs and prices; and an economy needs to choose at which of the two costs and two prices it will calculate its national income. Let us understand the confusion and the relevance of this confusion.[14]

(i) *Cost:* Income of an economy, i.e., value of its total produced goods and services may be calculated at either the 'factor cost' or the 'market cost'. What is the difference between them? Basically, ***'factor cost'*** is the 'input cost' the producer has to incur in the process of producing something (such as cost of capital, i.e., interest on loans, raw materials, labour, rent, power, etc.). This is also termed as *'factory price'* or 'production cost/price'. This is nothing but 'price' of the commodity from the producer's side. While the ***'market cost'*** is derived after adding the indirect taxes to the factor cost of the product, it means the cost at which the goods reach the market, i.e., showrooms (these are the cenvat/central excise and the CST which are paid by the producers to the central government in India). This is also known as the *'ex-factory price'*. The weight of the state taxes are then added to it, to finally derive the 'market cost'. In general, they are also called *'factor price'* and *'market price'*.

In India, income is calculated at factor cost, and so is the case with most of the developing countries (but among the developed economies it is calculated at the market cost). The reasons are, lack of uniformity in taxes, goods are not printed with their prices, etc. In present time, we see a great degree of tax-related uniformity coming to India upto the extent of the central taxes only, but the state taxes are still neither single nor uniform. Once the GST is implemented this abberation will end. Though for statistical purposes, income at market cost is also released by the Central Statistical Organisation (CSO).

(ii) *Price:* Income can be derived at two prices constant and current. The difference in the constant and current prices is only that of the *impact of inflation*. Inflation is considered stand still at a year of the past (this year of the past is also known as the ***'base year'***) in the case of the constant price while in the current price the present day inflation is added. Current price is, basically, the maximum retail price (MRP) which we see printed on the goods selling in the market.

14. The informations on the issues like 'cost', 'price', 'taxes' and 'subsidies' are based on the different ***Discussion Papers*** released by the ***Central Statistical Organisation*** (GoI) from time to time.

As per the new guidelines the *base year* in India has been revised from the 1993–94 to 2004–05 (the data based on the new constant year is presently known as the 'new series' of data) — announced in September, 2010. *India calculates its national income at constant prices*—so is the situation among other developing economies, while the developed nations calculate it at the current prices. Though, for statistical purposes the CSO releases the national income data at the current prices, too. Why? Basically, inflation has been a challenging aspect of policymaking in India because of its level (i.e., range in which it dwindles) and stability (how stable it has been). In such situations the growth in the income levels of the population living below the poverty level (BPL) can never be measured accurately (due to higher inflation the section will show higher income) and the government will never be able to measure the *real* impact of the poverty alleviation programmes it runs for the population.

Here, one important aspect of income needs to be understood. Income of a person has three forms—the first form is ***nominal income*** (the wage someone gets in hand per day or per month), the second form is ***real income*** (this is nominal income minus the present day rate of inflation—adjusted in percentage form), and the last one is the ***disposable income*** (the net part of wage one is free to use which is derived after deducting the direct taxes from the real/nominal income, depending upon the need of data). What happens in practice is that while the nominal income might have increased by only 5 per cent, it looks 15 per cent if the inflation is at the 10 per cent level. Unlike India, among the developed nations, inflation has been around 2 per cent for many decades (it means it has been at lower levels and stable, too. This is why the difference between the incomes at constant and current prices among them are narrow and they calculate their national income at current prices. They get more reliable and realistic data of their income).

Taxes & National Income

While accounting/calculating national income the taxes, direct and indirect, collected by the governments, needs to be considered. In the case of India, to the extent the **direct taxes** (individual income tax, corpoarate income tax, i.e., the corporate tax, divident tax, interest tax, etc.) are concerned, there is no need of adjustment whether the national income is accounted at factor cost or market cost. This is so because at both the 'costs' they have to be the same; besides these taxes are collected at the incomes of the concerned person or group.

But the amount of **indirect taxes** (cenvat, customs, central sales tax, sales tax/vat, state excise, etc.) needs to be taken care of if the national income is accounted at 'factor cost' (which is the case with India). If the national income is calculated at factor cost then the corpus of the total indirect taxes needs to be deducted from it. Why so? This is because, they have been added twice: once in the hands of the people/group who pay them (because they pay for it from their 'disposable income' while puchasing things) and other in the hands of the governments (as their income receipts). Collection/source of indirect taxes are the *'disposable income'* (which individuals and companies have with them after paying their direct taxes—from which they do any purchasing and finally, the indirect taxes reach the various governments). Thus, if the national income is calculated at factor cost, the formula to seek it will be:

National Income at Factor Cost = NNP at Market Cost – Indirect Taxes

However, if the national income is being derived at 'market cost', the indirect taxes do not need to be deducted from it. In this case, the governments need not add their income accruing from indirect taxes to the national income either. It means, that the confusion in the case of national income accounting at factor cost is only related with indirect taxes.

SUBSIDIES & NATIONAL INCOME

Similar to the indirect taxes, the various subsidies which are forwarded by the governments need to be adjusted while calculating national income. They are added to the national income at market cost, in case of India. Subsidies are added in the national income at market cost to derive the national income at factor cost . This is because the price at which the subsidised goods and services are made available by the governments are not their real factor costs (subsidies are forwarded on the factor costs of the goods and services) otherwise we will have a distorted value (which will be less than its real value). Thus the formula will be:

National Income at Factor Cost = NNP at Market Cost + Subsidies

If the national income is derived at the market cost and governments forward no subsidies there is no need of adjustments for the subsidies, but after all there is not a single economy in the world today which does not forward subsidies in one or the other form.

Putting 'indirect taxes' and 'subsidies' together, India's National Income will be derived with the following formula (as India does it at factor cost):

National Income at Factor Cost = NNP at Market Cost – Indirect Taxes + Subsidies

REVISION IN THE BASE YEAR AND METHOD OF NATIONAL INCOME ACCOUNTING

The Central Statistics Office (CSO), in January 2015, released the **new** and **revised** data of National Accounts, effecting two changes:

1. The *Base Year* was revised from 2004–05 to 2011–12. This was done in accordance with the recommendation of the National Statistical Commission (NSC), which had advised to revise the base year of all economic indices every five years.
2. This time, the *methodology* of calculating the National Accounts has also been revised in line with the requirements of the System of National Accounts (SNA)-2008, an internationally accepted standard.

The **major changes** incorporated in this revision are as given below:

(i) **Headline growth rate** will now be measured by *GDP at constant market prices*, which will henceforth be referred to as 'GDP' (as is the practice internationally). Earlier, growth was measured in terms of growth rate in *GDP at factor cost and at constant prices.*

(ii) Sector-wise estimates of Gross Value Added (GVA)[15] will now be given at **basic prices**[16] instead of factor cost. The relationship between GVA at factor cost, GVA at basic prices, and GDP (at market prices) is given below:

15. GVA, which measures the difference in value between the final good and the cost of ingredients used in its production, widens the scope of capturing more economic activity than the earlier 'factor cost' approach—a sum of the total cost of all factors used to produce a good or service, net of taxes and subsidies.
16. The **basic price** is the amount receivable by the producer from the purchaser for a unit of a good or service produced as output minus any tax payable (such as sales tax or VAT the buyer pays), and plus any subsidy receivable, on that unit as a consequence of its production or sale; it excludes any transport charges invoiced separately by the producer. In other words, the basic price is what the seller collects for the sale, as opposed to what the buyer pays.

GVA at basic prices = CE + OS/MI + CFC + production taxes less production subsidies.

GVA at factor cost = GVA at basic prices – production taxes less production subsidies.

GDP = GVA at basic prices + product taxes – product subsidies.

[Where, **CE** : compensation of employees; **OS**: operating surplus; **MI**: mixed income; and **CFC**: consumption of fixed capital. **Production taxes** or **production subsidies** are paid or received with relation to production and are independent of the volume of actual production. Some examples of **production taxes** are *land revenues, stamps and registration fees* and *tax on profession.* Some **production subsidies** are subsidies to Railways, input subsidies to farmers, subsidies to village and small industries, administrative subsidies to corporations or cooperatives, etc. **Product taxes** or **subsidies** are paid or received on per unit of product. Some examples of product taxes are excise tax, sales tax, service tax and import and export duties. **Product subsidies** include food, petroleum and fertilizer subsidies, interest subsidies given to farmers, households, etc., through banks, and subsidies for providing insurance to households at lower rates].

(iii) Comprehensive coverage of the *corporate sector* both in manufacturing and services by incorporation of annual accounts of companies as filed with the Ministry of Corporate Affairs (MCA) under their e-governance initiative, MCA21. Use of MCA21 database for manufacturing companies has helped account for activities other than manufacturing undertaken by these companies.

(iv) Comprehensive coverage of the *financial sector* by inclusion of information from the accounts of stock brokers, stock exchanges, asset management companies, mutual funds and pension funds, and the regulatory bodies including the Securities and Exchange Board of India (SEBI), Pension Fund Regulatory and Development Authority (PFRDA) and Insurance Regulatory and Development Authority (IRDA).

(v) Improved coverage of activities of *local bodies* and *autonomous institutions*, covering around 60 per cent of the grants/ transfers provided to these institutions.

Owing to these changes, estimates of GVA both at aggregate and sectoral levels have undergone changes. The sector-wise shares in aggregate GVA have undergone significant revision especially in the case of manufacturing and services. Changes have also been observed in the growth rates in GVAs of individual sectors and contribution of each sector to overall GVA due to use of sales tax and service tax data for estimation in the years 2012-13 and 2013-14. Caution needed to be exercised while comparing estimates and growth rates from the earlier series to the new series, as per the CSO.

The lates set of data for the National Income of India for **2014–15** *(as per the revised Base Year and new Methodology of the CSO, announced in January 2015)* are as given below:

(i) **GDP** (at Constant Market Price): Rs. 1,06,56,925 and Growth Rate at 7.4 per cent.

(ii) **GVA** at Basic Price (at 2011–12 prices): Rs. 98, 57, 672 and Growth Rate at 7.5 per cent.

(iii) **Per Capita Net National Income** (at Current Market Prices): Rs. 88,533.

UNIQUENESS OF THE INDIAN ECONOMY

Indian economy did show some traits[17] which were unique:

(i) The contribution of the primary sector in the GDP has fallen down regularly and today it stands at 14.1 per cent, which is sufficient to conclude that it is no more an agrarian economy.

(ii) The share of its tertiary sector increased to over 66 per cent in the GDP by 2014–15. This proves India is a service economy.

(iii) The dependency of population on the primary sector for its employment still remains at over 56.8 per cent, a symptom of an agrarian economy. The expansion of industries was not sufficient to attract the labour force from the primary activities. India is still lagging on this front badly.

(iv) The share of the secondary sector in the GDP is at 18.4 per cent and never crossed 40 per cent.

(v) In the last decade (2003–04 to 2014–15), growth has increasingly come from the services sector, whose contribution to the overall growth of the economy has been 64 per cent, while that of the industry and agriculture sectors have been 26 per cent and 10 per cent, respectively.

(vi) India has been basically the first case which directly had either over 50 per cent of its GDP coming from the primary sector or the tertiary sector—an agrarian economy shifting directly to the service economy (at least partially, if we forget the dependency ratio of the population on the sectors). It means India jumped the stage of being a fully-developed industrial economy.

Without fully realising the industrial and manufacturing potential and directly converting into a service economy, has created tougher macro and micro challenges for policymakers in India.

17. As per information made available by the ***Central Statistical Organisation,*** Feb. 2014, GoI, New Delhi; ***Economic Survey 2014-15,*** MoF, GoI, New Delhi and the ***India 2015,*** Pub. Div., MoIB, GoI, New Delhi.