

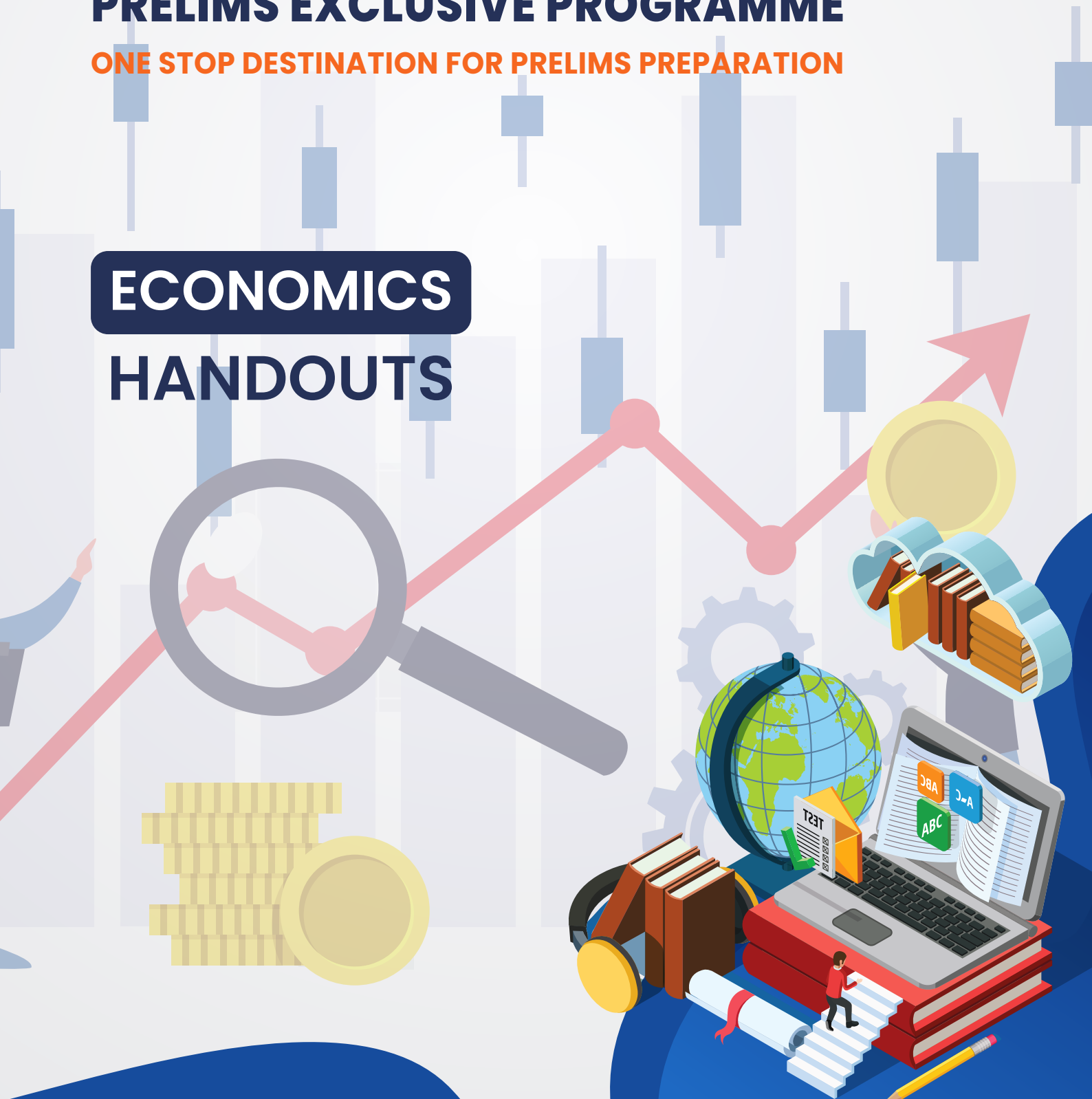


PEP – 2024

PRELIMS EXCLUSIVE PROGRAMME

ONE STOP DESTINATION FOR PRELIMS PREPARATION

**ECONOMICS
HANDOUTS**





[Notes](#)

TOPICS:

Economics Basics- Macro & Micro,
National income,
Sectors - Primary,
Secondary,
Tertiary,
GDP & alternatives,
Economic Systems - Capitalist,
Socialist,
Mixed Economy;
Inflation,
Types of Inflation,
Effects of Inflation,
Steps to check inflation,
Indices to measure Inflation,
Related Terms.

Contents

PREVIOUS YEARS QUESTIONS2	Alternatives to GDP 18
BRANCHES OF ECONOMY2	INFLATION 21
SECTORS IN ECONOMY3	INFLATION 23
ORGANISED AND UNORGANISED SECTOR.....6	TYPES OF INFLATION..... 23
DOMESTIC ECONOMY MAY BE DIVIDED INTO THREE LARGER SECTORS7	EFFECTS OF INFLATION..... 25
1. General Government Sector7	STEPS TO CHECK INFLATION..... 26
ECONOMIC SYSTEMS8	WHOLESALE PRICE INDEX (WPI) 27
NATIONAL INCOME9	INDICES WHICH MEASURE INFLATION IN AN ECONOMY..... 27
India overtakes UK16	CONSUMER PRICE INDEX (CPI) .. 28
RECESSION.....16	OR Retail Inflation 28
Purchasing Power Parity (PPP) ..17	IMPORTANT TERMS..... 31



PREVIOUS YEARS QUESTIONS

[Notes](#)

Q.1) Consider the following statements:

1. Inflation benefits the debtors.
2. Inflation benefits the bond-holders.

Which of the statements given above is/are correct?

- a) 1 only
- b) 2 only
- c) Both 1 and 2
- d) Neither 1 nor 2

Q.2) The national income of a country for a given period is equal to the

- a) total value of goods and services produced by the nationals
- b) sum of total consumption and investment expenditure

- c) sum of personal income of all individuals
- d) money value of final goods and services produced

Q.3) With reference to the Indian economy, consider the following statements:

1. The rate of growth of Real Gross Domestic Product has steadily increased in the last decade.
2. The Gross Domestic Product at market prices (in rupees) has steadily increased in the last decade.

Which of the statements given above is/are correct?

- a) 1 only
- b) 2 only
- c) Both 1 and 2
- d) Neither 1 nor 2

BRANCHES OF ECONOMY

- International Monetary Fund (IMF) defines macroeconomics as part of economics concerned with how the overall economy works. It studies such things as National Income, GDP, and inflation—the stuff of news stories and government policy debates.
- On the other hand, microeconomics is concerned with how supply and demand interact in individual markets for goods and services, it deals with concepts like consumer behaviour, individual markets, supply-demand of a good etc. Microeconomics is the logical starting point for the study of economics.



- For an understanding if economics is a wagon, the macroeconomics deals with the running of wagon (engine, motor etc.) and microeconomics deals with the nuts and bolts keeping the wagon intact.
- The differentiation between two concepts in economics started during Great depression of early 1930s with publishing of John Maynard Keynes' book General theory of Employment, interest and money (1936). J.M Keynes is considered as father of Macroeconomics.

Micro Economics	Macro Economics
1. It studies the individual unit.	1. It studies the whole economy or large groups.
2. Laws related to Marginal analysis are included in its scope.	2. Problems related to whole economy like employment, public finance, national income etc. are included in its scope
3. Micro Economics provides the information relating to the individual prices, individual consumption and production.	3. Macroeconomics provides the information relating to National Income, total output, total consumption and general price level
4. Micro economics analysis is simple	4. Macroeconomics is complex due to the study of large groups.
5. Micro economics particularly focus on price analysis.	5. Macro Economics particularly focus on income analysis
6. Micro economics studies individual problems and it is less important for comparative study	6. Macroeconomics studies the problems relating to the economy and its importance is growing.

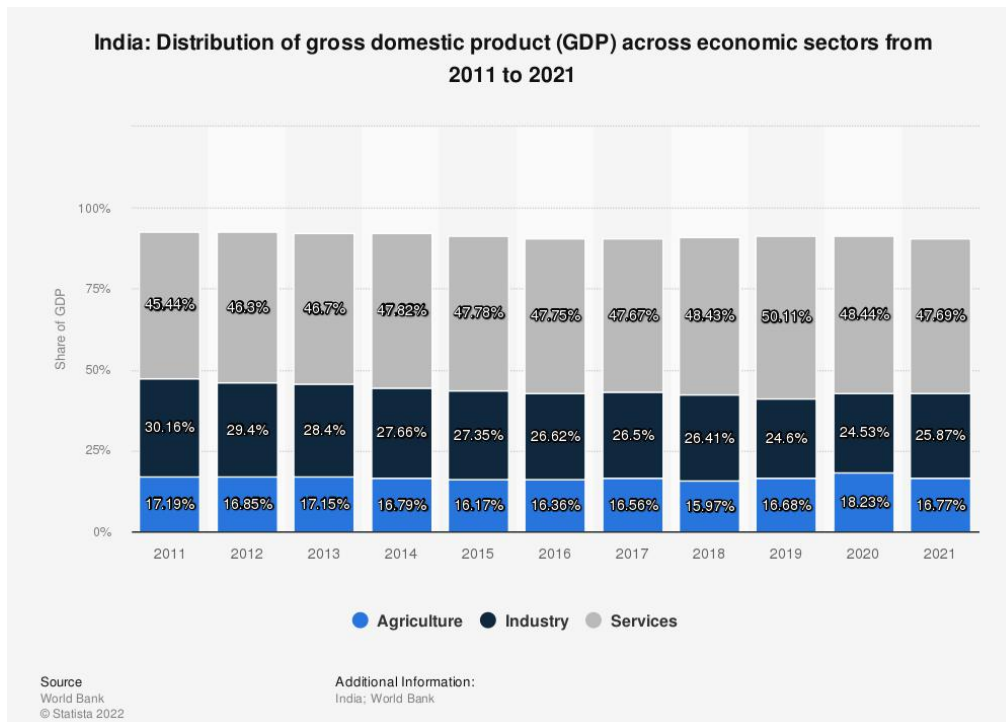
SECTORS IN ECONOMY

Primary sector	Which makes direct use of natural resources - Agriculture and allied activities, Forestry, Fishing etc.
Secondary or Industry Sector	Which transform inputs into output. This sector includes the following production activities - Mining and Quarrying (in India it is considered as secondary sector), Manufacturing, Construction, Electricity Gas and water supply & other utility services
Tertiary or Service Sector	Services providers - Trade, repair, hotels, transport, communication and services related to broadcasting, Financial, real estate & professional services, Public Administration, defence and other services



Quaternary sector	<p>It includes all industries that are concerned with the creation and distribution of knowledge. Ex: Research & development, Education etc. Also known as “Knowledge Sector”. Defines quality of human resources</p> <ul style="list-style-type: none">• These intellectual services and activities are what drive technological advancement, which can have a huge impact on short- and long-term economic growth.
Quinary sector	<p>Highest levels of decision making in an economy.</p> <ul style="list-style-type: none">• This sector includes top executives or officials in such fields as government, science, universities, non-profits, health care, culture, and the media.• New trends in quinary services include knowledge processing outsourcing (KPO) and ‘home shoring’, the latter as an alternative to outsourcing. The KPO industry is distinct from Business Process Outsourcing (BPO) as it involves highly skilled workers. It is information driven knowledge outsourcing. KPO enables companies to create additional business opportunities.• Economists sometimes also include domestic activities (duties performed in the home by a family member or dependent) in the quinary sector. These activities, such as child care or housekeeping, are typically not measured by monetary amounts but contribute to the economy by providing services for free that would otherwise be paid for.

[Notes](#)



Updated Image (Containing data till 2021)

Four Major Sectors of Economy from Macro Economic Point of View:

1. Household Sector:

- This sector covers everyone, consumers, individuals, and every member of society.
- The household sector purchases products and services for consumption while also supplying producing inputs such as land, labour, capital, and entrepreneurs.
- This sector oversees the consumption expenditures component of GDP.
- In a nutshell, a household is defined as a single or group of people who make independent decisions about their economic activities, such as consumption and production.

2. Firms:

- People in the household sector work as workers in firms and make a living. Firms are economic units that produce goods and services.
- They utilise and organise production factors and carry out production processes for the purpose of profit.
- This comprises sole proprietorships, partnerships, and corporations. This sector oversees the GDP's investment expenditure.

3. Government Sector:

- A government preserves law and order, promotes growth and stability, and administers government services. This sector is in charge of the government's purchase involvement in GDP.
- A government's primary goal is to levy taxes to fund development projects such as dams, roads, and heavy industries, which typically have extended gestation periods.
- The government also invests in education and health sectors and delivers these services at a low cost. Examples include the Department of Transportation and the Environmental Protection Agency.

4. Foreign/ External Sector:

- This sector deals with the export and import of products and services. Export occurs when domestically produced goods and services are sold to the rest of the world.
- When goods and services are purchased from the rest of the world, this is referred to as import.
- Apart from the export and import of goods, there can be an inflow of goods, i.e., a country welcoming capital from other countries, and an outflow of foreign capital, i.e., investing in foreign countries. Net exports (Exports minus Imports) are the foreign sector's expenditure on GDP.

ORGANISED AND UNORGANISED SECTOR

- The Organised Sector is one that is incorporated with the appropriate authority or government and follow its rules and regulations.
- On the contrary, the Unorganised Sector can be understood as the sector, which is not incorporated with the government and thus, no rules are required to be followed.

Organised Sector	Unorganised Sector
It is a sector where the employment terms are fixed and regular, and the employees get assured work.	The unorganised sector is characterised by small and scattered units, which are largely outside the control of the government.



[Notes](#)

They are registered by the government and have to follow its rules and regulations, which are given in various laws such as the Factories Act, Minimum Wages Act, Payment of Gratuity Act, Shops and Establishments Act, etc.	There are rules and regulations but these are not followed since they are not registered with the government.
The job is regular and has fixed working hours. If people work more, they get paid for the overtime by the employer.	Jobs are low-paid and often not regular.
Workers enjoy the security of employment.	Employment is not secure. People can be asked to leave without any reason.
People working in the organised sector get several other benefits from the employers such as paid leave, payment during holidays, provident fund, gratuity, etc.	There is no provision for overtime, paid leave, holidays, leave due to sickness, etc.
People get medical benefits. The factory manager has to ensure facilities like drinking water and a safe working environment. When they retire, these workers get pensions as well.	There are no such facilities in the unorganised sector.
Examples of the organised sectors are Government employees, registered industrial workers, Anganwadi workers, village health workers, etc.	Examples of the unorganised sectors are Shopkeeping, Farming, Domestic works, Labouring, Rickshaw pulling, etc.

DOMESTIC ECONOMY MAY BE DIVIDED INTO THREE LARGER SECTORS

1. General Government Sector

- The general functions of the government units are as follows:
 - provide the community or individual households with certain goods and public services by financing their transactions out of taxes or other incomes;
 - redistribute the community's income or wealth by means of transfers;
 - produce nonmarket goods and services.



- The areas of government units' activity are governance, defence or army, education, health, national and social security, etc.

2. Real Sector

- The real sector of the economy consists of enterprises (nonfinancial corporations), households and non-profit institutions serving households (NPISH)
- Examples of NPISHs are political parties, churches, religious organizations, charities, professional and other unions, cultural organizations, some educational and research institutions, etc.

3. Financial Sector

- The financial sector provides financial intermediation services for the economy. It includes all entities whose main activity involves supplying assets to savers (such as households) while lending at a different maturity to borrowers (such as enterprises).
- The financial sector includes commercial banks, credit unions, savings and loan associations, investment banks, pension funds, and insurance companies

Thus, the financial sector is the economy's money issuing sector; the real sector is the economy's money holding sector; the general government sector is not a money holder, despite it may influence the quantity of money through its operations.

ECONOMIC SYSTEMS

Basis	Capitalist Economy	Socialist Economy	Mixed Economy
Ownership of Property	Private ownership	Public ownership	Both public and private ownership
Price Determination	Prices are determined by the market forces of demand and supply	Prices are determined by the central planning authority.	Prices are determined by central planning authority and demand and supply.
Motive of Production	Profit motive	Social welfare	The profit motive in the private sector and



[Notes](#)

			welfare motive in the public sector.
Role of Government	No role	Complete role	Full role in the public sector and limited role in the private sector
Competition	Exists	No competition	Exist only in the private sector
Distribution of income	Very Unequal	Quite Equal	Considerable inequalities exist.

Open- Economy	Closed- Economy
Which has economic relations with the rest of the world. Most countries of the world are open economy.	Which has no economic relations with the rest of the world. Example - North Korea
In an open economy, exports constitute an additional source of demand for domestic goods and services.	In closed economy Saving and investment, Gross Domestic Product (GDP) and Gross National Product (GNP) are equal but in an open economy, they can differ.

NATIONAL INCOME

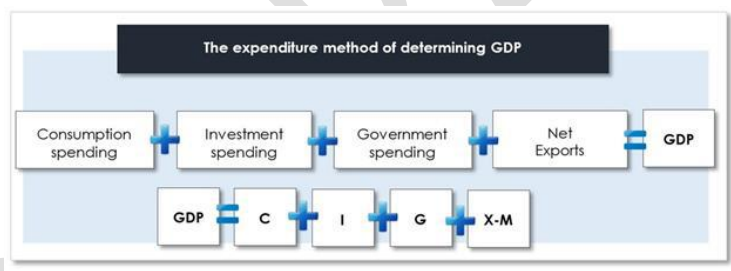
National income is the total value a country's final output of all new goods and services produced in one year. Typically, goods are produced in a number of 'stages', where raw materials are converted by firms at one stage, then sold to firms at the next stage. Value is added at each, intermediate, stage, and, at the final stage, the product is given a retail selling price. The retail price reflects the value added in terms of all the resources used in all the previous stages of production.

Gross Domestic Product (GDP)	Market value of all final goods and services produced within the domestic economy during a year. or GDP at market price = Gross Value Added (GVA) at basic price + Indirect tax- Subsidies For India, this calendar year is from 1st April to 31st March Gross means total; <i>domestic'</i> means all economic activities done within the boundary of a nation/ country
-------------------------------------	---



[Notes](#)

	and by its own capital; ' <i>product</i> ' is used to define 'goods and services' together; and ' <i>final</i> ' means the stage of a product after which there is no known chance of value addition in it.
Released by	National Statistical Office (NSO), Ministry of Statistics and Program Implementation
Base Year	The base year of the national accounts is chosen to enable inter-year comparisons. It gives an idea about changes in purchasing power and allows calculation of inflation-adjusted growth estimates. The last series has changed the base year to 2011-12 from 2004-05.
Final Goods	An item that is meant for final consumption and will not pass through any more stages of production or transformations is called a final good. For example, bread, butter, biscuits etc. used by the consumer
Intermediate Goods	Which are used as raw material or inputs for production of other commodities. These are not final goods. Eg- Rubber in Tyres. Intermediate goods are not included in the calculation of national income. Only final goods are included in the calculation of national income because value of intermediate goods is already included in the value of final goods. If it is included in national income it will lead to the problem of double counting.
Indirect taxes	Indirect taxes are those taxes which are levied by the government on sales and production and also on imports of the commodities. For example, GST, Import/custom duties etc.
Subsidies	Government gives financial help to the production units for selling their product at lower prices fixed by the government. Such help is given to those commodities whose production government wants to encourage
Nominal GDP	GDP at current prices is called nominal GDP. But It does not show the true picture of economic growth of a country as any increase in nominal GDP might be due to rise in price level without any change in physical output.

<p>Real GDP</p>	<p>In order to eliminate the effect of price changes, GDP is estimated at a constant/base price called real GDP. Nominal GDP adjusted for inflation.</p> <p>For developing countries inflation is high & unstable, hence they calculate national income at constant prices to understand real picture.</p> <p>Developed countries inflation has been around 2% for many decades. This is why the difference between the incomes at constant and current prices among them are narrow and they calculate their national income at current prices.</p>
<p>GDP Deflator</p>	<p>GDP adjusted due to inflation on a base year = Nominal GDP / Real GDP</p>
<p>Methods for calculating GDP</p>	<p>1) Expenditure Method</p> <div data-bbox="470 862 1204 1131" data-label="Diagram">  <p>The diagram illustrates the expenditure method of determining GDP. It shows four boxes representing different types of spending: 'Consumption spending', 'Investment spending', 'Government spending', and 'Net Exports'. Each box is connected to the next by a plus sign, and the final result is 'GDP'. Below this, the formula is written as $GDP = C + I + G + X-M$.</p> </div> <p>2) Income Method → Based on factor cost Factor cost = Labor (Wages) + Capital (Interest) + Entrepreneurship (Profit) + Land (Rent)</p> <p>3) Output Method: Production Method: Gross Value Added (GVA) GDP (at current market price) = \sum GVA of all goods and services produced + Tax-Subsidies</p>
<p>GDP @ Market Price</p>	<p>GDP @ Factor cost + Taxes – Subsidies</p>



Net Domestic Product (NDP)	<p>NDP = GDP – Depreciation</p> <ul style="list-style-type: none">• During production process fixed capital assets like machines, building etc. get depreciated and their value goes down. This is known as normal wear and tear of machinery or consumption of fixed capital or depreciation.• The governments of the economies decide and announce the rates by which assets depreciate (done in India by the Ministry of Commerce and Industry) and a list is published, which is used by different sections of the economy to determine the real levels of depreciations in different assets.• NDP of an economy has to be always lower than its GDP for the same year, since there is no way to cut the depreciation to zero.
Gross National Product (GNP)	<ul style="list-style-type: none">• GNP is the GDP of a country added with its 'income from abroad'. In other words, it is the value of all finished goods and services owned by a country's residents over a period of time• Here, the trans-boundary economic activities of an economy is also taken into account.• The items which are counted in the segment 'Income from Abroad' are: Private Remittances, Interest on External Loans, External Grants.• In India's case 'Income from abroad' has always been negative (due to heavy outflows on account of trade deficits and interest payments on foreign loans)• $GNP = GDP + NR$ (Net receipts from abroad or inflows from abroad) – NP (Net payment outflow to foreign assets)
Net National Product (NNP)	<p>$NNP = GNP - Depreciation$</p> <p>When we divide NNP by the total population of a nation we get the '<i>per capita income</i>' (PCI) of that nation, i.e., '<i>income per head per year</i>'.</p>
NNP at factor cost or National Income	<p>National Income = NNP at market prices – Indirect taxes + Subsidies</p> <p>But from January 2015 onwards, National Income in India</p>



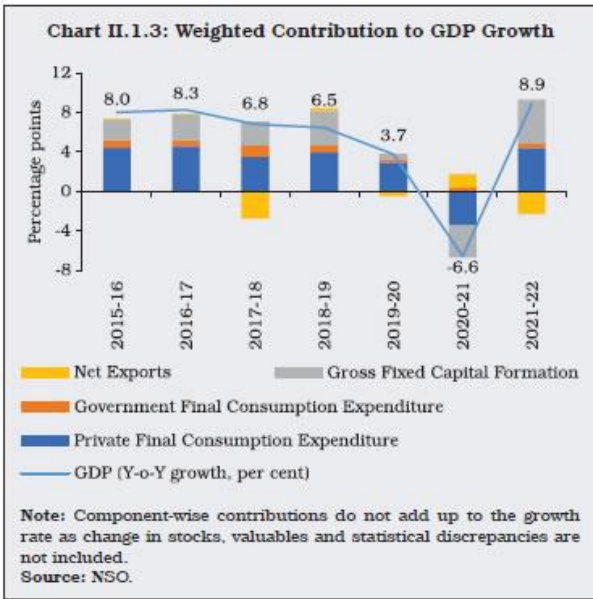
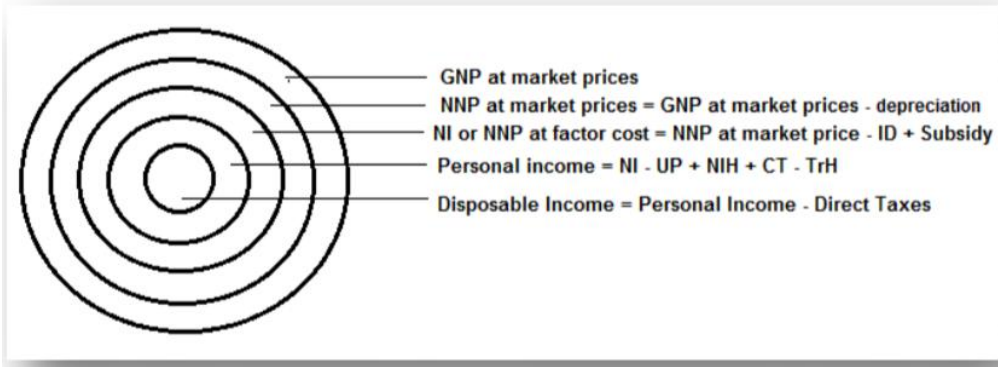
[Notes](#)

	<p>is being computed at market price i.e. National Income= NNP at market prices</p>
Personal Income (PI)	<p>PI is the Part of National Income (NI) which is received by households.</p> <p>Personal Income (PI) = National Income – Undistributed profits – Net interest payments made by households – Corporate tax + Transfer payments to the households from the government and firms</p> <p>Undistributed profits - A portion of corporates profit which is for future expenditure and expansion and it is not share with shareholders and factors of production.</p> <p>Corporate Tax - It is imposed on the earnings made by the firms</p> <p>Net interests paid by the households - The households do receive interest payments from private firms or the government on past loans advanced by them. Households may have to pay interests to the firms and the government as well, in case they had borrowed money from either.</p> <p>Transfer payments - The households receive transfer payments from government and firms (pensions, scholarship, prizes, for example).</p>
New Method from 2015	<ol style="list-style-type: none">1. Change of base year – 2004-05 to 2011-122. Change in GDP calculation to using market prices rather than factor costs.3. Adopted the international practice of valuing industry-wise estimates as gross value added (GVA) at basic prices instead of factor cost. <p>GVA at basic prices = GVA at factor cost + production taxes less production subsidies.</p> <p>GVA at factor cost = CE + OS/MI + CFC</p> <p>[CE: compensation of employees; OS: operating surplus; MI: mixed income; and CFC: consumption of fixed capital i.e., depreciation]</p> <p>Production taxes or production subsidies are paid or received with relation to production and are independent</p>



[Notes](#)

	<p>of the volume of actual production.</p> <ul style="list-style-type: none">• Some examples of production taxes are land revenues, stamps and registration fees and tax on profession.• Some production subsidies are subsidies to Railways, input subsidies to farmers, subsidies to village and small industries, administrative subsidies to corporations or cooperatives, etc
Gross value added (GVA)	<p>It is an economic productivity metric that measures the contribution of a corporate subsidiary, company or municipality to an economy, producer, sector or region.</p> <p><i>GVA at basic prices = GVA at factor cost + (Production taxes less Production subsidies)</i> <small>ISEP</small></p> <p><i>GDP at market prices = GVA at basic prices + taxes on products – subsidies on products</i></p> <p>Product taxes or subsidies are paid or received on per unit of the product.</p> <ul style="list-style-type: none">• Some examples of product taxes are excise tax, sales tax, service tax and import and export duties.• Product subsidies include food, petroleum and fertilizer subsidies, interest subsidies given to farmers, households, etc.
Gross Capital Formation (GCF)	<p>The percentage of the investment made each year out of the total GDP is called Gross Capital Formation. High GCF denotes higher rate of savings in the economy which is required for high rate of production, capital formation, changes in production techniques. GCF includes capital formation in public sector, private sector and also household sector.</p>



STEADY GROWTH

The top ten economies

	Nominal GDP (\$ billion)	Share (%)
US	26,695	24.1
China	21,865	19.80
Japan	5,291	4.8
Germany	4,565	4.1
India	3,894	3.5
UK	3,687	3.3
France	3,086	2.8
Canada	2,362	2.1
Italy	2,169	2
Brazil	1,980	1.8

(India is the 5th largest economy)

How India's economy has inched up over the years



Source: IMF, SBI Research



India overtakes UK

In terms of overall GDP, India overtook the UK and became the fifth-largest economy behind the US, China, Japan and Germany.

How India overtook the UK?

- The first thing to understand is that this is a massive achievement but it has not come about overnight; it has taken India several decades to accomplish.
- Until the Global Financial Crisis of 2008, the UK kept extending the gap between India and itself on the overall GDP.
- In 2007, for instance, the difference between the GDPs of the two countries was at its peak. The UK's GDP was \$3.1 trillion while that of India's was just \$1.2 trillion. But the Global Financial Crisis made the UK lose its way.
- UK's total GDP has fluctuated since then — growing one year, contracting the next — and it was still around \$3.2 trillion at the start of 2021. In other words, 14 years went by and the UK's overall GDP barely grew.
- India, on the other hand, did not allow the global disorder to derail its growth trajectory. Of course, India did lose a step or two, but broadly speaking, it continued to post relatively fast growth rates and kept adding to its overall GDP.
- Between 1960 and 1991, there were 8 years when India's growth rate was inferior to the UK's. But since 1991, India's record is even better. There has been just one year — 1997 — when India's annual GDP was inferior to the UK's.

Why is it not enough?

- In per capita terms, India is far behind the UK. The GDP per capita is over \$47,000 for the UK and just \$2,200 for India.
- Between 2007 and 2009, UK's GDP per capita fell by \$12,000 — that is 6 times India's present-day GDP per capita — and still the UK's was at the \$39,000 level.
- This is just one way to show the stark difference between the two countries despite them being on the same levels of overall GDP.

RECESSION

- A recession is when the **economy stops growing and starts shrinking**.
- It means not only shrinking GDP but also **declining incomes, employment, industrial production and retail sales**.
- It happens when the value of goods and services produced in a country known as the **gross domestic product declines for two consecutive quarters**, or half a year.
- A recession ends when **economic growth returns**.

Causes:

- Rising in unemployment.
- Rises in bankruptcies, defaults, or foreclosures.
- Falling interest rates.
- Lower consumer spending and consumer confidence.
- Falling asset prices.

Do You Know? Problem of Double Counting:



- When computing national income, the problem of double counting arises. The national income estimates become muddled when double accounting occurs in the calculation of national income. [SEP]
- Methods to avoid the problem of double counting:
- Only the value of finished goods should be counted (final output method).
- Only the value added that equals the value of output less intermediary consumption should be counted (Value added method).

Purchasing Power Parity (PPP)

- It is the rate at which the currency of one country would have to be converted into that of another country to buy the same amount of goods and services in each country.
- The PPP exchange rates are constructed to ensure that the same quantity of goods and services are priced equivalently across countries.
- The purchasing power parity formula can be expressed as
$$S = P1 / P2$$
Where,
$$S = \text{Exchange rate of one currency 1 to currency 2}$$
$$P1 = \text{Cost of a good in currency 1}$$
$$P2 = \text{Cost of the same good in currency 2}$$
- PPP exchange rates are used to convert the national poverty lines from some of the poorest countries in the world to determine the Global Poverty Line.
- Government agencies use PPP to compare the output (GDP) of various countries.
- Note that Currency Exchange Rate in market is different from this theoretical concept of PPP.
- Currently, the India is ranked sixth in the world in terms of nominal GDP. In terms of PPP, India is third largest economy.

Limitations of GDP

- **Distribution of Wealth:** The GDP system only counts the spending of wealth. It does not account which wealth it belongs to. The top 10% richest can easily hold 50% of the total value of an entire economy.
- **Environmental Damage:** The GDP system would want companies and citizens to spend and produce as much as possible, no matter how much it degrades the environment.
- **Well-Being:** The GDP system only favors monetary value. Monetary value doesn't always mean happiness or good human well-being. For those who have worked to escape poverty, happiness is a feeling, not a

static objective. While having money certainly helps, it doesn't guarantee your happiness nor your well-being.

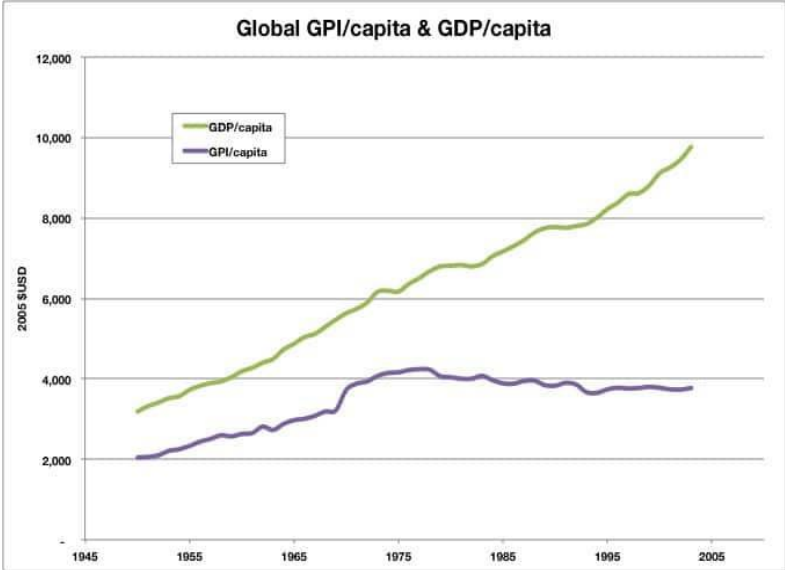
[Notes](#)

Alternatives to GDP

<p>Human Development Index (HDI)</p>	<p>This gives a weighting to national income, life expectancy and quality of education.</p> <p>Components of the Human Development Index</p> <p>The HDI—three dimensions and four indicators</p> <p>Note: The indicators presented in this figure follow the new methodology, as defined in box 1.2. Source: HDRO.</p> <p>The index is composed of</p> <ol style="list-style-type: none"> 1. Life Expectancy Index. Average life expectancy compared to a global expected life expectancy. 2. Education Index <ol style="list-style-type: none"> 1. mean years of schooling 2. expected years of schooling 3. Income Index (Gross National Income – GNI at PPP) <p>Therefore, it is much more than GDP because it looks at education standards, health care and life expectancy.</p>
<p>Human Poverty Index (HPI)</p>	<p>It was introduced by UN Development Programme (UNDP) To measure rates of economic development for low-income countries it examines education, life expectancy, rates of absolute poverty and access to health care and safe drinking water.</p> <p>(HPI-1) It involves combining:</p> <ol style="list-style-type: none"> 1. Probability at birth of not surviving to age 40 (times 100) 2. Adult illiteracy rate 3. Arithmetic average of these three characteristics: <ul style="list-style-type: none"> ○ The percentage of the population without access to safe water. ○ The percentage of population without access to health services. ○ The percentage of malnourished children under five.

<p>Gross National Happiness (GNH)</p>	<p>GNH looks at nine different factors including psychological well-being, health, time use, education, cultural diversity and resilience, good governance, community vitality, ecological diversity and resilience, and living standards. The four pillars of GNH are:</p> <ul style="list-style-type: none"> • Sustainable and equitable socio-economic development; • Environmental conservation; • Preservation and promotion of culture • Good governance. <p>It has been adopted by Bhutan since 2008 and is strongly influenced by Buddhist concepts.</p>
<p>Happy Planet Index (HPI)</p>	<ul style="list-style-type: none"> • This is a measure of human wellbeing adjusted for environmental impact. It looks at life expectancy and life satisfaction divided by the ecological impact of the nation. • So, if a country has a high carbon footprint, it will, ceteris paribus have a lower HPI score because more resources are needed. • A high score would have a high life satisfaction combined with low ecological footprint. • The highest-ranking countries are in Central America – Colombia, Costa Rica, Dominica and Panama. • The US with high carbon footprint is ranked as one of the lowest.
<p>Green GDP</p>	<ul style="list-style-type: none"> • This adjusts GDP for resource depletion and environmental degradation. • In 2004, China experimented with green GDP. But once pollution and environmental costs were added in it displayed zero growth. It was discarded in 2007. • Pros: Green GDP embraces broader accounting of economic development that considers the effects of pollution and resource depletion. • Cons: Local governments that don't want their economic growth statistics affected by environmental factors have been resistant to adopting this as a GDP alternative. <div style="border: 1px solid black; padding: 5px; margin-top: 10px;"> <p style="text-align: center;">Green GDP Means</p> <ol style="list-style-type: none"> 1 monetization of the loss of biodiversity 2 accounting for costs caused by climate change 3 subtracting resource depletion, environmental degradation from traditional GDP figures 4 helping to manage both economies as well as resources </div>

Notes

<p>Genuine Progress Indicator (GPI)</p>	<p>GPI starts with GDP as its base but also takes into account environmental and social factors such as</p> <ul style="list-style-type: none"> • Pollution • Poverty rates • Health standards • Inequality rates • Crime rates • Cost of pollution abatement • Cost of commuting • Cost of road accidents • Value of education • Value of housework and parenting <div data-bbox="411 678 1200 1245" data-label="Figure">  </div> <ul style="list-style-type: none"> • This graph for global GPI, shows it is much harder to increase GPI than GDP. This is because if people spend time sitting in a traffic jam, that increases GDP but not GPI. • Pros: GPI shifts the value basis of a product by adding its social and environmental impacts to the equation. It also assigns values to non-financial human contributions, such as volunteering. • Cons: Some finance professionals believe that non-economic variables are too subjective and that GPI is not an effective tool for assessing the state of the business cycle.
<p>Physical Quality of Life Index (PQLI)</p>	<ul style="list-style-type: none"> • Developed by Morris David Morris, it was first attempt towards providing comprehensive measure of economic development. • PQLI is the average of three values i.e. Life expectancy, basic literacy rate and infant mortality rate. (Each value scaled on 1 to 100, where 1

[Notes](#)



	<p>represents the worst and 100 represents the best.)</p> <ul style="list-style-type: none"> Essential components of human development are: equity, sustainability, productivity and empowerment.
--	--

[Notes](#)

INFLATION

Before understanding the concept of inflation, it is important to the concepts of aggregate demand and aggregate supply of the economy.

Aggregate Supply	Aggregate Demand
<p>Aggregate supply, also known as total output, is the total supply of goods and services produced within an economy at a given overall price in a given period.</p>	<p>It is the total demand of all products (goods and services) in an economy. It is expressed as the total amount of money exchanged for those goods and services at a specific price level and point in time.</p>
<p>Aggregate supply= consumption + savings.</p> <p>Various factors influence aggregate supply like existing levels of labor costs, physical capital, technology, and institutions.</p>	<p>It consists of four components</p> <ol style="list-style-type: none"> Consumption (C) Investment (I) Government Spending (G) Net Exports (Export-Import) (X-M) <p>Thus, Aggregate Demand = C + I + G + (X-M)</p> <p>Aggregate demand over the long-term equals gross domestic product (GDP) because the two metrics are calculated in the same way.</p>
<p>The graph shows the Aggregate Supply (AS) curve. The vertical axis is General Price Level (GPL) and the horizontal axis is Quantity of Goods. The AS curve is upward-sloping. At price level GPL1, the quantity is Y1. A rise in price level to GPL2 results in a higher quantity Y2, labeled as an expansion of aggregate supply. A fall in price level to GPL3 results in a lower quantity Y3, labeled as a contraction of aggregate supply.</p>	<p>The graph shows the Aggregate Demand (AD) curve. The vertical axis is General Price Level (GPL) and the horizontal axis is Quantity of Goods. The AD curve is downward-sloping. At price level GPL1, the quantity is Y1. A rise in price level to GPL2 results in a lower quantity Y2, labeled as a contraction of AD. A fall in price level to GPL3 results in a higher quantity Y3, labeled as an expansion of AD. The equation AD = C + I + G + (X - M) is shown.</p>



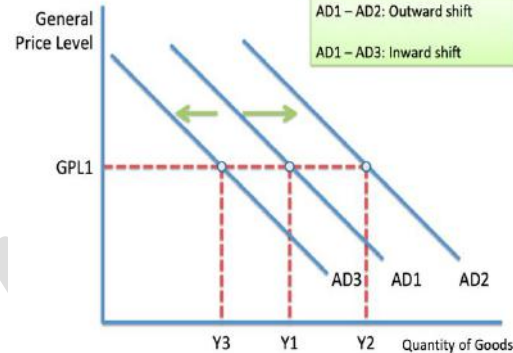
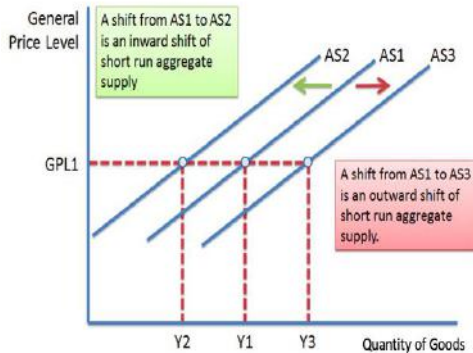
Notes

The upward-sloping aggregate supply curve shows the positive relationship between price level (final price of goods & services) and aggregate supply.

The downward-sloping aggregate supply curve shows the negative relationship between price level (final price of goods & services) and aggregate demand.

The aggregate supply curve slopes up because when the price level for outputs increases while the price level of inputs remains fixed, the opportunity for additional profits encourages more production.

Downward slope indicates that increases in the price level of outputs lead to a lower quantity of total spending (lower demand)



Shifts in Aggregate Supply curve is caused by various reasons like changes in productivity, changes in labour costs, government policies, inflow of capital etc

Any change in the four components (C, I, G, X) will cause a change in the aggregate demand curve.

For example: Ineffective transportation network & increase in labour costs leads to AS curve shifting leftwards i.e. due to increased input costs (and output price remaining same), the producer will produce less goods to maintain his profits (Y1 to Y2 at GPL1)

For Example: Increase in government expenditure (increased salaries, increased wage rates in MGNREGA) will increase aggregate demand and push AD curve outwards.

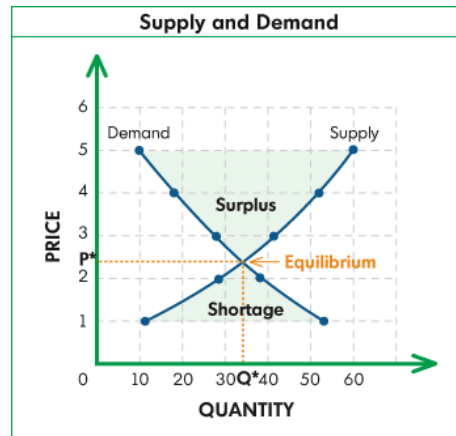
Likewise increased productivity/innovation which reduces input costs will help increase production and shift the AS curve rightwards.

Likewise, a fall in consumption & fall in investment will lead to decrease in Aggregate demand.

As per the British Economist, **John Maynard Keynes**, when economy is functioning at full employment, aggregate supply will match aggregate demand. At this Equilibrium we will have general price level.

When the aggregate supply and aggregate demand shift, so does the point of equilibrium.

Keynes argued that in the event of depression, where there is lower aggregate demand, government has to step up and increase its expenditure so as to spur the aggregate demand to revive the economy



INFLATION

- Inflation refers to a sustained/continuous rise in the general price level of goods and services in an economy over a period of time.
- Inflation measures the average price change in a basket of commodities and services over time.
- Inflation is indicative of the decrease in the purchasing power of a unit of a country's currency. This could ultimately lead to a deceleration in economic growth.
- High rates of inflation is bad because, it can eat up hard-earned money of ordinary people. Life of common man will become tough.
- However, a moderate level of inflation is required in the economy to ensure that production is promoted.

TYPES OF INFLATION

1. Demand-Pull Inflation

This type of inflation is caused due to an increase in aggregate demand in the economy.

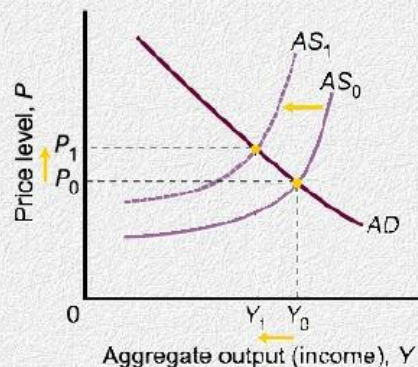
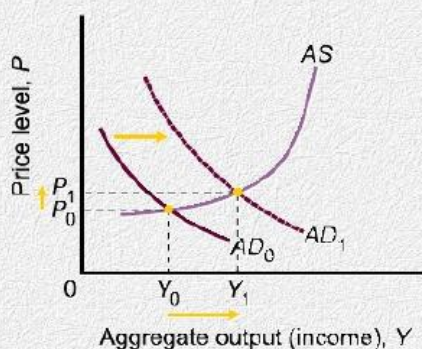
- Price rise because aggregate demand in an economy is greater than the aggregate supply (at full employment level) of goods and services.
- Thus, there is a situation where too much money chasing few goods and services.

Some of the factors which leads increase in AD are

- A growing economy or increase in the supply of money – When consumers feel confident, they spend more and take on more debt. This leads to a steady increase in demand, which means higher prices.
- Asset inflation or Increase in Forex reserves- A sudden rise in exports forces a depreciation of the currencies involved.
- Government spending or Deficit financing by the government – When the government spends more freely, spending capacity of people increased and as a result prices go up.
- Due to fiscal stimulus
- Increased borrowing
- Depreciation of rupee

Causes of Inflation

- **Demand-pull inflation** is inflation initiated by an increase in aggregate demand.
- **Cost-push, or supply-side, inflation** is inflation caused by an increase in costs.



2. Cost-Push Inflation

- When price rise because aggregate supply in an economy declines or is lower than the aggregate demand (at full employment level) of goods and services.
- This decline in aggregate supply is majorly due to rise in production cost.
- Cost pull inflation is considered bad among the two types of inflation. Because the National Income is reduced along with the reduction in supply in Cost-push type of inflation.
- This type of inflation is caused due to various reasons such as:
 - Increase in wages of the employees



- Increase in price of inputs
- Hoarding and Speculation of commodities
- Defective Supply chain: Increases the transit cost of firms
- Increase in indirect taxes: It will be passed on to the consumers
- Crude oil price fluctuation: A rise in prices of oil will lead to rise in input cost (transportation cost will increase) and thus will lead to cost push inflation.
- Depreciation of Currency (for India): Leads to increased import cost of Oil which will further lead to inflation
- Food Inflation (growth agriculture sector has been averaging at low 3.5%)
- Increase in Profit margin by firms: If firms decide to increase their profit margin, it results in increase in prices of goods and services. It usually happens when a single company is major supplier of the goods (monopoly)
- Interest rates were increased by RBI

3. Structural Inflation

It means that inflation is due to structural factors. For example

- Infrastructural bottlenecks, regulatory compliance burden will increase logistic cost and will result in overall increase in prices of commodities
- Similarly, structural bottlenecks in agricultural sector such as APMCs, involvement of middlemen, imperfect price discovery leads to rise in food prices
- Resource constraints (such as government Budget constrain) to finance infrastructure development.
- Structural Inflation is generally significant in explaining the food inflation in India

EFFECTS OF INFLATION

- The effect of inflation is not distributed evenly in the economy. There are chances of hidden costs for different goods and services in the economy.
- Sudden or unpredictable inflation rates are harmful to an overall economy. They lead to market instability and thereby make it difficult for companies to plan a budget for the long-term.
- Inflation can act as a drag on productivity as companies are forced to mobilize resources away from products and services to handle the situations of profit and losses from inflation.



- Inflation leads to decline in the value of money over a period of time. It erodes purchasing power of money. Thus, it will hurt people with fixed income.
- People on fixed salaries, fixed pensions etc. will be negatively impacted by the inflation as they will be able to buy lesser.
- However, businessman and entrepreneurs may benefit from inflation as the price of final product rises (faster than the input prices)
- Moderate inflation enables labour markets to reach equilibrium at a faster pace.

Effect of Inflation on lenders and borrowers

- Inflation is bad for lender (creditor) and good for borrower (debtors). Inflation helps borrowers and hurt lenders. Inflation re-distributes wealth from creditors to lenders.
- Lenders suffers due to inflation. It is because the money they get paid back has less purchasing power than the money they loaned out.
- Borrowers (Debtors) benefit out of inflation. Inflation reduces the value of money. Interest rate that a borrower pay is effectively lower thanks to inflation.
- Inflation redistributes wealth from creditors to debtors i.e. lenders suffer and borrowers benefit out of inflation. **Bondholders have lent money** (to debtor) and received a bond in return. So, bond-holder is a lender and he suffers due to inflation.

STEPS TO CHECK INFLATION

1. Monetary Policy (Contractionary policy)

- In India RBI is responsible for maintaining price stability by controlling inflation
- The monetary policy of the Reserve Bank of India is aimed at managing the quantity of money supply in an economy in order to meet the requirements of different sectors of the economy and to boost economic growth.
- When the total money supply is increased rapidly than normal, it is called an expansionary policy while a decrease of the same refers to a contractionary policy.
- RBI adopts contractionary monetary policy when there is inflation especially if it is demand pull inflation caused by increased money supply in economy. Here, RBI tries to restrict the money supply in economy.



- This contractionary policy is manifested by decreasing bond prices and **increasing interest rates**. This helps in reducing expenses during inflation which ultimately helps halt economic growth and, in turn, the rate of inflation.

2. Fiscal Policy

- Fiscal policy deals with the Revenue and Expenditure policy of the government. It deals with taxation, spending by government and borrowing.
- Tools of fiscal policy
 - Direct taxes should be increased so as to decrease the purchasing power of people that helps in controlling demand pull inflation
 - Indirect taxes should be reduced
 - Public Expenditure should be decreased (should borrow less from RBI and more from other financial institutions)

3. Supply Management measures

- Import commodities which are in short supply
- Decrease exports
- Government may put a check on hoarding and speculation
- Distribution through PDS

INDICES WHICH MEASURE INFLATION IN AN ECONOMY

WHOLESALE PRICE INDEX (WPI)

- WPI measures the changes in the prices of goods sold and traded in bulk by wholesale businesses to other businesses. In other words, WPI tracks **prices at the factory gate** before the retail level.
- The numbers are released by the **Ministry of Commerce and Industry**
- Base year is 2011-12. The new base year aligns with the base year of other indicators like the GDP and IIP.
- Major criticism for this index is that the general public does not buy products at wholesale price.
- Even as the WPI is used as a key measure of inflation in some economies, the RBI no longer uses it for policy purposes, including setting repo rates.
- Provisional figures of WPU are released on 14th of every month (or next working day) with a time lag of two weeks of the reference month and compiled with data received from institutional sources and selected manufacturing units across India.
- WPI was revised in 2017 and key highlights are

- WPI continues to constitute three major groups—Primary Articles, Fuel and Power, and Manufactured Products. The **number of items has been increased** from 676 to 697—in all 199 new items have been added and 146 old items have been dropped.
- The prices used for compilation **do not include indirect taxes** in order to remove impact of fiscal policy. This is in consonance with international practices and will make the new WPI conceptually closer to Producer Price Index (PPI).
- Item level aggregates for new WPI have been compiled using **Geometric Mean (GM)** following international best practice and as is currently used for compilation of the CPI.
- A **new Wholesale Food Price Index (WPI)** has been introduced—combining the *Food Articles* (belonging to the group Primary Articles) and *Food Products* (belonging to the group Manufactured Products).

Major Group / Group	Weight		No. of items	
	2004–05	2011–12	2004–05	2011–12
All Commodities	100.00	100.00	676	697
Primary Articles	20.12	22.62	102	117
Fuel & Power	14.91	13.15	19	16
Manufactured Products	64.97	64.23	555	564

CONSUMER PRICE INDEX (CPI)

OR Retail Inflation

- It is an index measuring retail inflation in the economy by collecting the change in prices of most common goods and services used **by consumers**.
- It is released by **Central Statistics Office (CSO)** under Ministry of Statistics and Programme implementation
- In April 2014, the RBI had adopted the CPI as its key measure of inflation.
- At the national level, there are four Consumer Price Index (CPI) numbers. These are:

CPI Type	Basket	Base Year	Utility
CPI for Industrial Workers (IW)	260 items (plus the services)	2001	<ul style="list-style-type: none"> • The wages/salaries of the central government employees are revised on



[Notes](#)

			<p>the basis of the changes occurring in this index, the dearness allowance (DA) is announced <i>twice</i> a year.</p> <ul style="list-style-type: none">• When the Pay Commission recommends pay revisions, the base is the CPI (IW).
CPI for Agricultural Labourers (AL)	260 commodities collected in 600 villages with a monthly frequency and has three weeks time lag.	1986–87	<ul style="list-style-type: none">• This index is used for revising minimum wages for agricultural labourers in different states.• Centre and states remain vigilant regarding the changes in this index as it shows the price impact on the most vulnerable segment of the society, this segment spends almost 75 per cent of its total income on the purchase of food articles.
CPI for Rural Labourers (RL)	260 commodities collected in 600 villages with a monthly frequency and has three weeks time lag.	1983	<ul style="list-style-type: none">• The agricultural and rural labourers in India create an overlap, i.e., the same labourers work as the rural labourers once the farm sector has either low or no employment scope.• Probably, due to this reason this index was dropped by the government in 2001–02.• But after the government change at the Centre the index was revived again.



<p>CPI for Urban Non-Manual Employees (UNME).</p>	<p>146–365 commodities in the basket for which data is collected at 59 centres in the country</p>	<p>1984–85</p>	<ul style="list-style-type: none"> • This price index has limited use and it is basically used for determining dearness allowances (DAs) of employees of some foreign companies operating in India (i.e., airlines, communications, banking, insurance, embassies and other financial services). • It is also used under the Income Tax Act to determine <i>capital gains</i>. • Since the publication of the CPI (U) started the index was discontinued with from January 2011.
--	---	----------------	---

- While the first three are compiled and released by the Labour Bureau in the Ministry of Labour, the fourth one (CPI-UNME) is released by the Central Statistical Organisation (CSO) in the Ministry of Statistics and Programme Implementation
- In 2011, CSO introduced three new CPI's
 - CPI – Urban
 - CPI – Rural
 - CPI – Combined
- **The National Statistical Office (NSO)**, Ministry of Statistics and Programme Implementation is releasing Consumer Price Index (CPI) on **Base year 2012.**

Group Description	Old Series of CPI (Weights computed on the basis CES 2004–05)			Revised Series of CPI (Weights computed on the basis CES 2011–12)		
	Rural	Urban	Comb.	Rural	Urban	Comb.
Food and beverages	56.39	35.81	47.58	34.18	36.29	45.86
Pan, tobacco and intoxicants	2.72	1.34	2.13	3.26	1.36	2.35
Clothing and Footwear	5.36	3.91	4.73	7.36	5.57	6.53
Housing	–	22.54	9.77	–	21.67	10.07
Fuel and Light	10.42	8.40	9.49	7.94	5.50	6.84
Miscellaneous	24.91	28.00	26.31	27.26	29.53	28.32
Total	100.00	100.00	100.00	100.00	100.00	100.00



Difference between WPI & CPI

- WPI, tracks inflation at the **producer level** and CPI captures changes in prices levels at the **consumer level**.
- Both baskets measure inflationary trends (the movement of price signals) within the broader economy, the two indices differ in which **weightages are assigned to food, fuel and manufactured items**.
- WPI does not capture changes in the **prices of services**, which CPI does.

Headline Retail Inflation Vs Core Inflation

- **Headline inflation** is the raw inflation figure reported through the Consumer Price Index (CPI) that is released by CSO. The headline figure is not adjusted for seasonality or for the often-volatile elements
- **Core inflation** removes the CPI components that can exhibit large amounts of volatility from month to month, which can cause unwanted distortion to the headline figure. The most commonly removed factors are those relating to the cost of food and energy.

IMPORTANT TERMS

Deflation

- Deflation is a decrease in the general price levels of goods and services. It is opposite of Inflation. During deflation prices of goods and services tend to fall.
- Deflation occurs when inflation rate falls below 0%.
- It increases the value of Money
- It increases the Purchasing power of money. People can buy more from same amount of money
- Deflation is good for lenders and bad for borrowers
- Deflation increases the real value of debt
- Thus deflation discourages borrowing (and by extension, consumption and investment today.)
- People may have less propensity to spend and more to save as they will hold on to in expectation of further decline in prices.
- In deflation, there is a steep decline in the general price level, which indicates an unhealthy condition of the economy. It can cause high unemployment, increase layoff, fall in the wage rates, decrease profits, low demand, low income, restricted credit supply in the economy.
- **Ways to Combat Deflation:** Increase the credit supply



	<p>in the economy. Reduce repo rate, CRR and SLR</p>
Disinflation	<ul style="list-style-type: none">• Disinflation is a decrease in the rate of inflation. Being how much prices are increasing per unit of time; it can be expressed using the word disinflation: The slowing of the rate of inflation per unit of time.• For example, in one month the rate of inflation was 4.4% and in May the rate of inflation was 4.0%. In this instance the price of goods and services is still increasing; however, it is increasing at a slower rate, 0.4% less, than a month before.• It should not be confused with deflation, which is an overall decrease in prices.• Disinflation is generally considered to be a very positive state for the economy.• Over the last twenty years North America has seen steady disinflation, and many credits this with the strong growth during this period. While disinflation is generally perceived as positive, it is not good for the effect to go so far as deflation, which is generally perceived to be a very negative state for an economy.
Reflation	<ul style="list-style-type: none">• This term is used to refer the situation where measures are taken to curb deflation. Steps can be like fiscal policy (reducing taxes) or monetary policy (increasing money supply or reducing interest rates)
Creeping Inflation	<ul style="list-style-type: none">• When prices rise at very slow rate, i.e. creeper's speed, it is called 'creeping inflation. Generally, 3% annual rise in prices is considered as 'creeping inflation'.
Walking or Trotting Inflation:	<ul style="list-style-type: none">• When inflation is in between 3% to 7%, it's regarded as 'walking or trotting inflation'. Some economists have extended the boundary of this type of inflation up to 10% per annum.• This type of inflation is considered as a warning signal for the government to take some measures to control the situation.
Galloping Inflation	<ul style="list-style-type: none">• This is a 'very high inflation' running in the range of double-digit or triple digit (i.e., 20, 100 or 200 per cent in a year).• In the decades of 1970s and 1980s, many Latin American countries such as Argentina, Chile and Brazil had such rates of inflation—in the range of 50 to 700



[Notes](#)

	<p>per cent.</p> <ul style="list-style-type: none">• It is also known as jumping inflation and running or runaway inflation
Hyperinflation	<ul style="list-style-type: none">• This form of inflation is 'large and accelerating' which might have the annual rates in million or even trillion.• In such inflation not only the range of increase is very large, but the increase takes place in a very short span of time, prices shoot up overnight.• The best example of hyperinflation that economists cite is of Germany after the First World War—in early 1920s.• At the end of 1923, prices were 36 billion times higher than two years earlier.• This inflation was so severe that paper German currencies (the Deutsche Mark) were more valuable as stove fuel than as actual money• Some recent examples of hyperinflation had been the Bolivian inflation of mid-1985 (24,000 per cent per annum) and the Yugoslavian inflation of 1993 (20 per cent per day)
Inflationary Gap	<ul style="list-style-type: none">• The excess of total government spending above the national income (i.e., fiscal deficit) is known as inflationary gap.• This is intended to increase the production level, which ultimately pushes the prices up due to extra-creation of money during the process.
Deflationary Gap	<ul style="list-style-type: none">• The shortfall in total spending of the government (i.e., fiscal surplus) over the national income creates deflationary gaps in the economy.• This is a situation of producing more than the demand and the economy usually heads for a general slowdown in the level of demand. This is also known as the <i>output gap</i>
Inflation Tax	<ul style="list-style-type: none">• Inflation erodes the value of money and the people who hold currency suffer in this process.• As the governments have authority of printing currency and circulating it into the economy (as they do in the case of deficit financing), this act functions as an income to the governments.• This is a situation of sustaining government



	<p>expenditure at the cost of people's income.</p> <ul style="list-style-type: none">• This looks as if inflation is working as a tax. That is how the term inflation tax is also known as <i>seigniorage</i>.• It could also be used by the governments in the form of prices and incomes policy under which the companies pay inflation tax on the salary increases above the set level prescribed by the government
Stagflation	<ul style="list-style-type: none">• It is a situation where the inflation rate is high, the economic growth rate slows down, and unemployment is also high• Stagflation = High Inflation + High Unemployment + Stagnant Growth• It raises a dilemma for economic policy since actions designed to lower inflation may exacerbate unemployment, and vice versa.• It is unusual because policies to reduce inflation make life difficult for the unemployed, while steps to alleviate unemployment raise inflation. <p>Case of Stagflation</p> <ul style="list-style-type: none">• In the early and mid-1970s when OPEC (The Organisation of Petroleum Exporting Countries), which works like a cartel, decided to cut supply and sent oil prices soaring across the world.• On the one hand, the rise in oil prices constrained the productive capacity of most western economies that heavily depended on oil, thus hampering economic growth. On the other hand, the oil price spike also led to inflation and commodities became more costly.• For instance, in 1974, the oil prices went up by almost 70% and it leads to a consequent rise in inflation.
Skewflation	<ul style="list-style-type: none">• This occurs there is a price rise of one or a small group of commodities over a sustained period of time• In India, food prices rose steadily during the last months of 2009 and the early months of 2010, even though the prices of non-food items continued to be relatively stable.
Disinflation	<ul style="list-style-type: none">• Reduction in the rate of inflation
Shrinkflation	<ul style="list-style-type: none">• Shrinkflation is the practice of reducing the size of a product while maintaining its sticker price. It is a form of hidden inflation.



[Notes](#)

	<ul style="list-style-type: none">• Raising the price per given amount is a strategy employed by companies, mainly in the food and beverage industries, to stealthily boost profit margins or maintain them in the face of rising input costs.• It is also referred to as package downsizing in business• Rising production costs are generally the primary cause of it.• Fierce competition in the marketplace may also cause it.									
Inflation Premium	<ul style="list-style-type: none">• The bonus brought by inflation to the borrowers is known as the inflation premium.• The interest banks charge on their lending is known as the <i>nominal</i> interest rate, which might not be the real cost of borrowing paid by the borrower to the banks.• To calculate the real cost a borrower is paying on its loan, the nominal rate of interest is adjusted with the effect of inflation and thus the interest rate we get is known as the real interest rate.• Rising inflation premium shows depleting profits of the lending institutions. At times, to neutralise the effects of inflation premium, the lender takes the recourse to increase the nominal rate of interest									
Misery index	<ul style="list-style-type: none">• Rate of inflation + Rate of unemployment									
Philips Curve	<ul style="list-style-type: none">• It is a curve which provides relationship between inflation and unemployment.• As per the Philips curve, there is inverse relationship between Inflation and Unemployment• The underlying logic behind the Phillips curve is that wages are quite “sticky”, or inflexible, in a market economy, so unemployment is bound to shoot up whenever workers refuse to accept lower wages <p>Inflation rate %</p> <p>Phillips Curve</p> <table border="1"><caption>Data points from the Phillips Curve graph</caption><thead><tr><th>Point</th><th>Unemployment Rate %</th><th>Inflation rate %</th></tr></thead><tbody><tr><td>B</td><td>4.5</td><td>5.5</td></tr><tr><td>A</td><td>6.5</td><td>2.5</td></tr></tbody></table> <p>Unemployment Rate %</p>	Point	Unemployment Rate %	Inflation rate %	B	4.5	5.5	A	6.5	2.5
Point	Unemployment Rate %	Inflation rate %								
B	4.5	5.5								
A	6.5	2.5								



Note:

The J-curve effect/Curve is seen in economics when a country's trade balance initially worsens following a devaluation or depreciation of its currency.

In economics, the **Laffer curve** is a representation of the relationship between rates of taxation and the resulting levels of government revenue.

GDP Deflator

- It is a measure of general price inflation.
- It is calculated by dividing nominal GDP by real GDP and then multiplying by 100.
- $\text{GDP Deflator} = (\text{GDP at Current Prices} / \text{GDP at constant Price}) * 100$
- GDP deflator is much more broader and comprehensive measure of inflation than CPI and WPI.
- GDP deflator reflects the prices of all domestically produced goods and services in the economy whereas, other measures like CPI and WPI are based on a limited basket of goods and services.
- GDP deflator also includes the prices of investment goods, government services & exports, and excludes the price of imports.
- GDP deflator is usually released quarterly or yearly (CPI, WPI are released monthly) by Ministry of Statistics and Program Implementation.

Base Effect

- It refers to the impact of the rise in price level (i.e., last year's inflation) in the previous year over the corresponding rise in price levels in the current year (i.e., current inflation)
- When a change in the index in the base period has a considerable effect on the measured inflation, this is called base effect of inflation

	Price Index				Inflation		
	2007	2008	2009	2010	2008	2009	2010
Jan	100	120	140	160	20	16.67	14.29

- The index has increased by 20 points in all the three years, viz., 2008, 2009 and 2010.
- However, the inflation rate (calculated on 'year-on-year' basis) tends to decline over the three years from 20 per cent in 2008 to 14.29 per cent in 2010 (Base



[Notes](#)

	<p>Effect)</p> <ul style="list-style-type: none">This is because the absolute increase of 20 points in the price index in each year increases the <i>base year price index</i> by an equivalent amount, while the absolute increase in price index remains the same.
Inflation Targeting	<ul style="list-style-type: none">In India, the RBI had earlier pursued a 'multiple indicators approach', implying concern for outcomes other than inflation, including even the balance of payments.However, the Indian government instituted inflation targeting as the sole objective of monetary policy since 2016-17.While the Government of India tries to accelerate the GDP growth rate of India, the RBI keeps trying to bring down the rate of inflation within a sustainable limit known as inflation targeting.As a result, the Government of India and Reserve Bank of India signed a Monetary Policy Framework Agreement in 2015.As per the agreement, RBI would set the policy interest rates and would aim to bring inflation below 6 per cent by January 2016 and within 4 per cent with a band of (+/-) 2 per cent for 2016-17 and all subsequent years.
Monetary Policy Committee (MPC)	<ul style="list-style-type: none">Setup based on recommendations of Urjit Patel committee.MPC consist of six members, 3 from RBI and 3 appointed by the GovernmentMembers from RBI are governor of RBI (ex-officio Chairman), a deputy governor and one officer of RBI.Members from government are appointed on the recommendations of a search cum selection committee headed by cabinet secretary and including RBI Governor, Economics Affairs Secretary, three experts in the field of Banking/Finance.

Copyright © by IASbaba

All rights are reserved. No part of this document may be reproduced, stored in a retrieval system or transmitted in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission of IASbaba.