BUSINESS ENVIRONMENT
UNIT 3

In an economy, there are many products and services that are produced by the organisations and individuals in a year. It is not possible to add up all in their original state and therefore, need to be expressed in a common term which is money.

National income is referred to as the net money value of all the final goods and services that are produced by the residents living within the boundary of the country within an accounting year.

National Income is the aggregate value of all goods and services produced by firms in a given financial year. It can be stated that when the aggregate revenue generated by the firms is paid out to factors of production, it equals aggregate income or National Income. There are different variants or aggregates of National Income and each of the aggregates has a specific meaning, use, and method of measurement. These aggregates are as follows:

1. *Gross Domestic Product at Market Price* (GDP_{MP})
2. *Gross Domestic Product at Factor Cost* (GDP_{FC})
3. *Net Domestic Product at Market Price* (NDP_{MP})
4. *Net Domestic Product at Factor Cost* (NDP_{FC})
5. *Gross National Product at Market Price* (GNP_{MP})
6. *Gross National Product at Factor Cost* (GNP_{FC})
7. *Net National Product at Market Price* (NNP_{MP})
8. *Net National Product at Factor Cost* (NNP_{FC})

Basic Aggregates of National Income

A number of goods and services are produced in a year by different production units within an economy. It is not possible to add those goods and services in terms of their quantity; therefore, these are added in terms of money. There are eight aggregates in National Income for measuring the value of goods and services in terms of money. These are as follows:

1. Gross Domestic Product at Market Price (GDP$_{MP}$)

GDP$_{MP}$ refers to the gross market value of all the final goods and services produced during a year within the domestic territory of a country.

Gross in GDP$_{MP}$ means that the total value of final goods and services includes depreciation, i.e., no provision has been made for it.

Domestic in GDP$_{MP}$ means that the final goods and services produced are located within the domestic boundaries of the country.

Product in GDP$_{MP}$ indicates that only final goods and services are included.

Market Price in GDP$_{MP}$ means that the amount of indirect taxes paid is included in GDP; however, the subsidies are excluded from it.

The rest of the aggregates are determined by making some adjustments in GDP$_{MP}$.

2. Gross Domestic Product at Factor Cost (GDP_{FC})

GDP_{FC} refers to the gross money value of all the final goods and services produced during a year within the domestic territory of a country. It can be determined as:

$$GDP_{FC} = GDP_{MP} - \text{Net Indirect Taxes}$$

3. Net Domestic Product at Market Price (NDP_{MP})

NDP_{MP} *refers to the net market value of all the final goods and services produced during a year within the domestic territory of a country. It can be determined as:*

$$NDP_{MP} = GDP_{MP} - \text{Depreciation}$$

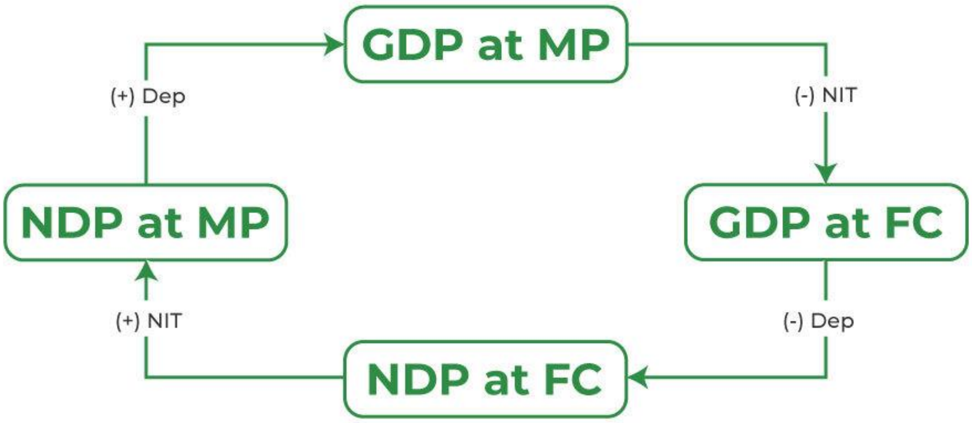
4. Net Domestic Product at Factor Cost (NDP_{FC})

NDP_{FC} *refers to the net money value of all the final goods and services produced during a year within the domestic territory of a country. It can be determined as:*

$$NDP_{FC} = GDP_{MP} - \text{Net Indirect Taxes} - \text{Depreciation}$$

NDP_{FC} is also known as **Domestic Factor Income** or **Domestic Income.**

> ***Relationship between the four Domestic Aggregates (GDP_{MP} GDP_{FC} NDP_{MP} and NDP_{FC})***
>
> *Domestic in each of these aggregates states that the contribution of only those producers whether they are resident or non-resident will be included who are producing within the domestic territory of the country.*



5. Gross National Product at Market Price (GNP_{MP})

GNP_{MP} refers to the gross market value of all the final goods and services produced during a year by the normal residents of a country. It can be determined as:

$$GNP_{MP} = GDP_{MP} + \text{Net Factor Income from Abroad}$$

GNP_{MP} of a country can be less than its GDP_{MP} if NFIA is negative. However, it can be more than GDP_{MP} if NFIA is positive.

6. Gross National Product at Factor Cost (GNP_{FC})

GNP_{FC} refers to the gross money value of all the final goods and services produced during a year by the normal residents of a country. It can be determined as:

$$GNP_{FC} = GNP_{MP} - \text{Net Indirect Taxes}$$

7. Net National Product at Market Price (NNP_{MP})

NNP_{MP} refers to the net market value of all the final goods and services produced during a year by the normal residents of a country. It can be determined as:

$$NNP_{MP} = GNP_{MP} - \text{Depreciation}$$

8. Net National Product at Factor Cost (NNP_{FC})

NNP_{FC} refers to the net money value of all the final goods and services produced during a year by the normal residents of a country. It can be determined as:

$$NNP_{FC} = GNP_{MP} - \text{Net Indirect Taxes} - \text{Depreciation}$$

NNP_{FC} is also known as **National Income.**

Relationship between the four Domestic Aggregates (GNP_{MP} GNP_{FC} NNP_{MP} and NNP_{FC})

National in each of these aggregates states that the contribution of only those producers who are normal residents of a country will be included. It does not matter if the production is being held outside the domestic territory of the country.

Importance

- **Economic policy**: National income data helps governments create policies that promote economic growth.
- **Inflation and deflation**: National income statistics help identify inflation and deflation, and create measures to combat inflation.
- **Budget planning**: National income figures are used to prepare government budgets.
- **Standard of living**: National income can be used to compare the standard of living across countries and over time.

- **Defense and development**: National income estimates help allocate funds for defense and development projects.
- **Economic status**: National income helps define a country's economic status.
- **Economic growth**: National income is used to analyze economic growth.
- **Economic health**: National income accounting provides information that helps track the health of an economy.

INDUSTRIAL POLICY -OVERVIEW

The phrase “industrial policy” is a catch-all term for a range of government interventions that seek to shape the economy, often by developing or supporting domestic manufacturing. A key feature of industrial policies is that they are selective, meaning they favor specific sectors, technologies, firms, and even stages of the value chain.

Industrial policies include targeted interventions such as subsidies, export incentives, and favorable public procurement rules. Industrial policies also include punitive measures aimed at protecting domestic production from foreign rivals, such as export restrictions, tariffs, and other import barriers.

Industrial policy is a plan, a framework, or a set of standard rules, guidelines, and regulations that the government forms for how an industry needs to be run. These standards are made such that a conducive environment can be formed for industries, which leads to the growth and development of that industry and the economy of the country.

Read below this comprehensive article to learn about the objectives of the industrial policies of India and the updated industrial policy.

Objectives of Industry Policy

- **Economic growth** of the industry, in such a manner, will lead to the growth and development of the country.
- **Employment generation: to** provide more employment opportunities in industry.
- **Utilization of Human Resources:** Through employment generation, human resources can be better utilized and, thus, living standards can be improved.
- **Healthy competitiveness:** to promote an environment of healthy competitiveness so that even small-scale industries can grow.
- **Foreign Investment:** A better environment for industries attracts more foreign investment, expertise, and new technology.

Industrial policies of India

After the independence of India in 1947, one of the significant steps taken by the Indian government for the growth and development of nations was to promote trade and industry. To do so, Indian leaders felt the need to formulate an industrial policy. As a result, many industrial policies were formed by the Indian government from 1948 onward, which are as follows:

Industrial Policy Resolution of 1948

- It was the first plan in independent India to create a self-sufficient economy. Some of the important features of this policy are:
- It declared India to be a mixed economy.
- It gave importance to small-scale industries.
- It restricted foreign investments.
- It divided Indian industries into four categories, which are as follows:

1. Industries on which there was an exclusive monopoly of the central government. Such as those dealing with arms and ammunition, atomic energy production, railway management, etc.
2. A new undertaking to be controlled by the state alone dealt with industries related to coal, iron and steel, aircraft manufacturing, shipbuilding, telegraph, telephone, etc.
3. Industries to be regulated (which means private participation as well) by the government that are of basic importance and needed, such as sugar and chemicals,.
4. Open to private enterprises, individuals, and cooperatives, including all remaining industries other than those above

Industrial Policy Resolution (IPR) 1956

This policy emphasized government control or public ownership and laid the basic framework of industrial policy, also known as the economic constitution of India.

It classified industries into three sectors.

Schedule A: Industries under this section are known as **<u>public sector industries</u>**, which are exclusively owned and operated by the state. It includes 17 industries, such as arms and ammunition, atomic energy, and railways.

Schedule B: Industries under this section are also known as **<u>mixed-sector (i.e., public and private)</u>** industries, which both state and private owners own, and the percentage of this ownership can vary. It includes 12 items, such as iron and steel, heavy machinery, and aircraft manufacturing.

Schedule C: **<u>Private Industries:</u>** These industries are completely owned by private enterprises and include industries such as textiles, paper, and chemicals.

This has provisions for the public sector, small-scale industry, and foreign investment. It made foreign investment restrictions stricter and introduced a licensing system. To meet new challenges, from time to time, IPR 1956 was modified through statements in 1973, 1977, and 1980.

Industrial Policy Statement, 1977

This policy was an extension of the 1956 policy and was introduced in the emergency era, when there was a large concentration of power in the hands of the government.

- This policy emphasized employment for people with low incomes (poverty eradication) and a reduction in the concentration of wealth.
- This policy is primarily focused on decentralization.

- It gave priority to small-scale industries (also in rural and small-town areas).
- It divided the small-scale sector into three categories. They were cottage and household, micro, and small-scale industries.
- This policy imposed restrictions on multinational companies (MNCs).

Industrial Policy Statement, 1980

The Industrial Policy Statement of 1980 was made to provide a long-term direction for the country's industrial growth. It focused on promoting healthy competition in the domestic market, modernization through technological advancement, and selective liberalization.

- It liberalized licensing and provided for the automatic expansion of capacity.
- This policy introduced the MRTP Act (Monopolies Restrictive Trade Practices) and the FERA Act (Foreign Exchange Regulation Act, 1973).
- The objective was to liberalize the industrial sector to increase its competitiveness in domestic markets and boost Indian products in international markets.
- It encouraged export-based enterprises.
- It promoted the growth of new industries and technologies, especially the high-technology (high-tech) industry.

New Industrial Policy, 1991

The New Industrial Policy of 1991 is the most significant policy that revolutionized Indian industries and the economy. Its main objective was to make the economy market-oriented and increase efficiency.

This policy has three main components, which are as follows:

Liberalization (reduction of government control and influence)

Privatization (increasing the role and scope of private sector enterprises)

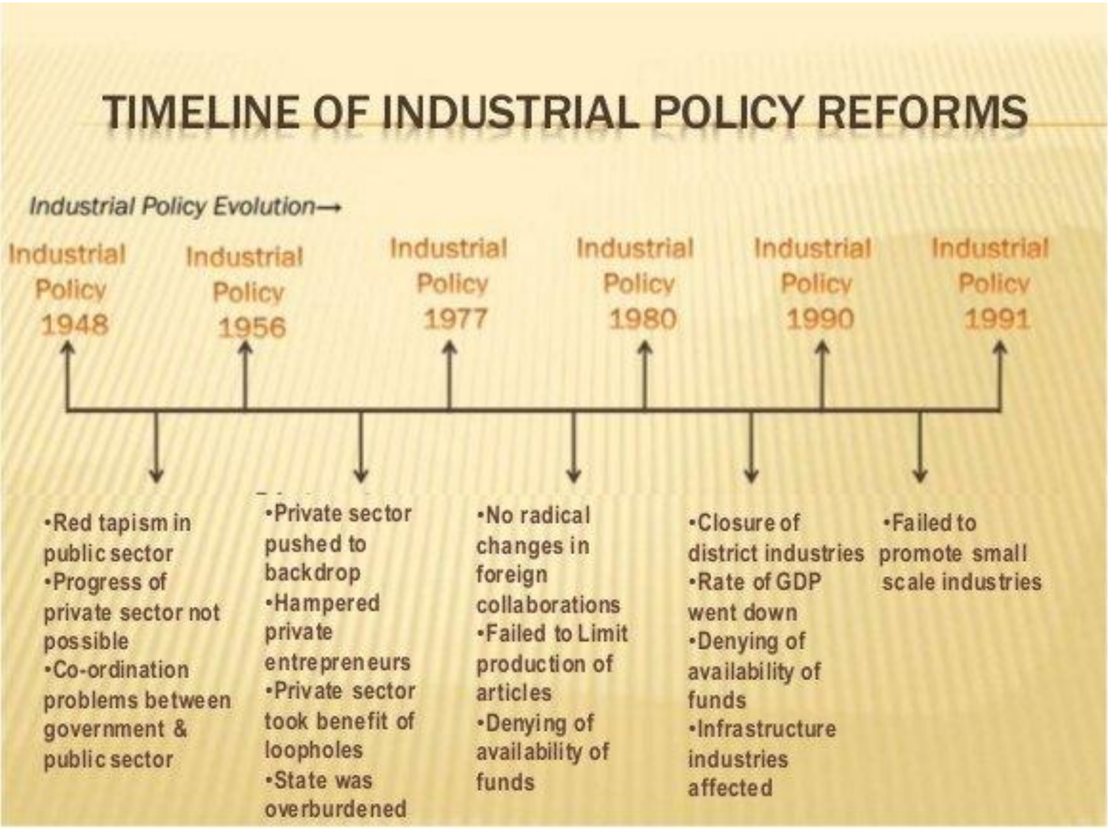
Globalization (integration of the Indian economy with the world economy by welcoming foreign investments instead of restrictions)

These LPG reforms enhanced the competition in the market.

- Old domestic firms have to compete with new domestic firms, MNCs, and imported items; more competition leads to a greater number of products in the market. Thus, people have many more options and varieties to buy the same products.
- The government allowed domestic firms to import advanced technology to improve efficiency and access better technology.
- The foreign direct investment ceiling was increased from 40% to 51% in selected sectors.
- The maximum FDI is limited to 100% in selected sectors, like infrastructure. The Foreign Investment Promotion Board was established.

- A single-window FDI clearance agency. The technology transfer agreement was allowed under the automatic route.
- Industrial licensing was abolished except for 18 industries. . So the reduction in cumbersome licensing processes and red tape can be curbed.
- The Phased Manufacturing Programme was a condition that forced foreign firms to reduce imported inputs and use domestic inputs; it was abolished in 1991.
- Under the mandatory convertibility clause, while giving loans to firms, part of the loan will or can be converted to equity of the company if the banks want the loan in a specified time. This was also abolished.
- Monopolies and Restrictive Trade Practices Act: Under MRTP, a commission was established. The MRTP Act was introduced to check monopolies. The MRTP Act was relaxed in 1991.
- It also aims to simplify labor laws and increase hiring flexibility.

On the recommendation of the SVS Raghavan committee, the Competition Act 2000 was passed. Its objectives were to promote competition by creating a conducive and enabling environment for industries and markets to grow.


TIMELINE OF INDUSTRIAL POLICY REFORMS
Industrial Policy Evolution→
Industrial Policy 1948
Industrial Policy 1956
Industrial Policy 1977
Industrial Policy 1980
Industrial Policy 1990
Industrial Policy 1991
•Red tapism in public sector •Progress of private sector not possible •Co-ordination problems between government & public sector
•Private sector pushed to backdrop •Hampered private entrepreneurs •Private sector took benefit of loopholes •State was overburdened
•No radical changes in foreign collaborations •Failed to Limit production of articles •Denying of availability of funds
•Closure of district industries •Rate of GDP went down •Denying of availability of funds •Infrastructure industries affected
•Failed to promote small scale industries

ROLE of New Industrial Policy

- **De-reservation of Public sector:** Sectors that were earlier exclusively reserved for public sector were reduced. However, pre-eminent place of public sector in 5 core areas like arms and ammunition, atomic energy, mineral oils, rail transport and mining was continued.
    - **Presently, only two sectors- Atomic Energy and Railway operations-** are reserved exclusively for the public sector.
- **De-licensing:** Abolition of Industrial Licensing for all projects except for a short list of industries.
    - There are only 4 industries at present related to security, strategic and environmental concerns, where an industrial license is currently required-
        - Electronic aerospace and defence equipment
        - Specified hazardous chemicals
        - Industrial explosives
        - Cigars and cigarettes of tobacco and manufactured tobacco substitutes
- **Disinvestment of Public Sector:** Government stakes in Public Sector Enterprises were reduced to enhance their efficiency and competitiveness.

- **Liberalisation of Foreign Investment:** This was the first Industrial policy in which foreign companies were allowed to have majority stake in India. In 47 high priority industries, upto 51% FDI was allowed. For export trading houses, FDI up to 74% was allowed.
    - Today, there are numerous sectors in the economy where government allows 100% FDI.
- **Foreign Technology Agreement:** Automatic approvals for technology related agreements.
- **MRTP Act** was amended to remove the threshold limits of assets in respect of MRTP companies and dominant undertakings. MRTP Act was replaced by the Competition Act 2002.

Outcomes of New Industrial Policies

- The 1991 policy **made 'Licence, Permit and Quota Raj' a thing of the past.** It attempted to liberalise the economy by **removing bureaucratic hurdles** in industrial growth.
- Limited role of Public sector reduced the burden of the Government.
- The policy provided **easier entry of multinational companies,** privatisation, removal of asset limit on MRTP companies, liberal licensing.
    - All this resulted in increased competition, that led to lower prices in many goods such as electronics

prices. This brought domestic as well as foreign investment in almost every sector opened to private sector.

- The policy was followed by special efforts to increase exports. Concepts like Export Oriented Units, Export Processing Zones, Agri-Export Zones, Special Economic Zones and lately National Investment and Manufacturing Zones emerged. All these have benefitted the export sector of the country.

Liberalisation, Privatisation, and Globalisation

LPG refers to Liberalisation, Privatisation, and Globalisation. When India under its New Economic Policy approached the International Banks for developing the country, they suggested that the government should open towards restrictions on trade which is mostly done by the private sectors in between India and other countries. After the suggestion put forward by the International Banks, the Indian Government announced New Economic Policy or NEP. This policy consisted of an extensive range of reforms. These measures are broadly classified into two groups- structural reforms and stabilisation measures.

The objective of structural measures was to develop international competitiveness. Moreover, the measures aimed to eliminate the rigidity in various sections of the country's economy. In stabilisation measures, the aim was to rectify and correct the existing weakness developed in controlling the inflation and balance of payments. Both sets of measures were taken for a short-term period. The stabilisation measure included Liberalisation, Privatisation, and Globalisation. Under this measure, the balance of payment was enabled to record all forms of economic transactions of a country with the rest of the world in a year. In such a scenario, inflation refers to the growth of prices in goods and services over a particular period.

Liberalisation

The objective of liberalisation was to put an end to those rigidities and restrictions that were acting as a hindrance to the growth of the country. Further, in this approach, the Government was expected to be flexible with its regulation in the nation. The objectives of this policy were to enhance the competition among the domestic industries and encourage international trade with planned imports and exports. Moreover, it aimed at increasing international technology and capital. Also, this policy was expected to expand the international market frontier of the nation and reduce the burden of debt in the country.

Objectives of Liberalization Policy

- To increase competition amongst domestic industries.
- To encourage foreign trade with other countries with regulated imports and exports.

- Enhancement of foreign capital and technology.
- To expand global market frontiers of the country.
- To diminish the debt burden of the country

Privatisation

The second policy of the stabilisation measure is privatisation. This policy aims to expand the domination of private sector companies and reduce the control of the public sectors. Thus, the Government-owned enterprise will have less ownership. Besides these Government companies can be converted into private sector companies with two approaches. These approaches are by withdrawing the control of the Government in the public sector company and by disinvesting. There are three forms of Privatisation which are a strategic sale, partial sale, and token privatisation. In the strategic sale or denationalisation, the Government needs to deliver 100% of productive resources ownership to the owners of the private companies. The Partial Sale or Partial privatization owns a minimum of 50% ownership with the help of the transfer of shares. They would, therefore, own the majority of the shares and would have control of the autonomy and functioning of the company. In the token or the deficit privatisation, the Government would have to disinvest the share capital by up to 5-10% in order to meet the shortage in the budget. This policy, therefore, aims to improve the financial situation in the country and reduce the work pressure of the public sector companies. Moreover, funds could be raised from the disinvestment. With the reduced work pressure the efficiency of the public sector would automatically increase and yield better quality of goods and services for the use of consumers.

Objectives of Privatization

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

Globalisation

In this policy, the country's economy is expected to grow with the help of the global economy. This means that the primary focus would be on foreign trade and institutional and private investments. It is the third and the last policy that is to be implemented. The objective of this phenomenon is to develop and independent the world with the implication of suitable strategies. It is the attempt to create a world where the requirements of one country can be driven and turned into one large economy. One of the major outcomes of Globalisation is outsourcing. Outsourcing means an enterprise can employ professionals from other countries to reach a particular goal. There is a lot of contractual work that is being outsourced in the field of Information Technology leading to its development. This has opened new avenues for a lot of private sectors and Indian skills are regarded as the most effective and vibrant across the globe. The low wage rate and dedicated employees have made India one of the constructive nations suitable for international outsourcing.

What are the Benefits of Globalization?

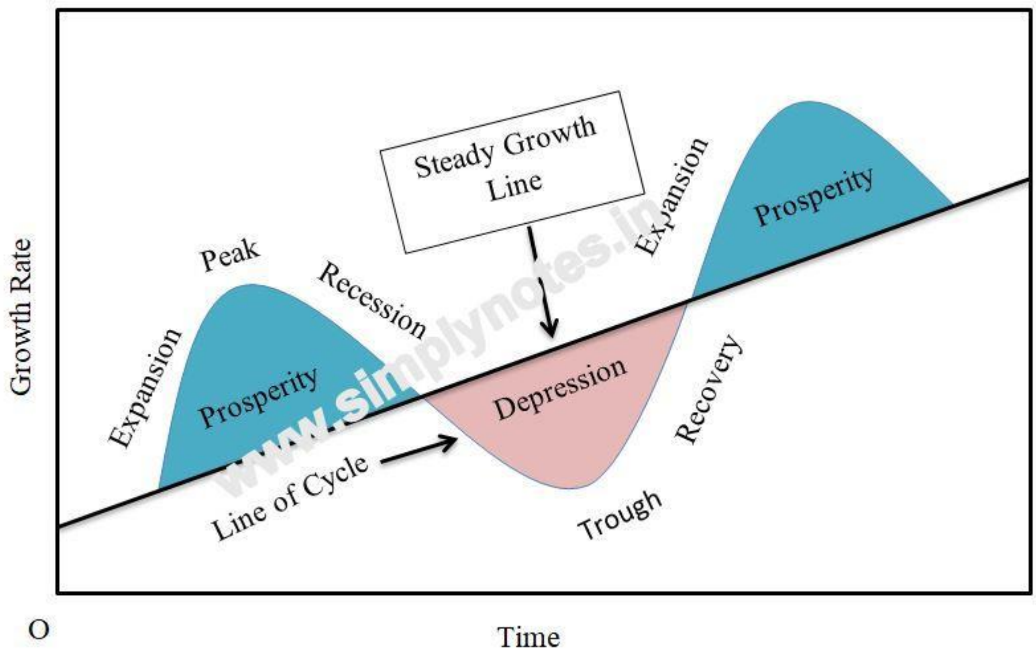
The most important advantage of outsourcing is that big multi-national corporate or even small enterprises can avail good services at a cheaper rate as compared to their country's standards. The skill set in India is considered most dynamic and effective across the world. Indian professionals are best at their work. The low wage rate and specialized personnel with high skills have made India the most favourable destination for global outsourcing in the later stage of reformation.

TRADE CYCLE

MEANING OF TRADE CYCLE

The "trade cycle" refers to the naturally occurring cyclical variations in economic activity that occur in economies. The cycle is described by phases of expansion, peak, contraction, and trough, each of which represents a different stage of the cycle.

A rise in economic activity during the expansionary phase leads to growth. The peak, or the highest point of expansion, is followed by the contraction phase, which is marked by a decline in output and growth. After that, the cycle continues as the economy enters an expansionary stage. The recession's lowest point is indicated by the trough. In this blog, we will look into what is trade cycle, trade cycle meaning, features of the trade cycle, and more.



Trade Cycle Definition

Business or trade cycles are the terms used to describe the cyclical expansion and contraction of economic activity. Period of Expansion, Upswing, or Prosperity" refers to the era of high income, high output, and high employment. The era of contraction, recession, downswing, or depression is a time of low income, poor production, and low employment.

Now that you understand the trade cycle's exact meaning let's look at its features.

Features of Trade Cycle

The trade cycle's key features are as follows:

- **Economic Activity Movement:** A trade cycle is a wave-like movement of the economy that exhibits both an upward and a negative tendency
- **Periodic:** Trade cycles do not exhibit the same regularity but recur periodically
- **Different Phases:** Trade cycles go through several phases, including prosperity, recession, depression, and recovery.
- **Two distinct types of trade cycles exist:** small and large. Primary trade cycles last 4–8 years or more, whereas minor trade cycles last 3–4 years. Although the time of trade cycles varies, they all follow a similar pattern of successive stages.
- **Duration:** Trade cycles can last between two years and a maximum of twelve years.
- **Dynamic:** All economic sectors change as a result of business cycles. Other factors, including employment, investment, consumption, interest rate, and price level, also experience fluctuations along with output and income.
- **Phases are Cumulative:** In a trade cycle, expansion and contraction are, in fact, cumulative, rising or reducing over time.
- **Economic Uncertainty:** Business people face economic uncertainty which is because earnings vary more than any other source of income.

- **International Character:** Trade Cycles have a global nature. Consider the 1930s Great Depression.

Different Types of Trade Cycles

Dynamic forces at work in a capitalist system produce different types of economic fluctuations. Listed below are the types of trade cycles:

- **A cycle of Short Duration:** This trading cycle lasts for a brief time. Other names for it include minor cycles. It has a 3–4 year lifespan.
- **Secular Trends:** This trade cycle, also known as a long-term cycle, lasts a considerable amount of time. It also goes by the name of the primary cycle.
- **Seasonal Fluctuations:** This term refers to trade cycles due to the economy's seasonal variations. For instance, a poor monsoon may result in an economic downturn, while a strong monsoon and an upward trend may follow.
- **Unpredictable or Random Fluctuations:** These trade cycles take place during times of strikes, war, etc., which shocks the economy.
- **Cyclic Fluctuation:** These shifts in economic activity resemble waves and are brought on by recurrent expansion and contraction periods. Economic changes in supply, demand, and other variables can create an upswing from a trough (low point) to a peak and a downswing from a rise to a track.

Trade Cycle Theories

Several business cycle hypotheses are listed below.

Keynesian Theory

Its foundation is that governments should boost expenditure and reduce taxes to increase demand during recessions. This idea suggests that by injecting additional funds into the economy, a government's intervention might lessen the severity of economic downturns. It encourages investment and consumption. Further economic expansion is facilitated by this increased activity, which also contributes to the creation of employment and household income.

The Austrian Theory

According to this theory, such cycles occur mainly because capital resources are misallocated due to artificially low interest rates set by central banks. It suggests that investors get too enthusiastic about potential profits when central banks reduce interest rates too rapidly or significantly. Thus they assume higher levels of risk as a result. These investments eventually result in losses for the investors.

The Monetarist Theory

According to this theory, boom-bust cycles are caused by inflationary forces. A company's production input costs, such as labour, materials, etc., rise more quickly than its output prices due to rises in overall demand. Because of this, they sell fewer units for a profit, which lowers overall business confidence and investment levels. Additionally, it causes GDP growth to slow over time to the point where an eventual economic recession happens.

Trade Cycle Phases

The phases of a trade cycle in economics are as follows.

The Peak Phase

It is when economic activity is at its peak and growth is at a standstill. Businesses operate fully during this phase, with high consumer spending and investment levels. As a result, prices rise due to inflation when demand exceeds supply. There may be indications that the economy is starting to slow down as it nears the apex of a cycle, such as growing unemployment or declining consumer confidence.

The Phase of Contraction

Beginning a recession means less company investment and consumer spending, causing the economy's production to drop. As a result of businesses cutting back on output in reaction to a decline in demand for products and services, inflation often declines during this time. Due to companies reducing personnel expenses to maintain profitability, unemployment also increases dramatically during this time.

The Phase of the Trough

No rebound will occur when economic activity reaches its lowest point following a recession. In this phase, GDP growth may stagnate or decline further depending on external causes like world events or political unrest. Regardless of their previous downturn, most economies ultimately rebound in some way.

The Phase of Expansion

It happens when the economy recovers from a recession, and investment flows return to the markets. The unemployment rate declines, and inflation returns to more manageable levels than at earlier peaks. Businesses take advantage of this by growing their operations and funding brand-new initiatives. Over time, it fuels more economic expansion until a new cycle starts.

INFLATION ANALYSIS

Inflation refers to an increase in the price level that is sustained over a significant period of time.

• High and/or volatile inflation hampers economic growth, and generates volatility in the ER.

• Aiming for low and stable inflation is typically a key objective for monetary policy.

Inflation is a gradual loss of purchasing power that is reflected in a broad rise in prices for goods and services over time.
The inflation rate is calculated as the average price increase of a basket of selected goods and services over one year.
High inflation means that prices are increasing quickly, while low inflation means that prices are growing more slowly.
Inflation can be contrasted with deflation, which occurs when prices decline and purchasing power increases.

Types of Inflation

Inflation can be classified into three types: demand-pull inflation, cost-push inflation, and built-in inflation.

Demand-Pull Effect

Demand-pull inflation occurs when an increase in the supply of money and credit stimulates the overall demand for goods and services to increase more rapidly than the economy's production capacity. This increases demand and leads to price rises.

When people have more money, it leads to positive consumer sentiment. This, in turn, leads to higher spending, which pulls prices higher. It creates a demand-supply gap with higher demand and less flexible supply, which results in higher prices.

Cost-Push Effect

Cost-push inflation is a result of the increase in prices working through the production process inputs. When additions to the supply of money and credit are channeled into a commodity or other asset markets, costs for all kinds of intermediate goods rise. This is especially evident when there's a negative economic shock to the supply of key commodities.

These developments lead to higher costs for the finished product or service and work their way into rising consumer prices. For instance, when the money supply is expanded, it creates a speculative boom in oil prices. This means that the cost of energy can rise and contribute to rising consumer prices, which is reflected in various measures of inflation.

Built-In Inflation

Built-in inflation is related to adaptive expectations or the idea that people expect current inflation rates to continue in the future. As the price of goods and services rises, people may expect a continuous rise in the future at a similar rate.

As such, workers may demand more costs or wages to maintain their standard of living. Their increased wages result in a higher cost of goods and services, and this wage-price spiral continues as one factor induces the other and vice versa.

How Inflation Impacts Prices

While it is easy to measure the price changes of individual products over time, human needs extend beyond just one or two products. Individuals need a big and diversified set of products as well as a host of services to live a comfortable life. They include commodities like food grains, metal, fuel, utilities like electricity and transportation, and services like healthcare, entertainment, and labor.

Inflation aims to measure the overall impact of price changes for a diversified set of products and services. It allows for a single value representation of the increase in the price level of goods and services in an economy over a specified time.

Prices rise, which means that one unit of money buys fewer goods and services. This loss of purchasing power impacts the cost of living for the common public which ultimately leads to a deceleration in economic growth. The consensus view among economists is that sustained inflation occurs when a nation's money supply growth outpaces economic growth.

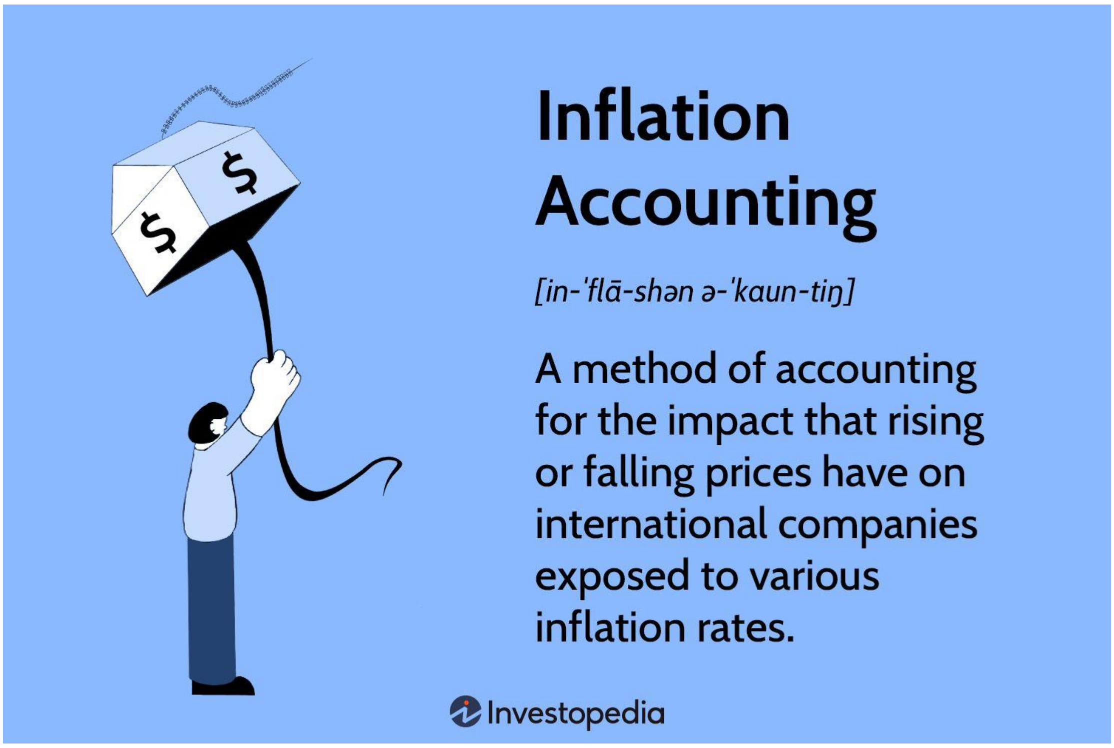
How to Protect Your Finances During Inflation

There are a range of measures that individuals can take to protect their finances against inflation. For instance, one may choose to invest in asset classes that outperform the market during inflationary times. This might include commodities like grain, beef, oil, electricity, and natural gas.

Commodity prices typically stay one step ahead of product prices, and price increases for commodities are often seen as an indicator of inflation to come. Commodities, which can also be volatile, are easily affected by natural disasters, geopolitics, or conflict.

Real estate income may also help buffer against inflation, as landlords can increase their rent to keep pace with the rise of prices overall.

The U.S. government also offers Treasury Inflation-Protected Securities (TIPS), a type of security indexed to inflation to protect against declines in purchasing power.



Types of Price Indexes

Depending upon the selected set of goods and services used, multiple types of baskets of goods are calculated and tracked as price indexes. The most commonly used price indexes are the Consumer Price Index (CPI) and the Wholesale Price Index (WPI).

Consumer Price Index (CPI)

The CPI is a measure that examines the weighted average of prices of a basket of goods and services that are of primary consumer needs. They include transportation, food, and medical care.

CPI is calculated by taking price changes for each item in the predetermined basket of goods and averaging them based on their relative weight in the whole basket. The prices in consideration are the retail prices of each item, as available for purchase by the individual citizens. CPI can impact the value of one currency against those of other nations.

Changes in the CPI are used to assess price changes associated with the cost of living, making it one of the most frequently used statistics for identifying periods of inflation or deflation. In the United States, the Bureau of Labor Statistics (BLS) reports the CPI each month and has calculated it as far back as 1913.[3]

Wholesale Price Index (WPI)

The WPI is another popular measure of inflation. It measures and tracks the changes in the price of goods in the stages before the retail level.

While WPI items vary from one country to another, they mostly include items at the producer or wholesale level. For example, it includes cotton prices for raw cotton, cotton yarn, cotton gray goods, and cotton clothing.[6]

Although many countries and organizations use the WPI, many other countries, including the U.S., use a similar variant called the Producer Price Index (PPI).7

Producer Price Index (PPI)

The PPI is a family of indexes that measures the average change in selling prices received by domestic producers of intermediate goods and services over time. The PPI measures price changes from the perspective of the seller and differs from the CPI, which measures price changes from the perspective of the buyer.8

In all variants, the rise in the price of one component (say oil) may cancel out the price decline in another (say wheat) to a certain extent. Overall, each index represents the average weighted price change for the given constituents which may apply at the overall economy, sector, or commodity level.

The Formula for Measuring Inflation

The above-mentioned variants of price indexes can be used to calculate the value of inflation between two particular months (or years). While a lot of ready-made inflation calculators are already available on various financial portals and websites, it is always better to be aware of the underlying methodology to ensure accuracy with a clear understanding of the calculations. Mathematically, *Percent Inflation Rate = (Final CPI Index Value ÷ Initial CPI Value) × 100*

Case Study: Impact of Liberalization, Privatization, and Globalization (LPG) on India's IT Industry

Introduction

In 1991, India introduced the **Liberalization, Privatization, and Globalization (LPG) policy** under the New Economic Policy. This marked a significant shift from a controlled economy to a more open and market-driven system. One of the industries that benefited immensely from these reforms was the **Information Technology (IT) sector**.

Pre-LPG Era: Limited Growth

Before 1991, India's IT industry was relatively small due to:

- High government regulations
- Limited foreign investments
- Lack of infrastructure

Post-LPG Reforms and Their Impact

The LPG policy led to several changes that transformed the IT sector:

1. **Liberalization**
   - **Reduced regulations**: The government reduced restrictions on private businesses, allowing the IT sector to grow.
   - **Foreign investment allowed**: Multinational companies (MNCs) like Microsoft, IBM, and Oracle entered India, bringing technology and job opportunities.
2. **Privatization**
   - Several government restrictions on IT firms were removed, allowing private companies like **TCS, Infosys, and Wipro** to expand.
   - Privatization led to increased competition, improving efficiency and innovation in the sector.
3. **Globalization**
   - Indian IT companies started exporting services worldwide, especially in **software development and IT-enabled services (ITES)**.
   - **Outsourcing boom**: Companies in the US and Europe outsourced work to India due to lower costs and skilled labor.

Economic Impact

- **Contribution to National Income**: The IT sector now contributes around **7-8% of India's GDP**.
- **Employment Generation**: Millions of jobs have been created in cities like **Bangalore, Hyderabad, and Pune**.

- **Foreign Exchange Earnings**: Software exports have become a major source of revenue for India.

Challenges and Inflation Impact

- **Rising inflation** affects operational costs, salaries, and overall profitability.
- **Trade cycles** impact demand for IT services during global recessions, as seen in the **2008 financial crisis** and **COVID-19 pandemic**.

Conclusion

The **LPG reforms** played a crucial role in making India a global IT hub. The case of the IT industry highlights how economic policies, trade cycles, and inflation trends shape business growth. It also demonstrates the importance of **industrial policy reforms** in national income generation.

Here are 30 questions based on the topics **National Income and its Aggregates, Industrial Policy, Liberalization, Privatization, Globalization (LPG), Trade Cycle, and Inflation Analysis**:

Section 1: National Income and its Aggregates

1. What is National Income?
2. What are the different methods of calculating National Income?
3. Define Gross Domestic Product (GDP) and its significance.
4. What is the difference between GDP at market price and GDP at factor cost?
5. Define Gross National Product (GNP) and how it differs from GDP.
6. What is Net National Income (NNI), and how is it calculated?
7. What is Per Capita Income, and why is it an important economic indicator?
8. How does National Income reflect the economic growth of a country?
9. What are the challenges in measuring National Income in a developing country like India?
10. How do the three sectors (Primary, Secondary, and Tertiary) contribute to National Income?

Section 2: Industrial Policy – Overview and Role

11. What is an Industrial Policy, and why is it important for economic development?
12. Discuss the key features of India's Industrial Policy of 1991.
13. What role does the government play in industrial growth?
14. How has the Industrial Policy contributed to employment generation in India?
15. What is the significance of Public Sector Enterprises (PSEs) in Industrial Policy?
16. How does Foreign Direct Investment (FDI) impact industrial growth in India?
17. What are the major challenges faced by industries in India?
18. Explain the role of Small and Medium Enterprises (SMEs) in industrial development.
19. What impact has the ‘Make in India’ initiative had on industrial growth?
20. How does technology and innovation contribute to industrial development?

Section 3: Liberalization, Privatization, and Globalization (LPG)

21. What is Liberalization, and how has it changed India's economy?
22. What are the key advantages and disadvantages of Privatization?
23. Define Globalization and its impact on trade and business in India.
24. How did the 1991 economic reforms transform the Indian economy?
25. What role do Multinational Corporations (MNCs) play in a globalized economy?
26. How has Globalization affected Indian agriculture and rural employment?
27. What are the effects of Liberalization on the banking sector in India?
28. Explain the concept of Public-Private Partnership (PPP) and its role in economic growth.
29. How has India's IT sector benefited from LPG reforms?
30. What are the negative impacts of Globalization on the Indian economy?