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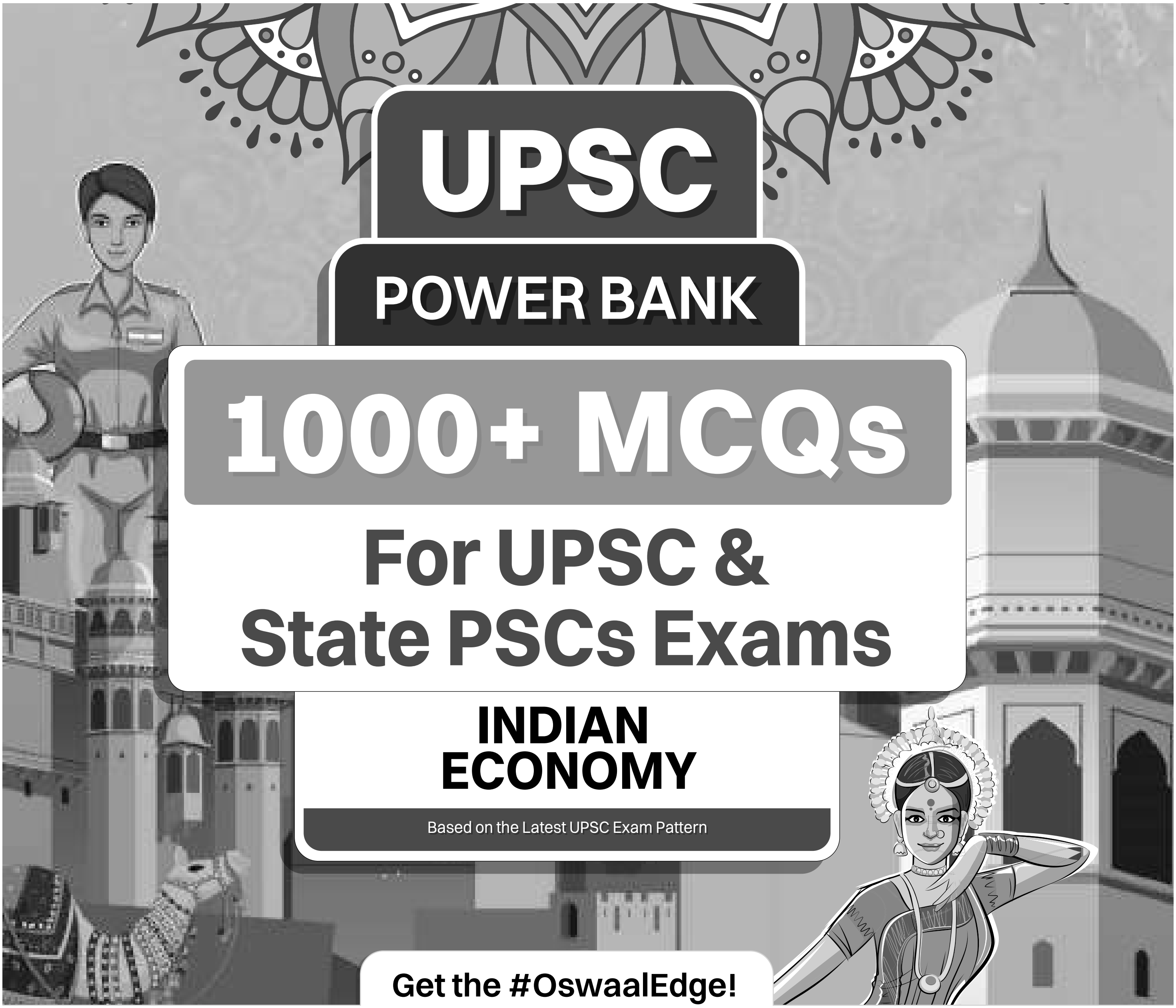

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PREFACE

The Indian Economy subject is an important component of the Civil Services Examination conducted by the Union Public Service Commission (UPSC). Aspirants who are preparing for this prestigious examination need to have a strong understanding of Indian Economy subject.
This book of UPSC Power Bank of Indian Economy subject has been designed keeping in mind the needs of aspirants who are preparing for the Civil Services Examination. The book covers all the important topics of Indian Economy including Money & Banking, Finance, Government Schemes, International Institutions , Report and Indices.

The questions in this book are comprehensive and have been curated after extensive research to ensure that they cover all the aspects of Indian Economy. Each question is accompanied by a detailed answer that not only explains the correct option but also provides additional information related to the question. This will help aspirants to build a strong foundation in Indian Economy subject and understand the subject in greater depth.

The objective of this book is:

1. **Assessing Knowledge:** by testing the candidates' understanding and knowledge of these topics.

2. **Testing Critical Thinking Skills:** to apply it in new and different contexts, analyse and evaluate information, and draw conclusions.

3. **Providing Practice:** by making them familiar with the format and style of UPSC questions.

4. **Preparing for the Exam:** by covering the same types of questions and difficulty levels as the actual exam.

5. **Identifying Knowledge Gaps:** By using the question bank, candidates can identify areas where they need to improve their knowledge or skills, and focus their study efforts accordingly.

6. **Improving Time Management:** This question bank provides a variety of questions that test different aspects of knowledge and skills, so that candidates can learn to manage their time effectively during the actual exam.

7. **Encouraging Self-assessment:** By detailed explanations and solutions to each question, candidates can assess their own performance and identify areas for improvement.

We hope that this book will prove to be a valuable resource for aspirants preparing for the UPSC Civil Services Examination and help them achieve their goals. We wish all the aspirants the very best for their preparation and future endeavours.

We also express our gratitude to **Mr. Ujjwal Garg & Mr. Lalit Sikarwar** who have contributed to the book, for their experience and their knowledge. Their contributions will help our readers gain valuable insights and knowledge and secure a high rank in the UPSC examination.
We wish the readers great success ahead!

All the best!
Team Oswaal

Study Approach for Indian Economy for UPSC Prelims

The Indian economy holds immense significance for UPSC exams. Its vastness, diversity, and dynamism make it a crucial topic for aspirants. Understanding its various sectors, policies, and challenges enables candidates to grasp India's development trajectory, its role in global affairs, and the intricacies of governance. A strong grasp of the Indian economy enhances one's chances of success in UPSC exams. Following are certain guidelines which will help you in the preparation of UPSC CSE exam.

- **Understand the Syllabus:** Begin by thoroughly understanding the economics syllabus for the UPSC Prelims.
- **Basic Concepts:** Start by building a strong foundation of basic economic concepts. This can be done by the Study of NCERTs. Prelims questions are mostly conceptual in nature. Focus on conceptual topics like demand and supply, national income accounting, inflation, monetary policy, fiscal policy, economic growth, and development.
- **Current Affairs:** Stay updated with current economic affairs, both national and international. Read newspapers, magazines, government websites, and reliable online sources to understand the recent trends, government policies, and economic indicators.
- **Analyse Government Reports:** Study government reports such as the Economic Survey of India and the Union Budget. Pay attention to important data, schemes, and initiatives mentioned in these reports.
- **Analyse the Questions:** Analyse previous year's question papers to understand the type of questions asked in the exam. You will get an idea of the important topics and the areas that require more focus.
- **Practice MCQs:** Practice multiple-choice questions (MCQs) of Other UPSC exams such as CDS, CAPF, NDA, UPSC IES. This will help you to assess your understanding of the subject and also familiarise you with the exam pattern.
- **Revision and Consolidation:** Regularly revise the topics you have studied to reinforce your understanding. Create concise notes or mind maps for quick revision.

Good luck for your UPSC prelims!

Aashirvad Kumar
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3 UPSC Interviews

Positive Affirmations

I courageuosly move in the direction of my dreams

I realize what I cannot Control and let the good things flow

I am Supported fully by the universe

I am wrapped in the loving energy of the universe

I allow my desires to flow to me now

All of my thoughts are aligned with my desires

Affirmations for the new "YOU"

"Accept yourself, love yourself, and keep moving forward. If you want to fly, you have to give up what weighs you down."

I am open to new experiences and welcome abundance into my life

I effortlessly attract my desires

When I let go, I create space for something better.

I have the power to shift my mindset and see the good in everything.

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Flash Facts

Unit-1: Basic Concepts and Planning

1. Basic Economic Concept

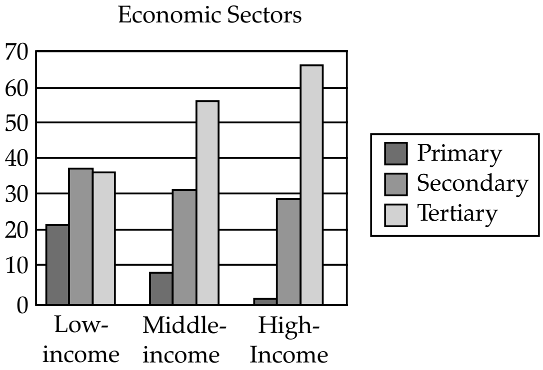
Introduction

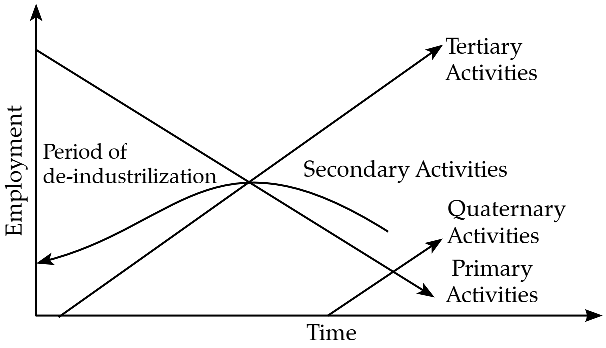
Economics and Economy

- Economics keeps an eye on the actions and performance of various economic agents. Its main objective is to analyse the economic factors. Economics is classified into two terms which are macroeconomics and microeconomics.
- The economy is considered as an area where different activities such as production, consumption, distribution and trade of goods take places. Different economic agents carry out these activities. It is considered as a social domain which is responsible for stressing practices that are associated with production and management of different resources.

Classification of Sectors of Economy

- **On the basis of Nature of Job:**
  - **Primary Sector**
    - It is concerned with the extraction of raw materials.
    - Agriculture, mining, fishing, forestry, dairy etc., are some examples of the primary sector.
  - **Secondary Sector**
    - It includes the industries where finished products are made from raw material produced in the primary sector.
    - Industrial production, textile, sugar, bread, automobiles, oil refinery etc., comes under this sector.
  - **Tertiary Sector (or Service Sector)**
    - This sector's activities help in the development of the primary and secondary sectors.
    - These activities, by themselves, do not produce good but they are an aid or a support for the production process.
    - Transport, storage, communication, banking, insurance, trade are some examples of tertiary activities.
    - These activities generate services rather than goods, therefore, the tertiary sector is also called the service sector.





- **On the basis of working condition**
  - **Organised Sector**
    - In this sector, employment terms are fixed and regular, and the employees get assured work and social security.
    - It is a sector, which is registered with the government and certain acts apply to the enterprises.
    - This sector provides security of employment.
  - **Unorganised Sector**
    - This sector refers to a home-based worker or a self-employed worker or a wage worker in the unorganised sector.
    - Further, it includes a worker in the organized sector who is not covered by any of the Acts pertaining to welfare schemes as mentioned in Schedule-II of Unorganised Workers Social Security Act, 2008.
    - This sector is marked by low incomes, unstable and irregular employment, and lack of protection either from legislation or trade unions.
- **On the basis of ownership:**
  - **Public Sector**
    - In this, the government owns most of the assets and provides all the services.

- Railways or post office is an examples of the public sector.
- The purpose of the public sector is not just to earn profits. Governments raise money through taxes and other ways to meet expenses on the services rendered by it.

- **Private Sector**
  - In this, ownership of assets and delivery of services is in the hands of private individuals or companies.
  - Example: companies like Tata Iron and Steel Company Limited (TISCO) or Reliance Industries Limited (RIL) are privately owned.
  - Activities in the private sector are guided by the motive to earn profits.

Economic Systems

The following five economic systems illustrate historical practices used to allocate resources to meet the needs of the individual and society.

- **Primitivism:** In primitive agrarian societies, individuals produced necessities from building dwellings, growing crops, and hunting game at the household or tribal level.
- **Feudalism:** This was defined by the lords who held land and leased it to peasants for production, who received a promise of safety and security from the lord.
- **Capitalism**
  - With the advent of the industrial revolution, capitalism emerged and is defined as a system of production where business owners organize resources including tools, workers, and raw materials to produce goods for market consumption and earn profits.
  - Supply and demand set prices in markets in a way that can serve the best interests of society.
- **Socialism**
  - Socialism is a form of a cooperative production economy.
  - Economic socialism is a system of production where there is limited or hybrid private ownership of the means of production.
  - In this system, prices, profits, and losses are not the determining factors used to establish who engages in the production, what to produce and how to produce it.
- **Communism:** Communism holds that all economic activity is centralized through the coordination of state sponsored central planners with common ownership of production and distribution.

Economic Indicators

Economic indicators detail a country's economic performance, and are published periodically by governmental agencies or private organizations.

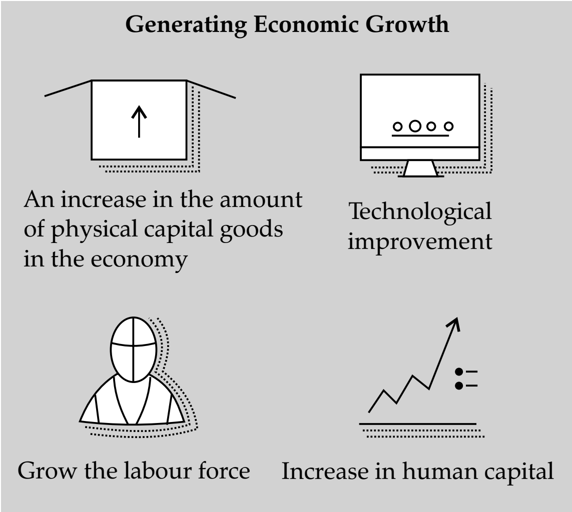
- **Gross domestic product (GDP):** It is the total market value of all finished goods and services produced in a country in a given year.
- **Industrial production**
  - The reports published by Government entities change according to the production of factories, mines, and utilities in the country.
  - This data is an indicator of price increases or supply shortages in the near term, Slack/ Tightening of the Economy, etc.
- **Employment Data:** Sharp increases in employment indicate prosperous economic growth and potential contractions may be imminent if significant decreases occur.
- **Consumer Price Index (CPI)**
  - This measures the level of retail price changes, and the costs that consumers pay, and is the benchmark for measuring inflation.
  - This report is an important economic indicator and its release can increase volatility in equity, fixed income, and forex markets.

Branches of Economics

- **Microeconomics**
  - Microeconomics studies how individual consumers and firms make decisions to allocate resources.
  - Whether a single person, a household, or a business, economists may analyse how these entities respond to changes in price and why they demand what they do at particular price levels.
- **Macroeconomics**
  - Macroeconomics is the branch of economics that studies the behaviour and performance of an economy as a whole.
  - Its primary focus is the recurrent economic cycles and broad economic growth and development.

Economic Growth

- Economic growth is an increase in the production of economic goods and services, compared from one period of time to another.



- It can be measured in nominal or real (adjusted for inflation) terms.

Economic Development

- Economic development is defined as a sustained improvement in material well being of society.
- In short, economic development is a process consisting of a long chain of interrelated changes in fundamental factors of supply and in the structure of demand, leading to a rise in the net national product of a country in the long run.

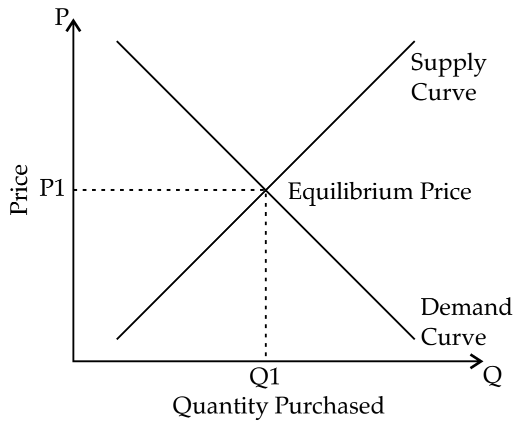
Differences between Economic Growth and Economic Development

Parameter	Economic Growth	Economic Development
Concept	It is the positive change in the indicators of the economy.	It is the quantitative and qualitative change in an economy.
Factors	Growth relates to a gradual increase in one of the components of Gross Domestic Product: consumption, government spending, investment and net exports.	Development relates to growth of human capital, decrease in inequality figures, and structural changes that improve the quality of life of the population.
Impact	It refers to the increment in the amount of goods and services produced by an economy.	It refers to the reduction and elimination of poverty, unemployment and inequality with the context of a growing economy.
Focus	This focuses on production of goods and services.	This focuses on distribution of resources.
Measurement	Economic Growth is measured by quantitative factors such as increase in real GDP or per capita income.	The qualitative measures such as HDI (Human Development Index), gender related index, Human Poverty Index (HPI), infant mortality, literacy rate etc. are used to measure economic development.
Relevance	It reflects the growth of national or per capita income	It reflects progress in the quality of life in a country.
Time Frame	It is for a short term/short period. It is measured in a certain time frame/period.	It is a continuous and long-term process. Economic development does not have a specific time period to measure.
Interaction	Economic growth is an automatic process that may or may not require intervention from the government	Economic development requires intervention from the government as all the developmental policies are formed by the government
Expectations	It is not concerned with happiness of public life	It is concerned with the happiness of public life.
Application	Economic growth is a more relevant metric for assessing progress in developed countries.	More relevant to measure progress and quality of life in developing countries.

Law of Supply and Demand

- The law of supply and demand is a theory that explains the interaction between the sellers of a resource and the buyers for that resource.
- The theory defines the relationship between the price of a given good or product and the willingness of people to either buy or sell it. Generally, as price increases, people are willing to supply more.

Law of Supply and Demand



Importance of concept of Supply and Demand

- The Law of Supply and Demand is essential because it helps investors, entrepreneurs, and economists understand and predict market conditions.
- For example, a company launching a new product might deliberately try to raise the price of its product by increasing consumer demand through advertising.
- At the same time, they might try to further increase their price by deliberately restricting the number of units they sell to decrease supply.

2. Planning and National Income

Economic Planning

The term economic planning is used to describe the long term plans of the government of India to develop and coordinate the economy with efficient utilization of resources. Economic planning in India started after independence in the year 1950 when it was deemed necessary for economic growth and development of the nation.

Objectives of Economic Planning in India

- **Economic Development:** Economic development is the primary goal of Indian planning. Increases in

India's Gross Domestic Product (GDP) and Per Capita Income are used to measure the country's economic development.

- **Increased Employment:** An essential goal of Indian economic planning is to better utilize the country's abundant people resources by raising employment levels.
- **Self-sufficiency:** India aspires to be self-sufficient in major commodities while simultaneously increasing exports. During the third five-year plan, from 1961 to 1966, the Indian economy had reached a critical stage of development.
- **Economic Stability:** In addition to India's economic growth, India's economic planning aims for stable market conditions. This entails maintaining a modest rate of inflation but simultaneously avoiding price deflation. The creation of structural faults in the economy occurs when the wholesale price index rises very high or very low, and economic planning seeks to avoid this.
- **Social Welfare and Efficient Social Service Provision:** All five-year plans, as well as plans proposed by the NITI Aayog, aim to improve labor welfare and social welfare for all sections of society. India has planned for the development of social services such as education, healthcare, and emergency services.
- **Regional Development:** India's economic strategy tries to decrease regional development discrepancies. Some states, such as Punjab, Haryana, Gujarat, Maharashtra, an d Tamil Nadu, are economically developed, whereas others, such as Uttar Pradesh, Bihar, Orissa, Assam, and Nagaland, are not. Others, such as Karnataka and Andhra Pradesh, have had unequal development, with world-class economic hubs in cities and a less developed countryside. In India, planning aims to investigate these inequities and propose methods to address them.
- **Comprehensive and sustainable development:** One of the key goals of economic planning is to develop all economic sectors, such as agriculture, industry, and services.
- **Economic Inequality Reduction:** Since independence, reducing inequality through progressive taxation, job creation, and job reservation has been a fundamental goal of Indian economic planning.
- **Social Justice:** This planning goal is linked with all the other objectives, and it has long been a focal point of planning in India. Its goal is to lower the number of individuals living in poverty by providing them with employment and social services.
- **Increased Standard of Life:** One of the key goals of India's economic planning is to raise the standard of living by raising per capita income and ensuring equal distribution of income.

Types of Planning

The majority of economies in today's world are mixed economies. There are different types of planning that are discussed below:

Indicative Planning

- It proposes/indicates a set of broad principles and recommendations for achieving a set of objectives. Indicative planning is unique to France's mixed economy. However, this is not the same as the planning that exists in other mixed economies.
- The term "mixed economy" refers to the simultaneous operation of the public and private sectors. The state exercised control over the private sector in a variety of ways, including quotas, prices, licenses, and so on.
- However, under suggestive planning, the private sector is not strictly supervised in order to meet the plan's aims and priorities. The government provides full support to the private sector but does not have control over it. Rather, it directs the private sector to implement the plan in particular areas.

Comprehensive/Imperative Planning

- This refers to centralized planning and implementation, as well as resource allocation. It is utilized by socialist countries, where the state has complete control over all aspects of planning.
- The state makes the best use of its resources in order to meet the plan's objectives. Under this type of planning, consumer sovereignty is surrendered. Consumers receive fixed volumes at fixed costs. The government's policies are rigid and difficult to change. Any change might have a negative impact on the economy.

Economic Planning In India – Five-Year Plans

- Post-independence, India began a Five-Year Plan program to make the most use of the country's resources and achieve rapid economic development.
- In India, development plans were designed and implemented within the mixed economy framework.
- Economic planning was implemented in India in the form of Five-Year Plans and was viewed as a development tool for a variety of reasons.
- In light of India's constrained resources, judicious mobilization and allocation of resources in the context of overall development programs.
- Since the year 2012, when the 12th Five Year Plan (2012-2017) was adopted by the NDC (National Development Council) on December 27, 2012, 12th Five-Year Plans have been formulated.

The following are the long-term goals of India's Five-Year Plans:

- To raise the living standards of India's citizens, a high growth rate is required.
- For prosperity, there must be economic stability.
- An economy that is self-sufficient.
- Reducing inequality and promoting social justice
- The economy is being modernized.

> Under the socialist influence of first Prime Minister Pt. Jawahar Lal Nehru, the idea of five-year economic planning was borrowed from the Soviet Union.

The first eight Indian five-year plans focused on expanding the public sector through massive investments in heavy and basic sectors, but since the start of the Ninth five-year plan in 1997, the focus has moved to make the government a growth facilitator.

The following is a list of all Five-Year Plans that have been executed in India:

Five-Year Plans	Years	Assessment	Objective
First Five-year Plan	1951- 1956	Targets and objectives more or less achieved. With an active role of the state in all economic sectors. Five Indian Institutes of Technology (IITs) were started as major technical institutions.	Rehabilitation of refugees, rapid agricultural development to achieve food self-sufficiency in the shortest possible time and control of inflation.
Second Five-year Plan	1956-1961	It could not be implemented fully due to the shortage of foreign exchange. Targets had to be pruned. Yet, hydroelectric power projects and five steel mills at Bhilai, Durgapur, and Rourkela were established.	The Nehru-Mahalanobis model was adopted. Rapid industrialisation with particular emphasis on the development of basic and heavy industries. Industrial Policy of 1956 accepted the establishment of a socialistic pattern of society as the goal of economic policy.
Third Five-year Plan	1961-1966	Failure-Wars and droughts. Yet, Panchayat elections were started. State electricity boards and state secondary education boards were formed.	'Establishment of a self-reliant and self-generating economy'
Plan Holidays – Annual Plans	1966-1969	A new agricultural strategy was implemented. It involved the distribution of high-yielding varieties of seeds, extensive use of fertilizers, exploitation of irrigation potential and soil conservation measures.	Crisis in agriculture and serious food shortage required attention
Fourth Five-year Plan	1969-1974	Was ambitious. Failure. Achieved growth of 3.5 percent but was marred by Inflation. The Indira Gandhi government nationalized 14 major Indian banks and the Green Revolution in India advanced agriculture.	'Growth with stability' and progressive achievement of self-reliance Garibi HataoTarget: 5.5 pc
Fifth Five-year Plan	1974-1979	High inflation. Was terminated by the Janta govt. Yet, the Indian national highway system was introduced for the first time.	'Removal of poverty and attainment of self-reliance'
Sixth Five-year Plan	1980-1985	Most targets achieved. Growth: 5.5 pc. Family planning was also expanded in order to prevent overpopulation.	'Direct attack on the problem of poverty by creating conditions of an expanding economy'
Seventh Five-year Plan	1985-1990	With a growth rate of 6%, this plan was proved successful in spite of severe drought conditions for the first three years consecutively. This plan introduced programs like Jawahar Rozgar Yojana.	Emphasis on policies and programs that would accelerate the growth in foodgrains production, increase employment opportunities and raise productivity
Annual Plans	1989-1991	It was the beginning of privatization and liberalization in India.	No plan due to political uncertainties
Eighth Five-year Plan	1992-1997	Partly success. An average annual growth rate of 6.78% against the target 5.6% was achieved.	Rapid economic growth, high growth of agriculture and allied sector, and the manufacturing sector, growth in exports and imports, improvement in trade and current account deficit to undertake an annual average growth of 5.6% . For the first time Indicative planning approach used.

Ninth Five-year Plan	1997-2002	It achieved a GDP growth rate of 5.4%, lower than the target. Yet, industrial growth was 4.5% which was higher than the targeted 3%. The service industry had a growth rate of 7.8%. An average annual growth rate of 6.7% was reached.	Quality of life, generation of productive employment, regional balance and self-reliance. Growth with social justice and equality growth target 6.5%
Tenth Five-year Plan	2002 –2007	It was successful in reducing the poverty ratio by 5%, increasing forest cover to 25%, increasing literacy rates to 75 % and the economic growth of the country over 8%.	To achieve 8% GDP growth rate,Reduce poverty by 5 points and increase the literacy rate in the country.
Eleventh Five-year Plan	2007-2012	India has recorded an average annual economic growth rate of 8%, farm sector grew at an average rate of 3.7% as against 4% targeted. The industry grew with an annual average growth of 7.2% against 10% targeted	Rapid and inclusive growth. Empowerment through education and skill development. Reduction of gender inequality. Environmental sustainability. To increase the growth rate in agriculture, industry, and services to 4%,10% and 9% resp. Provide clean drinking water for all by 2009.
Twelfth Five-year Plan	2012-2017	Its growth rate target was 8%.	"Faster, sustainable and more inclusive growth". Raising agriculture output to 4 percent and manufacturing sector growth to 10 % The target of adding over 88,000 MW of power generation capacity.

Comparison of Planning Commission and NITI Aayog

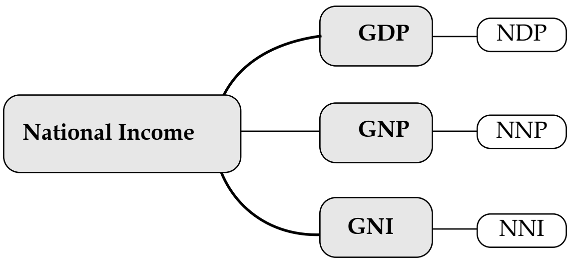
Planning Commission	NITI Aayog
Prepared the Five-Year Plans of India	NITI Aayog has given responsibility to draft: ● Three Year Action Agenda (2017-20). ● Seven Year Strategy Document. ● Fifteen Year Vision Document (2017-32). ● 2018: drafted Strategy for New India @ 75 covering the period 2017 to 2022-23.
How much money should the union give to each state for implementation of centrally sponsored schemes (CSS)? How much money should the union give to the five year plans of the state governments? PC would answer these questions using Gadgil Mukherjee formula (designed in 8TH FYP)- based on population, per capita income, special problems etc. of a state.	NITI Aayog doesn't decide how much money should be given to each state. That component is decided by the Finance Commission (tax devolution and grants) and Finance Ministry (Allocations for schemes). NITI Aayog primarily serves as the think tank, helps in policy design. Helps in monitoring schemes' implementation through its dash-board e.g. 'School Education Quality Index', 'SDG India Index', 'Digital Transformation Index' etc.

National Income

It is the sum of income earned by its residents from the factor services rendered to the production units, both within and outside the geographical boundaries of the country.

- **National:** It refers to the residents whose economic interests lie within the country in which they live.
- **Factor Income:** It is the income derived from factors of production such as Land, Labour, Capital and Entrepreneurship.

Measure of National Income



Gross Value Added (GVA)

- It is a measure of total output and income in the economy.
- It provides rupee value for the amount of goods and services produced in an economy after deducting the cost of inputs and raw materials that have gone into the production of goods and services.
- It gives a sector-specific picture of growth in an area such as industry, agriculture, manufacturing etc.
- **Classification of Good or Service as Intermediate Consumption**
  - It is purchased or acquired from another production unit.
  - It is acquired for resale, which amounts to being used up entirely in the course of production during the accounting period.

GVA = Value of Gross Output – Value of Intermediate Consumption

- In the revision of National Accounts Statistics done by the Central Statistical Organization (CSO), it was decided that while computing GDP, sector-wise estimates of Gross Value Added (GVA) will now be given at basic prices instead of factor cost.
- GVA at basic prices will include production taxes and exclude production subsidies available on the commodity.

GVA (at Basic Price) = GVA (at Factor Cost) + Production Taxes – Production Subsidies

- GVA at factor cost includes no taxes and excludes no subsidies.
- While calculating GDP at market prices, it includes both production and product taxes, and excludes both production and product subsidies.

Gross Domestic Product (GDP)

- It is the market value of all final goods and services produced within the territory of the country during a financial year.
- However, it can also be computed quarterly or half yearly.
- It is estimated by the Central Statistical Office (CSO).
- The Ministry of Finance uses the GDP numbers (at current prices) to peg the financial targets [as per the Fiscal Responsibility and Budget Management Act (FRBM), 2003].

Methods of Calculating GDP Production

- It is also known as the Value Added or the Output Method.
- In this method, the value of the final product of the primary, secondary and tertiary sector is included, and the transfer payments viz., scholarships, pensions etc. are excluded. Production by unwarranted or illegal activities is also excluded.
- The total Market Price of the final product should be equal to the Gross Value Added. Therefore, the GDP can be calculated using the Product or Value Added Method.

GDP using Value Added Method
GDP (at Factor Cost) = GVA (at Basic Price)
GDP (at Market price) = GVA (at Basic Price) + Product Taxes – Product Subsidies

Net Domestic Product (NDP)

- NDP is the value of net output of the economy during the year. Some of the country's capital equipment wears out or becomes obsolete each year during the production process. The value of this capital consumption is some percentage of gross investment which is deducted from GDP. Thus,
  Net Domestic Product = GDP at Factor Cost – Depreciation.

Nominal GDP

- Nominal gross domestic product is GDP that is evaluated at the present market prices. GDP is the financial equivalent of all the complete products and services generated within a nation in a definite time.
- The nominal varies from the real and incorporates changes in cost prices due to an increase in the complete cost price. Generally, economists utilize a gross domestic factor to change the nominal GDP to the real GDP, which is also known as current dollar GDP or chained dollar GDP.

Real GDP

- Real GDP is an inflation-adjusted calculation that analyses the rate of all commodities and services manufactured in a country for a fixed year. It is expressed in foundation year prices and referred to as a fixed cost price.
- It is also known as inflation-corrected GDP or constant price GDP. The real GDP is regarded as a reliable indicator of a nation's economic growth as it solely considers production and is free from currency fluctuations.

GDP Deflator

The GDP deflator, also called implicit price deflator, is a measure of inflation. It is the ratio of the value of goods and services an economy produces in a particular year at current prices to that of prices that prevailed during the base year.

Gross National Product (GNP)

- The total value of all goods and services generated by citizens and enterprises in a country, regardless of where they are produced, is referred to as the gross national product (GNP).
- The Gross National Product (GNP) accounts for investments made by enterprises and citizens of the country, both inside and outside the country. It also takes into account the value of products generated by domestically based industries.
- GNP does not include revenue made by foreign nationals in the country or any products manufactured by a foreign business in the country's manufacturing units.
- Only the final commodities and services are taken into account when calculating GNP. Double counting is prevented by avoiding intermediate products.

GNP = Consumption expenditure + Investment + Government expenditure + Net exports + Net income

Net National Product

NNP is the total value of finished goods and services produced by a country's citizens overseas and domestically over a time period without considering the depreciation

If we deduct depreciation from the GNP, what we get is NNP.

Net National Product (Market Price) = Gross National Product – Depreciation

Personal Income

- Personal Income is the part of National Income which is received by the households.
- The formula for calculating Personal Income (PI) is

Personal income (PI) = National Income – Undistributed profits (profits utilised by manufacturers for further production) – Net interest payments made by households – Corporate tax + Transfer payments to the households from the government and firms(old-age pensions, unemployment compensation, relief payment etc.).

Personal Disposable Income

- Personal Disposable Income refers to the income that is available to the households that they can spent as they wish.
- All the Personal Income is not available to individuals to spend. They have to pay taxes (e.g. Income tax) and non-tax payment such as fines.
- The formula for Personal Disposable Income is

Personal Disposable Income (PDI) PI – Personal tax payments – Non-tax payments (such as fines etc)

- Thus, Personal Disposable Income is the part of aggregate income which belongs to the households. They may decide to consume a part of it, and save the rest.

National Disposable Income

- National Disposable Income is the sum of the disposable incomes of all resident and institutional units.
- National Disposable Income gives us an idea of what is the maximum amount of goods and services the domestic economy has at its disposal
- The formula for National Disposable Income is

National Disposable Income = Net National Product at market prices + Other current transfers from the rest of the world

- Current transfers from the rest of the world includes items such as gifts, aids etc.

Private Income

- Private income is the total of factor incomes and transfer incomes received from all sources by private sector (private enterprise and households) within and outside the country.

The formula for Private Income is

Private Income = Factor income from net domestic product accruing to the private sector + National debt interest + Net factor income from abroad + Current transfers from government + Other net transfers from the rest of the world

The concept of private income is broader than personal income because private income consists of personal income + profit tax + undistributed profit.

- National income accounting equation is an equation that shows the relationship between income and expense of an economy and other categories. It is represented by the following equation:

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

  Where

  Y = National income

  C = Personal consumption expenditure

  I = Private investment

  G = Government spending

  X = Net exports

  M = Imports

  The most important metrics that are determined by national income accounting are GDP, GNP, NNP, disposable income, and personal income. Let us know more about these concepts briefly in the following lines.

Significance of National Income Accounting

- It helps in comparing estimates, forecasting growth, and policy formulation for the future.
- It helps in comparing economies around the world.
- It is helpful in effective decision making on investments, thereby helping business houses to plan for productions.

Unit-II: Money Circulation in Economy

1. Fiscal Policy

Introduction

- Fiscal policy is the use of government revenue collection (mainly taxes but also non-tax revenues such as divestment, loans) and expenditure (spending) to influence the economy.
- Through fiscal policy, the government of a country controls the flow of tax revenues and public expenditure to navigate the economy.
- Fiscal policy in India is the guiding force that helps the government decide how much money it should spend to support the economic activity, and how much revenue it must earn from the system, to keep the wheels of the economy running smoothly.

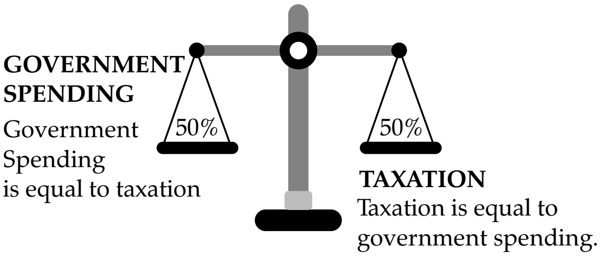
The major fiscal measures are:

Public Expenditure	Government spends money on a wide variety of things, from the military and police to services like education and health care, as well as transfer payments such as welfare benefits.

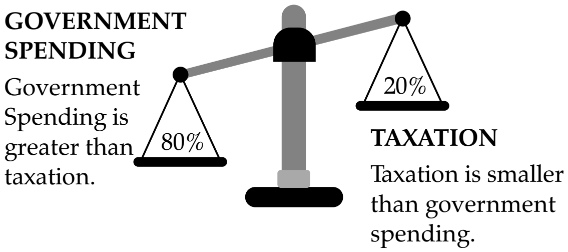
Taxation	Government imposes new taxes and changes the rate of current taxes. The expenditure of the government is funded by the imposition of taxes.
Public Borrowing	Government also raises money from the population or from abroad through bonds, NSC, Kisan Vikas Patra, etc.
Other Measure	Other measures adopted by the government are: ● Rationing and price control ● Regulation of wages ● Increase the production of good nd services.

Types of Fiscal Policy

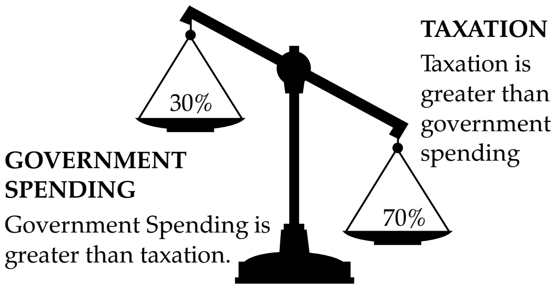
FISCAL NEUTRAL POLICY



EXPANSIONARY FISCAL POLICY



CONTRACTIONARY FISCAL POLICY



Objectives of Fiscal policy	**To promote economic growth:** ● Government promotes economic growth by setting up basic and heavy industries like steel, chemicals, fertilizers, machine tools, etc. ● It also builds infrastructure like roads, canals, railways, airports, education and health services, water and electricity supply, telecommunications, etc. that foster economic growth. ● To reduce income and wealth inequalities: Government reduces inequalities in income and wealth by taxing the rich more and spending more on the poor. Further, it provides employment opportunities to the poor that help them to earn. **To provide employment opportunities:** ● Employment opportunities are increased by the government in various ways, One, jobs are created when it sets up public sector enterprises. ● It also encourages setting up of small-scale, cottage and village industries by people which are employment oriented. **To ensure stability in prices:** Government ensures stability of prices of essential goods and services by regulating their supplies. **To correct balance of payments deficit:** ● The balance of payments account of a country records its receipts and payment with foreign countries. ● When payments to foreigners are more than receipts from foreigners, the balance of payments account is said to be in deficit. **To provide for effective administration:** Government incurs expenditures on police, defence, legislatures, judiciary, etc. to provide effective administration.

Components of Fiscal Policy

The components of the Fiscal Policy can be categorized as

- Government Receipts
- Government Expenditures
- Public Accounts of India

Government Receipts

- The government's income in the form of Taxes, interests, and earnings on investments, cess, and other receipts for services rendered are altogether known as government receipts.
- This is the total amount of money received by the government from all sources.
- Government receipts are divided into two groups—**Revenue Receipts and Capital Receipts.**

Revenue Receipts	● Receipts that neither create liabilities nor reduce assets ● Revenue Receipts can be subdivided into two: Tax and non-tax revenues. ● Tax revenues are of two types: direct and indirect taxes ● Non Tax revenue sources are interest and dividend on government investment, cess and other receipts for services rendered by the government, income through licenses, permits, fines, penalties, etc.

Capital Receipts	● Incoming cash flows is another term used for capital receipts. ● All kinds of borrowings, loans, etc. are treated as debt receipts as the government has to repay this money and, with its interests in some cases.

Government Expenditure

Government expenditure is classified in two ways: **Capital Expenditure and Revenue Expenditure.**

Revenue expenditures	● When the government incurs expenditure that neither creates any asset nor reduces any liability, such expenditure is known as revenue expenditure. ● **Example:** Salaries and employee wages, utilities, rents, property taxes on government-owned properties, etc. ● These do not create any public asset
Capital Expenditure	● Investments made by the government in capital to maintain or to expand its business and generate additional revenue. ● Purchase of long-term assets, buying fixed assets, which are physical assets such as equipment. As a result, capital expenditures are typically for larger amounts than revenue expenditures. ● **Example:** purchase of factory equipment, purchases for business, other government purchases like furniture, spending on infrastructure, etc.

Public Accounts of India (Public Debt)

- According to Article 266(2) of the Constitution, this fund was established. It takes into consideration flows for transactions in which the government only serves as a banker.
- Examples include minor savings, provident funds, etc.
- This money doesn't belong to the government; instead, they must be returned to their original owners at some point.
- Consequently, the Parliament is not required to authorize spending from the public account.

Deficit

Revenue Deficit: It refers to the excess of total revenue expenditure of the government over its total revenue receipts.

> Revenue deficit = Total Revenue expenditure – Total Revenue receipts.
>
> OR
>
> Revenue deficit = Total Revenue expenditure – (Tax Revenue + Non-Tax Revenue)

Fiscal Deficit: Fiscal deficit is defined as excess of total expenditure over total receipts excluding borrowings during a fiscal year.

> - Fiscal deficit = Total budget expenditure – Total budget receipts excluding borrowings OR Fiscal Deficit = (Revenue expenditure + Capital expenditure) – (Revenue Receipts + Capital receipts excluding borrowings) Fiscal deficit shows the borrowing requirements of the government, during the budget year.
> - Fiscal deficit reflects the borrowing requirements of the government, for financing the expenditure including interest payments.
> - Fiscal deficit = Revenue expenditure + capital expenditure – Revenue receipts – capital Receipts excluding borrowings OR Fiscal deficit = Revenue expenditure + capital expenditure – Tax Revenue – Non-Tax Revenue – recovery of loans – disinvestment OR
> - Fiscal deficit = Total borrowing requirement of the government

- Fiscal deficit indicates the additional number of financial resources needed to meet government expenditure.
- It is an indicator of the increase in future liabilities of the government on interest payment and loan repayment.
- The government has to pay back the borrowed amount with interest in the future.
- Consequently, the government has to either borrow more from the people or tax people more in future to pay interest and loan amount.

Primary Deficit

- Primary deficit is defined as fiscal deficit minus interest payments on previous borrowings.
- Primary deficit shows the borrowing requirements of the government for meeting expenditure excluding interest payment.
- Gross Primary deficit = Fiscal deficit – Interest payments.

> **Net Primary deficit** = Fiscal deficit + Interest received – Interest payments It shows the total amount that the central government needs to borrow.

Three Ways to Finance Deficit

- Borrowing from Public and Foreign Governments
- Withdrawing Cash Balances held with the Reserve Bank of India (R.B.I.)
- Borrowing from the Reserve Bank of India (R.B.I)

Fiscal Responsibility and Budget Management Act, 2003 (FRBMA)

- The Fiscal Responsibility and Budget Management Act, 2003 (FRBMA) is an Act of the Parliament of India to institutionalize financial discipline, reduce India's fiscal deficit, improve macroeconomic management and the overall management of the public funds by moving towards a balanced budget.

Major Provisions of the FRBM Act, 2003	• The FRBM rule set a target reduction of fiscal deficit to 3% of the GDP by 2008-09. This will be realized with an annual reduction target of 0.3% of GDP per year by the Central government. • Revenue deficit has to be reduced by 0.5% of the GDP per year with complete elimination by 2008-09. • Reduction of Public Debt • The government has to take appropriate measures to reduce the fiscal deficit and revenue deficit so as to eliminate revenue deficit by 2008-09 and thereafter, sizable revenue surplus has to be created. • It mandated setting annual targets for the reduction of fiscal deficit and revenue deficit, contingent liabilities and total liabilities. • The government shall end its borrowing from the RBI except for temporary advances. • The RBI was supposed to not subscribe to the primary issues of the central government securities after 2006. • The revenue deficit and fiscal deficit may exceed the targets specified in the rules only on grounds of national security, calamity and other exceptional grounds to be specified by the Central government.
Objectives of FRBM Act	• Establish transparent fiscal management mechanisms in the country. • Provide a more equitable and controllable distribution of the country's debts over time. • Achieve long-term fiscal stability for India. • Furthermore, the act was supposed to provide the Reserve Bank of India with the required flexibility in managing inflation in India.

- **Amendments to FRBM Act:** Fiscal Responsibility and Budget Management Act, 2003 was amended in 2012 that mandated the Central Government to lay before the Houses of Parliament, Macro-Economic Framework Statement, Medium Term Fiscal Policy Statement and Fiscal Policy Strategy Statement along with the Annual Financial Statement and Demands for Grants.
- **NK Singh committee**, which was set up in 2016 to review the FRBM Act, recommended that the government must target a fiscal deficit of 3% of the GDP in the years up to March 31, 2020, subsequently cut it to 2.8% in 2020-21 and to 2.5% by 2023.

2. Monetary Policy and Banking

Concept of Money

Money is anything that has general acceptance as a means of payment for goods and services or settlement of debts.

Major Functions of Money

- It is used as a medium of exchange.
- It gives a common measure of value.
- It is used as a standard of deferred payments. It can also be used as a store of value.

Commodity Money

- The commodity money derives its value from the commodity out of which it is made.
- The commodity itself represents money, for instance, commodities that have been used as a medium of exchange include gold, silver, copper, salt, precious stones, etc.

Representative Money

- It includes token coins or any other physical tokens like certificates, that can be reliably exchanged for a fixed amount/quantity of a commodity like gold and silver.
- It is used against the backing of equivalent values of gold and silver.

Fiat Money

- It is also known as the fiat currency and its value is not derived from any intrinsic value or guarantee that it can be converted into a valuable commodity like gold. It derives its value, which is only based on Government order.
- Fiat money is also one that is declared legal tender. This includes any form of currency in circulation such as paper money or coins.
- Legal tender means something which cannot be refused as an option for payment, for example Indian Rupee, US Dollar etc.

Cryptocurrency

- Crypto-currencies are peer-based money, such as bitcoin.
- This type of money is electronically based on electronic accounting entries that can be used as a medium of exchange.
- It works on block chain technology, which is a decentralized database that maintains a continuously growing list of records.
- In India Crypto-currencies are not legal tenders.

Measures of Money Supply

Money supply is the total stock of all types of money, such as currency and demand deposits held with public and banks.

The stock of money kept with the government and RBI, etc. is not taken into account in money supply as these are not in actual circulation in the economy.

The Government

It produces coins of all denominations and the One Rupee notes.

The government of India has the sole right to mint coins. However, these are issued for circulation only through the Reserve Bank in lieu of the RBI Act.

RBI

It is the only authority that has the sole right to issue currency notes, except one rupee notes which are issued by the Ministry of Finance.

However, the RBI follows a minimum reserve system in the note issue. It has to maintain only `200 crores of gold and foreign exchange reserves, of which gold reserves should be of the value of `115 crores.

Commercial Banks: These create the credit as per the demand deposits.

Monetary Aggregates	
M0	• It is known as the monetary base or reserve money. • It is sometimes referred to as High-powered money or primary money. • It includes all physical money like coins and currency along with demand deposits and other liquid assets held by the central bank.
M1	• It is also known as narrow money. • Narrow money only contains the most liquid financial assets which are accessible on demand. • It includes all the currency notes being held by the public on any given day, demand deposits with the commercial banks (both savings as well as current account deposits) and other deposits of the banks kept with the RBI. • Narrow money is the most liquid part of the money supply because the demand deposits can be withdrawn anytime during the banking hours.
M2 and M3	• When Post office Savings Deposits are also added to M1, it becomes M2. ■ M2= M1 + Savings Deposits of Post Office Savings account. • When we add time deposits in the narrow money (M1), we get broad money, which can be denoted by M3. ■ M3 = M1 + Time deposits of public with the banks. • Broad money does not include the interbank deposits. At the same time, time deposits of the public with the banks, including the cooperative banks are also included in Broad money. • M1, M2 and M3 are also called fortnight money as these three aggregates are computed or compiled fortnightly.
M4	• When we add total savings deposits with post offices with M3 we get M4 Money. ■ M4 = M3 + Total Saving deposits with Post offices • The most common measure used for money supply is M3 Money or the Broad money. • Currently M1 and M3 are extensively used for policy purposes and are the relevant indicators of money supply in India.

Targets and sub-targets for the Banks under priority sector are as follows:

Targets for scheduled commercial banks

The targets and sub-targets set under priority sector lending for all scheduled commercial banks operating in India are furnished below:

Table: Targets and Sub targets under Priority Sector

Categories	Domestic scheduled commercial banks and foreign banks with 20 branches and above	Foreign banks with less than 20 branches	Regional Rural Banks	Small Finance Banks
Total Priority Sector	40 per cent of Adjusted Net Bank Credit or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher.	40 per cent of Adjusted Net Bank Credit or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher; out of which up to 32% can be in the form of lending to Exports and not less than 8% can be to any other priority sector	75 per cent of ANBC as computed in para 6 below or CEOBE whichever is higher; However, lending to Medium Enterprises, Social Infrastructure and Renewable Energy shall be reckoned for priority sector achievement only up to 15 per cent of ANBC.	75 per cent of ANBC as computed in para 6 below or CEOBE whichever is higher.
Agriculture	18 per cent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher. Within the 18 per cent target for agriculture, a target of 8 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher is prescribed for Small and Marginal Farmers.	Not applicable	18 per cent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher.	18 per cent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher.

Micro Enterprises	7.5 per cent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher	Not applicable	7.5 per cent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher	7.5 per cent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher
Advances to Weaker Sections	12 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher	Not applicable	15 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher	12 percent of ANBC or Credit Equivalent Amount of Off-Balance Sheet Exposure, whichever is higher

BANKING

Commercial banks can be broadly divided into public sector, private sector, foreign banks and RRBs.

Historical evolution of banking system in India

Phase 1: Pre – Independence Phase	● The first bank to be established as the Bank of Hindustan was founded in 1770 in Calcutta. ● It closed down in 1832. ● The Oudh Commercial Bank was India's first commercial bank.
Phase 2: Post-Independence Phase	● In 1975, the Government of India recognized that several groups were financially excluded. Between 1982 and 1990, it created banking institutions with specialized functions in line with the evolution of financial services in India. ■ NABARD ■ EXIM Bank etc.
Phase 3: The LPG Era (1991 till date)	● From 1991 onwards, there was a sea change in the Indian economy. ● The government invited private investors to invest in India. Ten private banks were approved by the RBI. ● A few prominent names which exist even today from this liberalization are HDFC, Axis Bank, ICICI, DCB, and IndusInd Bank. ● In the early to mid-2000s, two other banks, Kotak Mahindra Bank (2001) and Yes Bank (2004) received their licenses. IDFC and Bandhan banks were also given licenses in 2013-14.
	Other notable changes are: ● Foreign banks like Citibank, HSBC, Bank of America set up branches in India. ● The nationalization of banks came to a standstill. Banks began to digitalize transactions and various other related banking operation.

Classification of Banks in India

Scheduled Banks

- Scheduled banks are banks that are listed in the 2nd schedule of the Reserve Bank of India Act, 1934.
- The bank's paid-up capital and raised funds must be at least ₹ 5 lakh to qualify as a scheduled bank.
- Scheduled banks are liable for low-interest loans from the Reserve Bank of India and membership in clearinghouses.
- They must, however, meet certain requirements, such as maintaining an average daily CRR (Cash Reserve Ratio) balance with the central bank at the rates set by it. The RBI allows Scheduled Banks to raise debts and loans at bank rates.
- All commercial banks, including nationalized, international, cooperative, and regional rural banks, fall under scheduled banks.

Non-scheduled Banks

- Non-scheduled banks, by definition, are those that do not adhere to the RBI's regulations.
- They are not mentioned in the Second Schedule of the RBI Act, 1934, and are therefore deemed incapable of serving and protecting depositors' interests.
- Non-scheduled banks must also meet the cash reserve requirement, but not with reserve banks, but with themselves.
- They are generally smaller in size and have a range of influence that is somewhat narrow.
- They are risky to do business with due to their financial limitations. The reserve capital of these banks is less than 5 lakh rupees.

Functions of Banks in an Economy

Collection of the Savings of the Community	● Nowadays people do not keep their savings at home. They deposit them in banks. Thereby the risk of loss (from theft, etc.) is avoided. ● Moreover, some interest is earned. There are different kinds of deposits. Some are current deposits.
Loans and Investment	● Banks lend money to traders, industrialists, and other persons. Lending is done through a variety of methods. Sometimes an account is opened in the name of the borrower and he is allowed to draw cheques on it. ● Banks invest money on shares and debentures of companies and on Government Promissory Notes. They lend money to industrial concerns against the security of Government Promissory Notes, shares, debentures, gold, goods in the course of manufacture, etc. Loans are also given to private individuals against G. P. Notes, shares, debentures, life insurance policies, and gold.
Creation of Money	● Formerly banks could print and issue notes payable by them on demand. ● The notes were used as a medium of exchange. Nowadays only the central bank of the country can issue notes.
Other Functions	Banks keep valuables in safe custody: lockers, shares, debentures, G.P. Notes, etc., and for the payment of insurance premium, bills, etc. They also act as executors and trustees of wills; and exchange currencies of different countries for one another.

Nationalization of Banks

Nationalization refers to the transfer of public sector assets to be operated or owned by the state or central government. In India, the banks which were previously functioning under the private sector were transferred to the public sector by the act of nationalization and thus the nationalized banks came into existence.

Reasons for the Nationalization of Banks

- For Social Welfare
- For Developing Banking Habits
- For Expansion of Banking Sector
- For Controlling Private Monopolies
- To Reduce Regional Imbalance
- For Prioritizing Sector Lending

The government through the Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969, and nationalized the 14 largest commercial banks on 19 July 1969. These lenders held over 80 percent of bank deposits in the country. Soon, the parliament passed the Banking Companies (Acquisition and Transfer of Undertaking) Bill, and it received presidential approval on 9 August 1969.

The banks that were nationalized included Allahabad Bank, Bank of Baroda, Bank of India, Bank of Maharashtra, Central Bank of India, Canara Bank, Dena Bank, Indian Bank, Indian Overseas Bank, Punjab National Bank, Syndicate Bank, UCO Bank, Union Bank and United Bank of India.

Thereafter, in 1980, six more banks that were nationalized included Punjab and Sind Bank, Vijaya Bank, Oriental Bank of India, Corporate Bank, Andhra Bank, and New Bank of India.

The committees that proposed the banking sector reforms are as mentioned below:

- The first Narasimham Committee- 1991
- The Verma Committee – 1996
- The Khan Committee – 1997
- The Second Narasimham Committee – 1998

Banking Reforms introduced in India in recent times

Some of the steps taken by the government to bring reforms in the banking sector are:

- The Ministry of Finance in its **Economic Survey 2015-16** suggested four R's – Recognition, Recapitalization, Resolution, and Reform to address the problem of NPAs.
- In October 2015, the Government announced Mission Indradhanush under which 7 key strategies were proposed to reform public sector banks (PSBs).
- In May 2015, the RBI advised all PSBs to appoint an internal Ombudsman to further boost the quality of customer service and to ensure that there is undivided attention to the resolution of customer complaints in banks.
- The Government announced its intention to introduce a comprehensive Insolvency and Bankruptcy Bill in the Parliament based on the recommendations of the Dr. T K Viswanathan-headed Bankruptcy Law Reforms Committee (BLRC).
- In order to rein in corruption, the Supreme Court on 23 February 2016 ruled that the top officials and employees of private banks will be considered as public servants for the purposes of the Prevention of Corruption Act, 1988.

Monetary Policy

- Monetary policy is a process implemented by the central bank to manage the money supply in order to achieve specific goals such as limiting inflation, maintaining an appropriate exchange rate, creating jobs, and promoting economic growth.
- Monetary policy entails changing interest rates, either directly or indirectly, through open market operations, reserve requirements, or foreign exchange trading.

Objective of Monetary Policy

- Monetary policy is concerned with making money available to the market at reasonable rates and in sufficient quantities at the appropriate time in order to achieve:
  - Price stability
  - Accelerating growth of economy
  - Exchange rate stabilization

- Balancing savings and investment
- Generating employment
- Financial stability

- The primary goal of monetary policy is to maintain price stability while keeping growth in mind. Price stability is a prerequisite for long-term growth.
- In order to maintain price stability, inflation must be kept under control.
- Every five years, the Indian government sets an inflation target.
- The Reserve Bank of India (RBI) plays an important role in the consultation process for inflation targeting. The current inflation-targeting framework in India is flexible.

Reserve Bank of India

- The Reserve Bank of India was established on April 1, 1935 in accordance with the provisions of the **Reserve Bank of India Act, 1934.**
- The Central Office of the Reserve Bank was initially established in Calcutta but was permanently moved to Mumbai in 1937. The Central Office is where the Governor sits and where policies are formulated.
- Though originally privately owned, since nationalization in 1949, the Reserve Bank is fully owned by the Government of India.

Amendments introduced in RBI act over the years

- An amendment to RBI Act, 1934 was made in May 2016, providing the statutory basis for the implementation of the flexible inflation-targeting framework.
- **Banking Regulation (Amendment) Bill, 2020:** Passed in Lok Sabha. The Bill replaces an ordinance to the same effect promulgated on June 26. The Bill proposes amendments to the Banking Regulation Act, 1949. With this new Bill, the central government aims to bring cooperative banks under the supervision of the Reserve Bank of India (RBI).

Main Functions of the RBI

Monetary Authority	• It implements and monitors the monetary policy and ensures price stability while keeping in mind the objective of growth. • An amendment to RBI Act, 1934, was made in May 2016, providing the statutory basis for the implementation of the flexible inflation targeting framework. • **Section 45ZB of the amended RBI Act, 1934,** also provides for an empowered six-member Monetary Policy Committee (MPC) to be constituted by the Central Government by notification in the Official Gazette.
Regulator and Supervisor of the Financial System	• Prescribes broad parameters of banking operations within which the country's banking and financial system functions such as issuing licenses, branch expansion, liquidity of assets, amalgamation of banks etc. • Objective: Maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services such as commercial banking, co-operative banking, to the public.
Manager of Foreign Exchange	• Manages the Foreign Exchange Reserves of India. • It facilitates external trade and payment and promotes orderly development and maintenance of foreign exchange market in India. • It also maintains the external value of rupee.
Issue of Currency	• Issues and exchanges or destroys currency and coins not fit for circulation. • Objective: to give the public adequate quantities of supplies of currency notes and coins and in good quality.
Related Functions	• Banker to the Government: performs merchant banking functions for the central and the state governments. • It is entrusted with central government's money, remittances, exchange and manages its public debt as well. • Banker to banks: maintains banking accounts of all scheduled banks. It also acts as lender of last resorts by providing funds to banks.

RBI Constitute

- **Official Directors (Central Board of Directors)**
  - Full-time: Governor and not more than four Deputy Governors.
    - Shri Shaktikanta Das is the present Governor of RBI
- **Non-Official Directors**
  - **Nominated by Government:** Ten Directors from various fields and two government Official
  - **Others: four Directors –** one each from four local boards (regional)

How does the RBI get its mandate to implement Monetary Policy?

- The Reserve Bank of India (RBI) is charged with implementing monetary policy. The Reserve Bank of India Act of 1934 expressly mandates this responsibility.
- There have recently been many changes in the way India's monetary policy is formed, with the introduction of the Monetary Policy Framework (MPF), Monetary Policy Committee (MPC), and Monetary Policy Process (MPP).

Monetary Policy Committee (MPC)

- The Monetary Policy Committee now determines the policy interest rate required to achieve the inflation target in India.
- The MPC is a six-person committee appointed by the Central Government (Section 45ZB of the amended RBI Act, 1934).
- The MPC must meet at least four times per year. The MPC meeting requires a quorum of four members. Each MPC member has one vote, and in the event of a tie, the Governor has a second or casting vote.
- Following the conclusion of each MPC meeting, the resolution adopted by the MPC is published.
- The Reserve Bank is required to publish a document called the Monetary Policy Report once every six months to explain:
  - the sources of inflation; and
  - the forecast of inflation for the next 6-18 months.

Monetary Policy Instruments

Monetary policy is implemented using a variety of direct and indirect instruments.

Repo Rate

- The (fixed) interest rate at which the Reserve Bank provides overnight liquidity to banks in exchange for the government and other approved securities as collateral under the liquidity adjustment facility (LAF).

Reverse Repo Rate

- The (fixed) interest rate at which the Reserve Bank absorbs liquidity from banks on an overnight basis in exchange for eligible government securities under the LAF.

Liquidity Adjustment Facility (LAF)

- The LAF is made up of both overnight and term repo auctions.
- The Reserve Bank has gradually increased the proportion of liquidity injected through fine-tuning variable rate repo auctions of various tenors.
- The goal of the term repo is to help develop the inter-bank term money market, which in turn can set market-based benchmarks for loan and deposit pricing and thus improve monetary policy transmission.
- The Reserve Bank also conducts variable interest rate reverse repo auctions as market conditions dictate.

Marginal Standing Facility (MSF)

- A facility through which scheduled commercial banks can borrow an additional amount of overnight money from the Reserve Bank by dipping into their Statutory Liquidity Ratio (SLR) portfolio up to a certain limit at a penal rate of interest.
- This acts as a safety valve for the banking system in the event of unexpected liquidity shocks.

Corridor

- The corridor for the daily movement in the weighted average call money rate is determined by the MSF rate and the reverse repo rate.

Bank Rate

- It is the rate at which the Reserve Bank is willing to purchase or rediscount bills of exchange or other commercial papers.
- Section 49 of the Reserve Bank of India Act, 1934 mandates the publication of the Bank Rate.
- This rate has been aligned with the MSF rate and, as a result, changes automatically when the MSF rate and the policy repo rate change.

Cash Reserve Ratio (CRR)

- The average daily balance that a bank is required to maintain with the Reserve Bank as a share of such percentage of its Net demand and time liabilities (NDTL) as specified by the Reserve Bank in the Gazette of India from time to time.

Statutory Liquidity Ratio (SLR)

- The percentage of NDTL that a bank must keep in safe and liquid assets such as unencumbered government securities, cash, and gold.
- SLR changes frequently have an impact on the availability of resources in the banking system for lending to the private sector.

Open Market Operations (OMOs)

- These include the outright purchase and sale of government securities for the purpose of injecting and absorbing long-term liquidity, respectively.

Market Stabilisation Scheme (MSS)

- This monetary management tool was introduced in 2004.
- Short-term government securities and treasury bills are sold to absorb longer-term surplus liquidity resulting from large capital inflows.
- The money raised in this manner is kept in a separate government account of the Reserve Bank.

What is a Digital Currency?

Digital currency is any currency that's available exclusively in electronic form.

- Crypto-currency is a type of digital currency.
- The majority of currencies in this world are digital. As per an estimate, around 92% of the world's currency is already in digital form. Only 8% is in cash.

What is a Central Bank Digital Currency (CBDC)?

Following the success of decentralized digital currencies like Bitcoin, Ethereum, etc. countries over the world are thinking to introduce their own digital currencies known as Central Bank Digital Currency (CBDC), or national digital currency, in India.

- CBDC is simply the digital form of a country's fiat currency. Instead of printing paper currency or minting coins, the central bank issues electronic tokens.
- This token value is backed by the full faith and credit of the government.

Note: Please keep in mind that Crypto-currency (like Bitcoin, Dogecoin etc.) is a type of digital currency. They are not the same.

Cryptocurrency vs Digital currency

Here are some key differences:

- Decentralization: Digital Currencies are centralized meaning they are regulated and issued by a single entity like a central bank.
- Openness: In Crypto-currencies, one can see all the transactions as the directory (ledger) is kept open. This functionality is an integral feature of blockchain where every block contains information about the previous transaction. In Digital Currencies, one would not be able to visualize the entire chain of transactions.
- Legal framework: Most Crypto-currencies have no legal frameworks while a digital currency is backed by an appropriate legal framework.

3. Public Finance

- Public finance is the management of a country's revenue, expenditures, and debt through various government, quasi-government institutions, policies, and tools.
- Components of public finance: public expenditure + public revenue + financial scrutiny + fiscal policy + financial administration + public borrowing.]

Annual Financial Statement (Budget): Article 112

- The term budget is nowhere used in the Constitution.
- Budget is referred to as the Annual Financial Statement in the constitution under Article 112.
- The Rail Budget was separated from the General Budget on the recommendations of the Acworth Committee in 1924.
- However, it was merged again in 2017.
- The Budget is a statement of the Government estimated receipts and expenditure in a financial year starting from April 1 and ending on 31 March.
- Those receipts and expenditure that relate to the current financial year only are included in the revenue account (also called revenue budget) and
- Those that concern the assets and liabilities of the government into the capital account (also called capital budget)

Budget

Receipt

- Revenue Receipt
- Tax Revenue
- Non-Tax Revenue
- Non-Revenue Receipt

Expenditure

- Capital Expenditure
- Revenue Expenditure (both discussed in Fiscal Policy)

Tax Revenue

- A tax is a legal requirement that individuals and businesses pay to the government of a country without receiving any direct benefit in return. The government imposes it on the people.
- Income tax, sales tax, service tax, excise duty, and customs duty are some of the taxes that a government collects.
  - Historically, tax revenue has been the principal source of government funding.
  - Those who earn income such as wages, salaries, rent, interest, and profit are subject to income tax.
  - The tax on the sale of goods is known as sales tax. When we buy something, a portion of our money goes to the government as sales tax.
  - The tax we pay when we use a service, such as a telephone, is known as service tax.
  - Excise duty is a tax paid by the manufacturer of a product.
  - When a product is imported or exported, customs tax is paid.
- **All taxes are of two kinds:**
  - Direct taxes
  - Indirect taxes
- **This distinction between taxes depends on**
  - the liability of payment of tax to the government and
  - the actual burden of the tax.

Direct Taxes

Direct taxes are levied on an individual's property or company property and revenue. Direct taxes are levied on businesses and individuals and are paid directly to the government. Direct taxes have an impact on people's income levels as well as their purchasing power. It also aids in the adjustment of the economy's aggregate demand. Direct taxation can be proportional, progressive, or regressive.

Indirect Taxes

Indirect taxes are those that affect an individual income or a company's income and property through their consumption expenditure. Indirect taxes, often known as compelled payments, are levied on products and services. The service tax is an example of indirect taxes.

Sources of Tax Revenue

- Corporation tax, income tax, customs, union excise charges, service tax, and a variety of other taxes are all major revenue generators.
- Wealth taxes include real estate taxes, wealth taxes on various sorts of wealth, and gift taxes. Customs revenue comes from import charges, basic tariffs, and levies on specific items. Export duties and a cess on exports also play a role in this.
- Goods and Services Tax (GST) on a wide range of products and services also contributes to tax revenue

Non-Tax Revenue

Non-Tax Revenue is recurrent income earned by the government from sources other than taxes. They are revenue receipts that are not derived through the taxation of the general population. The following are some of the most important non-tax revenue sources:

- Interests received by the government as a result of loans made to state governments, UTs, private businesses, and the general public constitute a significant source of non-tax revenue.
- Fees received by the central power authority of any country are included in this category. This comprises fees received by the Central Electricity Authority in India.
- **Fees:** These are charges levied by the government to pay the cost of recurrent services. It is a tax-like mandatory contribution.
- **License Fee:** A license fee is a type of tax levied by the government and its affiliated entities for engaging in a certain activity, such as starting a restaurant or operating a heavy vehicle.
- **Penalties and fines:** Fines are most commonly employed in the context of criminal law, where a court of law will impose a fine on a person convicted of a crime.
- Penalty, on the other hand, is employed in both civil and criminal law. It encompasses both monetary and physical penalties.
- **Escheats:** If an individual dies without leaving a legally binding bill or legal heirs, escheats are the transfer of estate assets or property to the government.
  - The government receives a number of funds from international organizations and foreign governments. Such grants are not a consistent source of money and are typically given in response to a national crisis such as war, flood, or natural disaster.
- **Forfeitures:** A forfeiture is the loss of property without compensation as a result of failing to fulfill contractual obligations or as a penalty for criminal behavior. Under the provisions of a contract, forfeiture refers to a defaulting party's obligation to relinquish ownership of an asset or cash flows from an asset in exchange for the other party's losses.
- **Interests:** This category includes interest on loans and insurance supplied to the government for non-planned and planned schemes, as well as interest on loans, advanced to PSEs and other statutory entities.
- **Communication Services Fees:** The license fees from telecom operators on account of spectrum usage costs that licensed Telecom Service Providers pay to the government ministry in charge of telecommunications make up the majority of this.

Non Revenue receipts:

Amounts received that either incur an obligation that must be met at some future date or change the form of an asset from property to cash and therefore decrease the amount and value of property.

Objectives of Budget

- Resource Allocation For Public Goods
- Redistribution Of Income
- Stabilisation In The Economy

Golden Rule of Budget

The Golden Rule is a guideline for the operation of fiscal policy, especially in countries who uses high borrowing to run the budget. It states that over the economic cycle, the Government should borrow only to invest and not to fund current spending (current expenditure means day to day running expenses). In layman's terms, this means that the government should borrow to finance investment that benefits future generations.

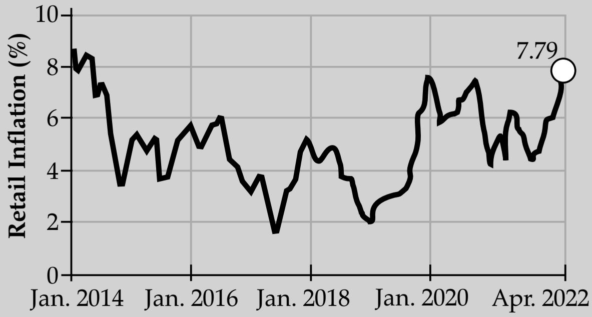
Balanced Budget	The government may spend an amount equal to the revenue it collects.
Surplus Budget	If the expected government revenues exceed the estimated government expenditure in a particular financial year.
Deficit Budget	If the estimated government expenditure exceeds the expected government revenue in a particular financial year.
Outcome Budget	It is a budget that converts outlays into outcomes by planning the expenditure, fixing appropriate targets, quantifying deliverables in each scheme and bringing to the knowledge of all, the outcomes for each scheme/ programme under various ministries.
Gender Budgeting	It is not an accounting exercise but an ongoing process of keeping a gender perspective in policy/programme formulation, its implementation and review.
Zero Based Budgeting	All expenses are evaluated each time a budget is made and expenses must be justified for each new period
Sunset Budgeting	Schemes are announced with a deadline, designed to self-destruct within a prescribed time.

4. Inflation

- Inflation refers to the rise in the prices of most goods and services of daily or common use, such as food, clothing, housing, recreation, transport, consumer staples, etc.
- Inflation measures the average price change in a basket of commodities and services over time.
- The opposite and rare fall in the price index of this basket of items is called 'deflation'. Inflation is indicative of the decrease in the purchasing power of a unit of a country's currency.
  - This example clearly explains the fall in the purchasing power of money. For ₹ 100 you could get 5 kg rice before, but now only 4 kg. So the purchasing power of money got reduced. This is inflation.

- This is measured in percentage.

Accelerating rates | India recorded an inflation of 7.79% in April 2022, which is the highest since May 2014. It has stayed above the RBI's tolerance threshold of 6% for the fourth consecutive month



Types of inflation	● **Demand Pull Inflation:** Demand pull inflation arises when aggregate demand in the economy becomes more than aggregate supply. ● **Cost Push Inflation:** When there is a decrease in aggregate supply of goods and services results into increase in cost of production. **Based on Speed or Intensity, the types of inflation are as follows:** ● **Creeping or Mild Inflation** ■ When the speed of upward thrust in prices is slow but small, it is known as creeping inflation. ■ It is helpful for economic development. ■ Prices rise at a very small rate (<3%). ● **Walking or Trotting Inflation** ■ When prices rise moderately, and the annual inflation rate rises by a single digit. ■ It is the time when the government should focus on the issue. ■ Price rises at a moderate rate (3% to 10%). ● **Galloping and Hyperinflation:** ■ When creeping and walking inflation are left unchecked, the rate will rise above 10%, called galloping inflation. ■ This leads to instability of the economy. ■ Hyperinflation is when the prices of goods and services rise more than 50% per month. ■ It is the last stage of inflation. ■ Examples: Germany in the 1920s, Zimbabwe in the 2000s, American Civil War, and Venezuela in 2018. ■ Prices rise at a very high rate (20% to 100%). ● **Stagflation:** ■ It is a situation in which the rate is high, the economic growth rate slows, and unemployment remains steadily high. ■ It is also known as recession inflation. ■ It is a dilemma for economic policy since actions intended to lower the rate may worsen the unemployment situation. ● **Core Inflation** ■ Price rise in all goods and services except food and energy due to high price fluctuations is core inflation. ■ It is calculated as the government needs a stable and true picture of the rate of price rise. ● **Headline Inflation** ● This measure considers total inflation in an economy, including food and energy prices, which are more volatile.
Causes of Inflation	**Demand-Pull Inflation** Various variables might cause an increase in aggregate demand. Some of them are: ● Fiscal Stimulus ● Population Pressure ● Increase in Net Exports ● Monetary Stimulus ● Policy Decisions **Cost-Push Inflation** The fundamental cause of cost-push inflation is rising production costs. The following reasons can cause production costs to rise. ● Employees' salaries being raised ● Raw material prices increasing ● Firms profit margins ● Import prices ● Increase in indirect taxes **Built-In Inflation** ● As the price of goods and services increases, labor expects and demands more wages to maintain their cost of living, increasing prices and the wage-price spiral continues. **Monetary Inflation** ● Reserve Bank of India printing more money (deficit financing) can trigger inflation. It is a sustained increase in the money supply of a country or currency area.

How inflation is measured?	• **In India, inflation is primarily measured by two main indices —** WPI (Wholesale Price Index) and CPI (Consumer Price Index), which measure wholesale and retail-level price changes, respectively. • The CPI calculates the difference in the price of commodities and services such as food, medical care, education, electronics etc, which Indian consumers buy for use. • On the other hand, the goods or services sold by businesses to smaller businesses for selling further are captured by the WPI. • In India, both WPI (Wholesale Price Index) and CPI (Consumer Price Index) are used to measure inflation. • **Producer Price Index:** It measures the average price changes in the selling prices over time received by the domestic producer.

Effect of Inflation in Indian Economy	• The purchasing power of a currency unit decreases as the commodities and services get dearer.
	• This also impacts the cost of living in a country. When inflation is high, the cost of living gets higher as well, which ultimately leads to a deceleration in economic growth.
	• A certain level of inflation is required in the economy to ensure that expenditure is promoted and hoarding money through savings is demotivated.
	• Repo Rate
	  ▪ It is expected to push up interest rates in the banking system. Equated Monthly Installments (EMIs) on home, vehicle and other personal and corporate loans are likely to go up.
	  ▪ Deposit rates, mainly fixed term rates, are also set to rise.
	• CRR (Cash Reserve Ratio)
	  ▪ The cost of funds will go up and banks' net interest margins could get adversely impacted.

Advantages and Disadvantages of Inflation	• Inflation targeting is a monetary policy in which a central bank has an explicit target inflation rate for the medium term and announces this inflation target to the public. • It will have price stability as the main goal of monetary policy. **Advantages:** • It will lead to increased transparency and accountability. • Policy will be linked to medium/long term goals, but with some short term flexibility. • With inflation targeting in place, people will tend to have low inflation expectations. If there was no inflation target, people could have higher inflation expectations, encouraging workers to demand higher wages and firms to put up prices. • It also helps in avoiding boom and bust cycles. • If inflation creeps up, then it can cause various economic costs such as uncertainty leading to lower investment, loss of international competitiveness and reduced value of savings. This can also be avoided with targeting. • Inflation targets can have various benefits, especially during 'normal' economic circumstances. However, the prolonged recession since the credit crunch of 2008 has severely tested the usefulness of inflation targets **Disadvantages:** • It puts too much weight on inflation relative to other goals. Central Banks start to ignore more pressing problems like unemployment. • Inflation targets reduce "flexibility". It has the potential to constrain policy in some circumstances in which it would not be desirable to do so. • Cost-push inflation may cause a temporary blip in inflation. • It cannot help remove supply bottlenecks and shortages • It cannot help external shocks, exchange rate might suffer in the short run • Growth and employment might take hits in the short run
Various other methods of combating inflation	• **Monetary Policy:** Monetary policy is one of the most commonly used measures taken by the government to control inflation. It uses tools like – Bank rate, Repo Rate, Open Market Operations, etc.

	● **Fiscal Policy:** The two main components of fiscal policy are government revenue and government expenditure. In fiscal policy, the government controls inflation either by reducing private spending or by decreasing government expenditure, or by using both. It reduces private spending by increasing taxes on private businesses. When private spending is more, the government reduces its expenditure to control inflation. However, in the present scenario, reducing government expenditure is not possible because there may be certain on-going projects for social welfare that cannot be postponed. ● **Price Control :** In this method, inflation is suppressed by price control, but cannot be controlled for the long term. The historical evidence has shown that price control alone cannot control inflation, but only reduces the extent of inflation.
Terms Related to Inflation	Some terms related to Inflation are as follows: ● **Disinflation:** Decrease in the rate. ● **Deflation:** Negative inflation or persistent price level decrease. ● **Reflation:** This happens when the Price level increases because the economy recovers from recession. ● **Stagflation:** When stagnation and inflation coexist in the economy. Stagnation- low national income growth and high unemployment. Inflation + Recession (Unemployment) ● **Misery index:** Rate of inflation + Rate of unemployment ● **Inflationary gap:** Aggregate demand > Aggregate supply ● **Deflationary gap:** Aggregate supply > Aggregate demand ● **Suppressed/Repressed inflation:** Aggregate demand > Aggregate supply. The government will not allow the rising of prices in this. ● **Open inflation:** Situation where price level rises without any price control measures by the government.

Initiative of Government to Control a Inflation

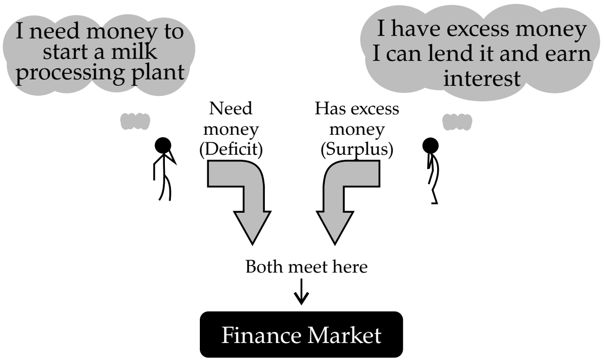
For example, in the previous years, government has taken following steps:

- Regular review meetings on price and availability are being held at the highest level including at the level of Committee of Secretaries, Inter Ministerial Committee, Price Stabilization Fund Management Committee and other Departmental level review meetings.
- Higher MSP has been announced so as to incentivize production and thereby enhance availability of food items which may help moderate prices.
- A scheme titled Price Stabilization Fund (PSF) is being implemented to control price volatility of agricultural commodities like pulses, onions etc.
- The Government approved enhancement in buffer stock of pulses from 1.5 lakh MT to 20 Lakh MT to enable effective market intervention for moderation of retail prices. Accordingly, a dynamic buffer stock of pulses of upto 20 lakh tones has been built.
- Pulses from the buffer are being provided to States/UTs for PDS distribution, Mid-day Meal scheme etc. The requirement of pulses by Army and Central Para-military Forces.
- States/UTs have been advised to impose stock limit on onions.
- The government permitted duty-free imports of 20 lakh tons of crude sunflower oil for the next two years.

Unit-III: Market

1. Financial Markets

- The financial market is the market in an economy where funds are exchanged between fund-surplus and fund-scarce individuals and groups.



Types of financial markets

A financial market is of two types:

- Money Market
- Capital Market

There can be one more type of classification of financial market:

- Organized financial market – regulated and controlled by any regulatory body like RBI. This organized market can be further divided into the following two categories:
  - Money Market
  - Capital Market
- Unorganised financial market – unregulated and not governed by any laws. Private moneylenders etc. come under this category.

Money Market

In a money market, short term financial assets that are close substitutes of money are sold & bought (for 364 days or less)

- Close substitutes mean those financial assets that can be quickly converted to cash with minimum transaction cost
- Short-term financial assets mean maturity period is less than a year. Examples include treasury bills, certificates of deposit, etc.
- This market is characterised by buying and selling of products with high liquidity (easily convertible to cash) and short-maturity (less than a year).

In simplest terms, the money market fulfills borrowing and lending needs of less than a year.

Types of Maturity

Borrowing and lending can be done for various time periods within 365 days. On the basis of these we define few terms:

- Call money or overnight call money – Here lending and borrowing is done on an overnight basis i.e., 1 day
- Notice money – Time period here is b/w 1 – 14 days (i.e., 2 to 13 days)
- Term money – Time period here is b/w 14 – 365 days (i.e., 15 to 364 days)

Types of money market instruments

- Treasury Bills
- Commercial bills
- Certificate of Deposit (CD)
- Commercial Paper (CP)
- Banker's acceptances
- Bills of exchange
- Money market mutual funds
- Repurchase agreements (Repos)

Capital Market

It is a market in which lending or borrowing is done for a period of more than 365 days.

- The capital market is characterized by long term financial assets like bonds, debentures, etc.
- This market is critical for our economy because it provides the financial resources required for the long-term sustainable development of the economy.
- Most projects which result in real tangible benefits, i.e., infrastructural projects at the ground level require long-term finance, like a building of roads, setting up of new industries, etc. The capital market fulfills this important responsibility.
- The capital market consists of development banks, commercial banks, and stock exchanges.
- Indian Capital Markets are regulated and monitored by the Ministry of Finance, The Securities and Exchange Board of India (SEBI), and RBI.

Types of Capital Market

Capital market is generally of two types:

- Primary market
- Secondary market

Primary Market

In this market, securities are issued for the first time

- The investors in this market are banks, financial institutions, insurance companies, mutual funds, and individuals.

Secondary Market

It deals with the buying and selling of existing or previously issued securities.

- This market is also known as the stock market or stock exchange

Capital Market Instruments

Capital market instruments are of three types:

- **Pure instruments:** These include shares, bonds, debentures. They do not share features of one another. They are pure.
- **Hybrid instruments:** They have a combination of features like a combination of bond & equity
- **Derivatives:** These instruments have no value of their own but derive their value from one or more financial assets. Some examples of derivatives include futures and options.

Major Terminologies – Financial Market

Treasury Bills: They are promissory notes issued by the RBI on behalf of the government as a short term liability and sold to banks and the public. The maturity period ranges from 14 to 364 days. They are negotiable instruments, i.e. they are freely transferable. No interest is paid on such bills but they are issued at a discount on their face value.

Commercial Bills: They are also called Trade Bills or Bills of Exchange. Commercial bills are drawn by one business firm to another in lieu of credit transactions. It is a written acknowledgment of the debt by the maker directing to pay a specified sum of money to a particular person. They are short-term instruments generally issued for 90 days. These are freely marketable. Banks provide working capital finance to firms by purchasing the commercial bills at a discount; this is called 'discounting of bills'.

Commercial Paper (CP): The CP was introduced in 1990 on the recommendation of the Vaghul Committee. A commercial paper is an unsecured promissory note issued by a corporate with a net worth of at least ₹ 5 crore to the banks for short term loans. These are issued at discount on face value for a period of 14 days to 12 months. These are issued in multiples of ₹ 1 lakh subject to a minimum of ₹ 25 lakh.

Certificate of Deposit (CD): The CD was introduced in 1989 on the recommendation of the Vaghul Committee. These are issued by banks against deposits kept by individuals and institutions for a period of 15 days to 3 years. These are similar to Fixed Deposits but are negotiable and tradable. These are issued in multiples of ₹. 1 lakh subject to a minimum of ₹ 25 lakh.

Discount and Finance House of India Ltd.: DFHI was set up as a subsidiary of RBI in 1988 on the recommendation of the Vaghul Committee. Its objective is to stimulate activity in the money market by providing liquidity to the money market instrument. It buys bills and short term securities from banks and financial institutions thereby developing a secondary market in them. DFHI was set