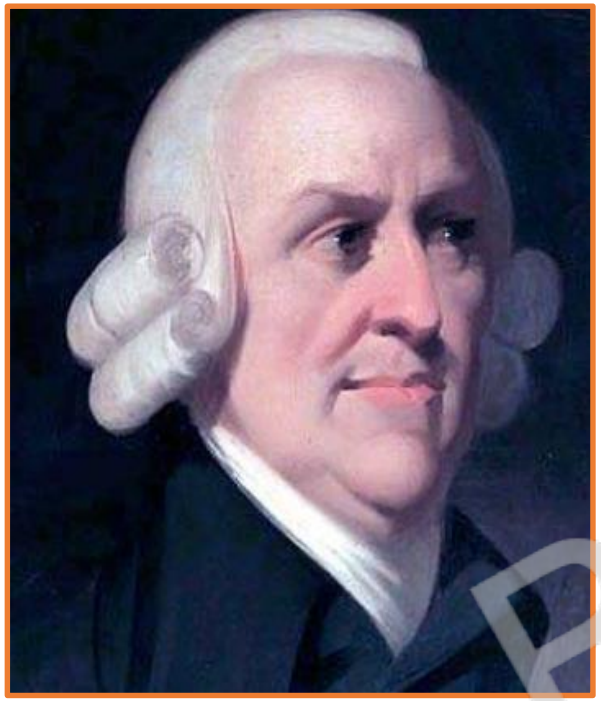
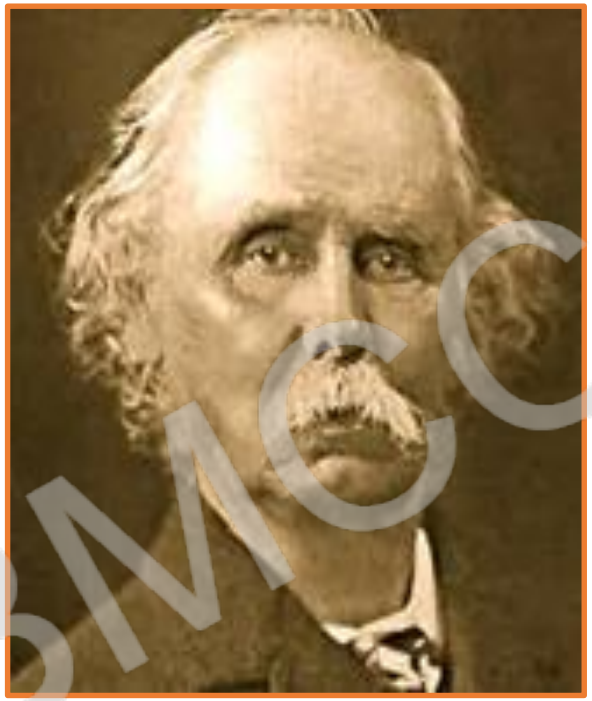
Indian Economy

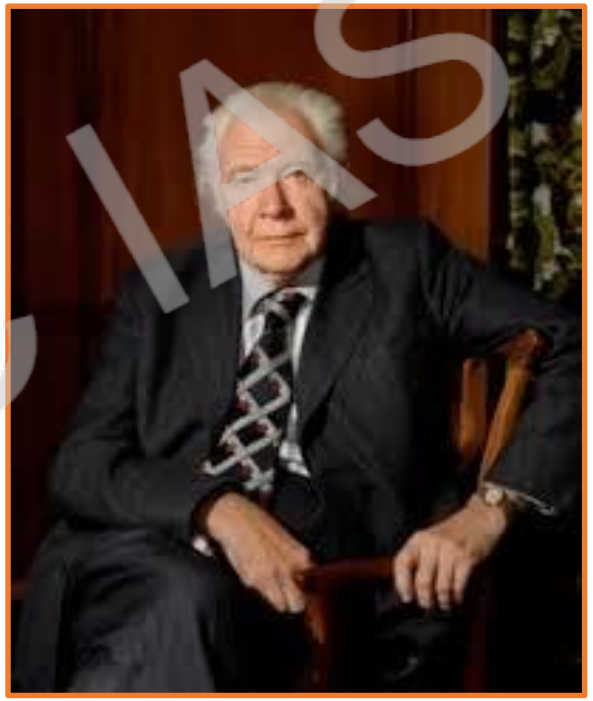
Modern economics has evolved through different schools of thought, often categorized by these foundational definitions:



Adam Smith



Alfred Marshall



Lionel Robbins

Paul Samuelson

Modern economics has evolved through different schools of thought, often categorized by these foundational definitions:

Wealth Definition (Adam Smith): Termed the "Science of Wealth," focusing on the production and consumption of wealth.

Welfare Definition (Alfred Marshall): Defines it as a study of mankind in the "ordinary business of life," emphasizing human well-being over just material wealth.

Scarcity Definition (Lionel Robbins): The most widely cited for UPSC; it defines economics as the study of human behavior as a relationship between **ends** (unlimited wants) and **scarce means** (limited resources) with alternative uses.

Growth & Development Definition (Paul Samuelson): A dynamic approach that includes the element of time, focusing on how resources are used to produce and distribute commodities for present and future consumption.

Economics

A social science concerned chiefly with description and analysis of the production, distribution, and consumption of goods and services.

NOTE

One of the **earliest recorded economists** was the 8th-century B.C. Greek farmer and poet Hesiod who wrote that labour, materials, and time needed to be allocated efficiently to overcome scarcity

The publication of **Adam Smith's 1776 book**, *An Inquiry Into the Nature and Causes of the Wealth of Nations* sparked the beginning of the current Western contemporary economic theories

Microeconomics: Focuses on individual decision-making units, such as households and businesses. It examines how these agents allocate limited resources and how their interactions in markets determine prices for goods and services. Key topics include supply and demand, consumer behavior, and production costs.

Macroeconomics: Studies the economy as a whole on a national or global scale. It analyzes aggregate indicators such as Gross Domestic Product (GDP), inflation, unemployment, and national income. This branch is essential for formulating government policies like fiscal and monetary strategies.

Schools of Economic Thought

The two most common Schools of Economic Thought

- Classical View
- Keynesian View

Classical Economics (late 18th–mid-19th c.): Founded by **Adam Smith** (often called the "Father of Economics"), this school emphasizes the "invisible hand" of the market, free trade, and self-regulating systems.

It believes that free markets are the best way to allocate resources and the government's role should be limited to that of a fair and strict referee.

Keynesian Economics (1930s–present): Originating from **John Maynard Keynes**, it argues that markets are not always self-correcting and advocates for active government intervention (fiscal and monetary policy) to manage aggregate demand during recessions.

It believes that markets do not work well at allocating resources on their own and that governments must step in from time to time and actively reallocate resources efficiently.

NOTE

Neoclassical Economics (late 19th c.–present): This school shifted focus to rational behavior and utility maximization, introducing mathematical modeling and the "marginalist revolution" to the mainstream.

New Classical & New Keynesian: Modern refinements of original theories. New Classical emphasizes rational expectations and microfoundations, while New Keynesianism incorporates these into Keynesian models of price and wage rigidity.

Market-Oriented & Monetary Schools

These schools prioritize market efficiency and specific control of the money supply

Austrian School: Emphasizes individual decision-making and subjective value. Proponents like **F.A. Hayek** advocate for extreme laissez-faire and oppose central bank intervention.

Types of Economy

- Capitalist Economy
- Socialist Economy
- Mixed Economy

Capitalist Economy

The capitalistic form of economy is based on the concept of ‘laissez faire’ state i.e. non-interference by the government, which was given by Adam Smith.

In such an economy, the decisions of what to produce, how much to produce, and at what price to sell are taken by private enterprises in the market, with the state having no economic role.

One of the most prominent features of a capitalist economy is that the market determines prices through the laws of supply and demand.

For example, when demand for coffee increases, a profit-seeking business will boost prices in order to increase its profit. If, at the same time, society’s appetite for tea diminishes, growers will face lower prices and aggregate production will decline.

Socialist Economy

Under a true socialist system, it is the government's role to determine output and pricing levels.

As opposed to a Capitalist Economy, distribution in a Socialist Economy is supposed to be based on what people need and not on what they can afford to purchase. Unlike capitalism, for example, a socialist nation provides free healthcare to the citizens who need it.

Mixed Economy

It is an economic system that features characteristics of both capitalism and socialism. A mixed economic system allows a level of private economic freedom in the use of capital but also allows for governments to interfere in economic activities in order to achieve social aims whenever required.

For example, in a Mixed Economy, the Government seeks to redistribute wealth by taxing the private sector and using funds from taxes to promote social objectives.

Type of Economy Adopted by India

Type of Economy Adopted by India

India has adopted a **mixed economy**. This system combines elements of both **socialism** and **capitalism**, where the public (government) and private sectors coexist and contribute to national development.

Evolution of the System

Adoption (1947–1956): Influenced by first Prime Minister Jawaharlal Nehru, India officially opted for a mixed economy model during the **Second Five-Year Plan (1956–1961)** to balance industrial growth with social welfare.

LPG Reforms (1991): Facing a severe economic crisis, India introduced **Liberalization, Privatization, and Globalization (LPG)** reforms. This shift reduced government control and gave the private sector a much larger role.

Modern Status (2025): As of 2025, India remains a mixed economy but has leaned increasingly toward a market-oriented approach, focusing on digital growth and global competitiveness while maintaining state involvement in strategic sectors like space and nuclear energy.

Coexistence of Sectors: Both government-owned enterprises (public sector) and privately-owned businesses (private sector) operate simultaneously.

Government Intervention: The state regulates key industries, manages essential services (like defense and railways), and implements welfare policies to ensure social justice.

Market Forces: Private enterprises are driven by profit and market competition, and for most goods, prices are determined by supply and demand.

Economic Planning: Historically, development was guided by Five-Year Plans. Today, the NITI Aayog provides long-term strategic direction while allowing for greater market freedom.

Structural Composition of an Economy

The structural composition of an economy refers to the makeup and distribution of its various sectors, specifically how they contribute to total economic output (GDP) and employment.

Primary Sector (Extraction

This sector involves the direct use of natural resources to produce raw materials

Key Activities: Agriculture, forestry, fishing, mining, and quarrying.

People engaged in primary activity are called **Red-Collar Workers** due to the outdoor nature of their work.

Role in Development: In developing nations, this sector is often the largest employer despite a lower share of GDP. In India for 2025, it contributes approximately 1**9.7%** to nominal GDP but employs over **40%** of the workforce.

Secondary Sector (Manufacturing)

This sector processes raw materials from the primary sector into finished goods.

Key Activities: Manufacturing, construction, electricity, gas, and water supply.

People engaged in secondary activity are called **Blue-Collar Workers.**

Role in Development: It is often considered the "backbone" of economic growth during industrialization phases. In India for 2025, it accounts for roughly **25.3%** of nominal GDP.

Tertiary Sector (Services)

The service sector provides intangible support and value-added activities rather than physical products.

Key Activities: Banking, education, healthcare, IT, tourism, and transportation.

People engaged in tertiary activities are called **White-Collar Workers.**

Role in Development: This is typically the dominant sector in advanced economies. In India, it is currently the largest contributor, accounting for **55%** of nominal GDP in 2025.

Alternative Structural Divisions

Economies are also analyzed through different lenses based on ownership and working conditions

Public vs. Private: Classification by ownership. The **Public Sector** is government-owned (e.g., railways), while the **Private Sector** is owned by individuals or corporations.

Organized vs. Unorganized: Classification by labor conditions. The **Organized Sector** follows formal regulations and labor laws, whereas the **Unorganized Sector** consists of informal, irregular work.

Rural vs. Urban: Classification by location of economic activity and population distribution.

NOTE

The primary sector is an unorganized sector.	The secondary sector is an organized sector.	The tertiary sector is a well-organized sector.

National income

National income is the total monetary value of all final goods and services produced by a country's residents within a specific period. In India, the National Statistical Office (NSO) is responsible for estimating it.

Some of the metrics used for this purpose are: Gross Domestic Product (GDP), Net Domestic Product (NDP), Gross National Product (GNP), Net National Product (NNP), Gross National Income (GNI), and Net National Income (NNI)

STATISTICAL SYSTEMS OF INDIA

Ministry of Statistics & Programme Implementation (MoS&PI) is the nodal ministry. → **Central Level**

- **Statistics Wing**
  National Statistical Office(NSO)
- **Programme Implementation Wing**

Legal Framework

Constitutional Placement: "Statistics" is a subject in both the **Union List** (Entry 94) and the **Concurrent List** (Entry 45) of the Seventh Schedule.

State Level: Each state and Union Territory (UT) has a **Directorate of Economics and Statistics (DES)**, which coordinates statistical activities and aggregates data from the district level.

Statistics Wing
National Statistical Office(NSO)

The NSO is a subordinate office under the **Ministry of Statistics and Programme Implementation (MoSPI)**. It was formed in May 2019 by merging two previous bodies: the Central Statistics Office (CSO) and the National Sample Survey Office (NSSO).

On the recommendation of Dr. C. Rangarajan Commission.

Key Functions: It acts as the nodal agency for the planned development of India's statistical system. It maintains standards for data collection, processing, and dissemination of economic and social indicators.

Major Data Releases

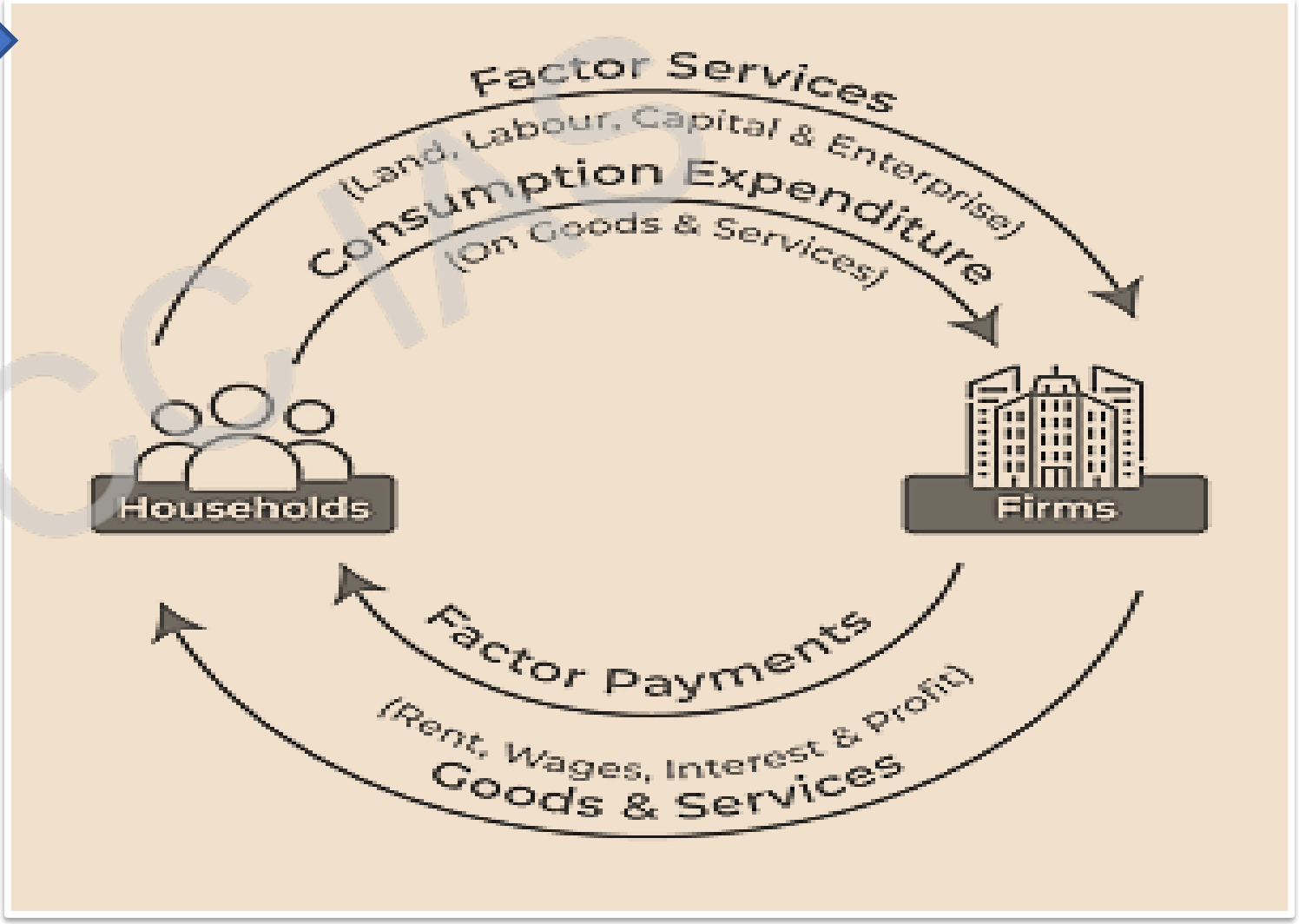
GDP & Economic Indicators: Compiles and publishes India's Gross Domestic Product (GDP) and Index of Industrial Production (IIP).

Consumer Price Index (CPI): Measures inflation at the consumer level.

Surveys: Conducts the Annual Survey of Industries (ASI), Economic Census, and Periodic Labour Force Survey (PLFS).

National income

Circular Flow of Income



Circular Flow of Income

The circular flow of income is an economic model that reflects how money or income flows through the different sectors of the economy. A simple economy assumes that there exist only two sectors, i.e., **Households** and **Firms.**

Households are consumers of goods and services and the owners of the factors of production (land labour, capital, and enterprise). However, the firm sector produces goods and services and sells them to households.

The circular flow of income in a two-sector economy is the form of a closed economy. The complexity of the model increases as the number of players like government, external trade, and savings are added. It is assumed there's no leakage in this model, i.e. there is no other way in which the income can be disposed of.

Domestic/ Economic Territory

It is geographical territory administered by the Government of India within which the person, goods, and capital can circulate freely.

Foreign embassies located in India are NOT a part of domestic/economic territory. However, Indian embassies located abroad are a part of domestic/economic territory.

Factor Cost (FC) and Market Price (MP)

Factor cost represents the expenses producers pay for the factors of production (land, labor, capital, and entrepreneurship), excluding taxes and subsidies. The **market price**, on the other hand, is the final price consumers pay for goods and services, which includes indirect taxes and excludes subsidies.

Factor Cost = Market Price – Indirect Taxes + Subsidies

Market Price = Factor Cost + Indirect Taxes – Subsidies

Factor Cost (FC) and Market Price (MP)

Purpose	Measures production cost and used for national income via income approach.	Used for transactions and national income via expenditure approach.
Perspective	Producer's cost viewpoint.	Consumer's willingness to pay.

Nominal Price / Current Price

Nominal/Current Price: The market price of a good or service at the time it is produced or sold.

The market price of any good or service in the current year is called the Nominal Price or Current Price. Since inflation is included in the current market price, the Nominal Price or Current Price changes as per the current level of inflation.

Real/Constant Price

Real/Constant Price: The price of a good or service adjusted for inflation, calculated using prices from a specific **Base Year** (currently **2011-12** in India).

2025 Context & Current Trends

Base Year Revision: While 2011-12 remains the current base year, there are ongoing discussions and proposals for a revision (potentially to 2022-23 or 2026) to better reflect structural changes in the Indian economy.

India's Ranking: India is currently among the top 10 countries globally by **Nominal GDP**. As of 2025, it is a leading contender for the world's 4th or 5th largest economy by this metric.

Inflation Impact: During periods of high inflation, the gap between Nominal GDP and Real GDP widens significantly.

Depreciation

Depreciation, also known as the Consumption of Fixed Capital, refers to the loss in value of fixed assets due to wear and tear, accidental damages, and obsolescence.

Net Factor Income from Abroad (NFIA)

Net Factor Income from Abroad (NFIA) is a macroeconomic measure representing the difference between the factor income earned by a country's residents from foreign sources and the factor income paid to foreign residents for services rendered within the domestic economy.

NFIA = (Factor Income Earned by Residents from Abroad) - (Factor Income Earned by Non-residents within the Country), often simplified as **NFIA = Factor Income from Abroad - Factor Income to Abroad**.

Key Components

Factor Income Earned from Abroad

Income received by residents (individuals, firms, government) from their investments and work abroad (e.g., wages of Indian workers in UAE, profits of Indian companies in US).

Factor Income Paid Abroad

Income earned by foreigners from their investments and work within the country (e.g., salaries of foreign workers in India, profits of American companies in India).

Transfer Payments

Transfer Payments refer to those unilateral payments corresponding to which there is no exchange of goods or services.
Examples: scholarships, gifts, donations, etc.
Transfer payments are not included in National Income (NI).

Capital Output Ratio (COR)

The **Capital Output Ratio (COR)** is an economic metric that expresses the relationship between the amount of capital invested in an economy and the resulting output (GDP) produced. It essentially measures the productivity and efficiency of capital: how many units of capital are required to produce one unit of output.

Capital Output Ratio (COR) = Capital/Output

Interpretation and Significance

Efficiency Metric: A **lower ratio** is generally preferred as it indicates higher efficiency; the economy can produce more output with less investment. A **higher ratio** suggests inefficiency or a more capital-intensive economic structure.

Economic Planning: Planners use COR to estimate the investment required to reach specific growth targets. For example, if a country targets 9% growth and has a COR of 4, it needs an investment rate of 36% (9% × 4).

Harrod-Domar Model: This foundational growth model posits that economic growth is directly proportional to the savings rate and inversely proportional to the capital-output ratio.

Measures of National Income (NI)

The total monetary value of all final goods and services produced within a country's geographical borders during a specific period, usually a year or a quarter.

The GDP growth rate is a crucial indicator of economic performance, reflecting health, growth, and development.

Types of GDP

- Nominal GDP = GDP at Current Price.
- Real GDP = GDP at Constant Price.

Feature	GDP at Current Price (Nominal)	GDP at Constant Price (Real)
Price Used	Current year market prices	Base year prices (2011-12)
Inflation	Includes the effect of inflation	Excludes inflation (Adjusted)
Growth Measure	Reflects changes in both quantity and price	Reflects **only** changes in physical output
Usefulness	Useful for comparing output within the same year	Best for comparing economic performance across years

GDP Deflator

The **GDP Deflator**, also known as the **Implicit Price Deflator**, is an economic metric that measures the level of price changes for all new, domestically produced final goods and services in an economy. It is used to convert **Nominal GDP** (measured at current market prices) into **Real GDP** (adjusted for inflation).

Formula: $$\text{GDP Deflator} = \left(\frac{\text{Nominal GDP}}{\text{Real GDP}} \right) \times 100$$

Interpretation

Value > 100: Indicates **inflation** (prices have risen since the base year).

Value < 100: Indicates **deflation** (prices have fallen compared to the base year).

Value = 100: Represents the **base year**, where Nominal and Real GDP are equal.

NOTE

Comprehensive Coverage: Unlike the Consumer Price Index (CPI), which tracks a fixed "basket" of goods, the GDP deflator includes **all** goods and services produced domestically, including those sold to businesses, the government, and for export.

Significance in Policy

Central banks and governments use the GDP deflator to gauge long-term economic health and set fiscal and monetary policies. By stripping away the effects of price changes, it allows for a more accurate assessment of **Real Growth**, ensuring that policymakers distinguish between a growing economy and one where nominal values are simply rising due to inflation.

Per capita GDP

Per capita GDP measures the average economic output or income per person in a country. It indicates the average living standards and productivity.

$$\text{GDP per Capita} = \frac{\text{Total GDP}}{\text{Total Population}}$$

According to recent projections from the International Monetary Fund (IMF) and World Bank:

World Average: The global nominal GDP per capita for 2025 is estimated at approximately **$14,610**.

Advanced vs. Developing: Major advanced economies (G7) average roughly **$66,090**, while sub-Saharan Africa averages about **$1,730**.

Key GDP per Capita Figures (2025)

Nominal GDP per Capita: Projected at approximately **$2,820 to $2,878**.

Purchasing Power Parity (PPP): Projected at approximately **$12,100 to $12,132**.

National Currency Estimate: The Ministry of Statistics estimated nominal per capita income at approximately **₹2,34,859** for the 2024-25 fiscal year.

Long-term Outlook: While currently a lower-middle-income country, projections suggest India could reach a GDP per capita of **$21,000 by 2050**, effectively becoming a high-income nation.

Nominal Ranking: India is currently ranked **136th to 142nd** globally out of roughly 190 economies.

PPP Ranking: India ranks higher in terms of purchasing power, holding the **119th to 125th** position globally.

Nominal GDP Per Capita (2025 Projections)

According to IMF projections for 2025

Key Major Economies

United States: $89,105 — Remains the highest among major global powers.

Germany: $55,911.

United Kingdom: $54,949.

Japan: $33,956 — Ranked lower per capita despite being a top 5 global economy.

China: $13,687.

Brazil: $10,234.

India: $2,934 — Despite being the 4th largest total economy in 2025, its high population results in lower per-person income.

Luxembourg: $140,941

Ireland: $108,919

Switzerland: $104,896

Singapore: $92,932

Iceland: $90,284

Norway: $89,694

United States: $89,105

Macao SAR: $76,314

Denmark: $74,969

Qatar: $71,653

Regional Averages (2025 Projections)

North America: $67,120

Europe: $40,060

Middle East: $13,790

South America: $10,190

Southeast Asia: $6,010

Sub-Saharan Africa: $1,690

Purchasing Power Parity (PPP)

Purchasing Power Parity (PPP) is an economic metric used to compare the relative value of different currencies by measuring the cost of a common "basket of goods" in each country.

While market exchange rates tell you how much of one currency you can buy with another, PPP tells you how much that money can actually buy locally.

Real-World Applications

GDP Rankings (2025): When adjusted for PPP, **China** is the world's largest economy, followed by the **United States** and **India**.

Salary Conversion: Professionals use PPP Salary Calculators to determine what an equivalent salary would be when moving between countries (e.g., earning ₹23 lakh in India is roughly equivalent to ~$80,000–$90,000 in the U.S. in terms of buying power).

The Big Mac Index: A popular, informal tool created by *The Economist* that compares the price of a McDonald's Big Mac worldwide to quickly estimate PPP.

GDP Calculation

3 Methods of GDP Calculation

Expenditure Method

→ **(Most Common)** → **Total Outlay Method**

This method calculates GDP by summing all the money spent by different groups within the economy.

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

C (Consumption): Total spending by households on durable goods (cars), non-durable goods (food), and services.

I (Investment): Business spending on capital equipment, infrastructure, and changes in inventory. It also includes household spending on new housing.

G (Government Spending): Expenditures on public services, salaries of government employees, and infrastructure like roads and schools.

X - M (Net Exports): The value of a country's exports minus its imports.

Income Method

It measures the total income earned by the factors of production, that is, labour and capital, within a country's domestic boundaries.

GDP = GDP at factor cost + Taxes – Subsidies.

Output Method

Production or Value-Added Approach

From the name, it is clear that value is added at the time of production. It is also known as the reverse of the expenditure approach. Estimating the gross value-added total cost of economic output is reduced by the cost of intermediate goods used to produce final goods.

Gross Value Added = Gross Value of Output – Value of Intermediate Consumption

GDP = Sum of all value-added to products during the production of a process

GDP Formula

Expenditure Approach = C + I + G + NX

Income Approach = Total National Income + Sales Taxes + Depreciation + Net Foreign Factor Income

Value Added Approach = Gross Value of Output – Value of Intermediate Consumption

Tax to GDP ratio

$$\text{Tax to GDP Ratio} = \frac{\text{Tax Revenue of the Nation During the Period}}{\text{Gross Domestic Product of the Nation}}$$

Calculation: The formula is (Total annual tax revenue / Gross Domestic Product) x 100.

Tax to GDP ratio

The **tax-to-GDP ratio** is an economic metric that compares a country's total tax revenue to the size of its economy (Gross Domestic Product). It is a key indicator of a nation's fiscal health and the government's ability to fund public services and infrastructure without excessive borrowing.

A higher tax-to-GDP ratio reflects better revenue generation and financial capacity.

World Bank Benchmark: A tax-to-GDP ratio of **15%** or higher is often considered a healthy benchmark for fostering economic growth and reducing poverty in developing countries

India’s tax-to-GDP ratio is projected to hit 11.7% in 2024-25, showcasing a steady increase from 11.6% in the preceding year and 11.2% in 2022-23.

Highest Ratios: Countries like **Denmark** and **France** consistently have some of the highest ratios, often exceeding **45%**.

Lower Ratios: Developing nations and some other economies typically have lower ratios. For example, India's ratio for the financial year 2024-25 is expected to reach **11.7%**. Mexico's ratio was **17.7%** in 2023.

Developed vs. Developing: Developed economies generally have higher tax-to-GDP ratios due to more extensive social welfare programs, broader tax bases, and efficient collection systems.

Causes of India's Low Tax-to-GDP Ratio

A large informal sector causes widespread tax evasion.

Agricultural dominance, with 15 out of 25 crore households exempt from taxes.

Disputes between taxpayers and authorities, lead to low arrear recovery.

Tax exemptions benefit the wealthier sectors.

Low per capita income, high poverty rates, and slowing economic growth reduce the potential tax base.

Gross Value Added (GVA)

GVA = GDP – Indirect Taxes + Subsidies

Gross Value Added (GVA) is an economic metric that measures the total value of goods and services produced in an economy, minus the cost of all inputs and raw materials directly attributable to that production.

It serves as a key indicator of the **supply side** of the economy, reflecting the productive contribution of individual sectors such as agriculture, manufacturing, and services.

Example

A brewer's GVA is the revenue from selling beer minus the cost of barley, hops, yeast, utilities, and other inputs.

Basic Formula: GVA = Value of Output – Intermediate Consumption.

Relation to GDP: GVA = GDP - Taxes on Products + Subsidies on Products.

Difference between GVA and GDP

GVA	GDP
Value of all the goods and services produced within a country after deducting the value of intermediate goods and services.	Market value of all the final goods and services produced within the country.
Gives insight into the economy from the input or supplier side.	Gives insight into the economy from the output or consumer side.
Generally, calculated on a sector-wise approach. e.g. GVA for the Primary Sector, Secondary Sector, etc.	Calculated for the whole economy. **(GDP of economy = GVA of all the sectors)**
Generally, calculated at Basic Prices.	Generally, calculated at Market Prices.

NOTE

In 2015, India opted to make major changes to its compilation of national accounts and decided to bring the whole process into conformity with the **United Nations System of National Accounts (SNA) of 2008.**

The SNA is the internationally agreed standard set of recommendations on how to compile measures of economic activity.

At the macro level, from a **national accounting perspective,** GVA is the sum of a country's GDP and net of subsidies and taxes in the economy.

Gross Value Added = GDP + subsidies on products - taxes on products

Earlier, India had been measuring GVA at **'factor cost'** till the new methodology was adopted in which GVA at **'basic prices'** became the primary measure of economic output.

GVA at basic prices will **include production taxes** and **exclude production subsidies.**

GVA at factor cost included no taxes and excluded no subsidies.

Current development-June 2025

The **Ministry of Statistics and Programme Implementation (MoSPI)** announced that the government is revising the **Gross Domestic Product (GDP)** **base year** from **2011-12** to **2022-23**. The revised data will be released on **27th February 2026**.

The base year for Index of **Industrial Production (IIP)** will also be revised to **2022-23** while the base year for **Consumer Price Index** will be revised to **2023-24**.

In June 2024, MoSPI set up a **26-member Advisory Committee on National Accounts Statistics (ACNAS)** to decide the **base year for GDP data**, under the chairmanship of **Biswanath Goldar.** It also focused on aligning **GDP** with other key **macro indicators** such as the **WPI**, **CPI**, and **IIP.**

Need: The **base year revision** ensures the inclusion of **new industries**, removal of **outdated ones**, adoption of **better data sources** and methods, and more **accurate measurement of real economic growth** after adjusting for **inflation.**

Frequency of GDP Base Year Revision: The upcoming **2026 revision** will be the **eighth base year update**, following seven earlier revisions, starting from **1948-49 to 1960-61** in **August 1967** and most recently from **2004-05 to 2011-12** on **30th January 2015**.

The first **national income estimates** for India were compiled by the **National Income Committee** (chaired by **P.C. Mahalanobis**) in **1949**.

Reflects Structural Changes in the Economy: India's economy has shifted from **agrarian-dominated (pre-1990s)** to **services-led** (now **55% of GDP**), requiring a new **base year** to reflect these changes.

It ensures inclusion of **emerging sectors** like **digital services**, **gig economy**, **renewable energy**, and reassessment or exclusion of **declining industries** like **traditional manufacturing.**

Shortcomings of GDP

GDP, as an indicator of economic growth, faces some shortcomings as explained below:

- Fails to measure the inequality
- Does not take into account non-market transactions
- Barter trade
- Undermines the concept of sustainable economic growth
- Black markets and illegal activities
- Does not measure the Happiness Level
- Fails to measure the actual well-being

Shortcomings of GDP

GDP, as an indicator of economic growth, faces some shortcomings as explained below:

It **fails to measure the inequality** status of a nation. Thus, it does not describe whether or not the people are truly benefitting from economic growth.

It **does not take into account non-market transactions,** such as volunteer work.

A large part of many undeveloped economies relies on **barter trade** (trade through swapping goods) rather than the employment of debt instruments and banknotes. GDP figures **underestimate** economic activities in such cases.

GDP does not take into account the **loss to the environment** and hence undermines the concept of **sustainable economic growth.**

Black markets and illegal activities create distortions in values and hence the figures of GDP.

It **does not measure the Happiness Level** of a nation

GDP **fails to measure the actual well-being** of a nation as it counts “bads” as well as “goods.”

- When an earthquake hits and requires rebuilding, GDP increases. Similarly, when someone gets sick and money is spent on their care, it’s counted as part of GDP. But, we’re not better off because of a destructive earthquake or people getting sick.

Gross National Product (GNP)

Total Value

(Without Any deduction of Depreciation)

Income of all Normal residents

(Whether in India or Outside India)

(Doesn't have Income of Foreign Citizens working in India)

Production of Final Goods and Services only

(Not Intermediate Goods)

GNP is Total value of Goods and Services Produced by *Normal Residents*

GNP = GDP + Net Factor Income from Abroad

GNP = GDP + Factor Income of Citizens working Outside Country - Factor Income of Foreign Citizens working in country

Thus, GNP = GDP + Factor Income from Abroad to India – Factor Income from India to Abroad.

= GDP + Net Factor Income from Abroad (NFIA)

Different Types of incomes	GDP	GNP
Income earned by Indian Citizen in India	Included (Domestic Territory)	Included (Normal Residents)
Income earned by Foreign nationals in India	Included (Foreign Territory)	Not Included (Foreign Residents)
Income earned by Indian Nationals Outside India	Not Included (Domestic Territory)	Included (Normal Residents)
Income earned by Foreign Nationals Outside India	Not Included (Foreign Territory)	Not Included (Foreign Residents)

Net National Product (NNP)

Net National Product (NNP) is the total market value of all final goods and services produced by a nation's citizens, both domestically and abroad, minus **depreciation** (the wear and tear on capital assets).

Formula: $NNP = GNP - Depreciation.$

Shows the **actual net income** of a nation after accounting for asset depreciation.

Example: If machines wear out in factories, their value is deducted to get NNP.

NDP (Net Domestic Product)

Formula: NDP = GDP - Depreciation.

NDP is calculated by subtracting the value of worn-out or obsolete capital goods from the total output.

Depreciation: Also known as **Capital Consumption Allowance (CCA)**, this accounts for the decrease in asset value due to factors like wear and tear or technological obsolescence.

Factors Affecting National Income

- Natural Resources
- Capital
- Land
- Labour and Entrepreneur
- Technology
- Government policies, laws, FDI, regulation
- Political stability

Budget

A budget acts as a financial roadmap outlining a organisation’s expected revenue, expenses, and cash flow for a specific period.

Setting of Goals: Budgeting involves planning. It serves as a roadmap to achieve the end goal of an individual or an entity. It prioritizes the objectives and provides a strategy to allocate the available resources accordingly.

Financial Stability: Preparing a well-planned budget helps in better planning and contributes to the overall financial stability of an organisation. A structured budget suggests a strategy to spend the money which reduces the financial stress of the organisation and provides a sense of security.

Decision-Making: It also helps to make informed decisions according to the end goal. Entities will sometimes be faced with large decisions that will impact their inflow and outflow of cash. With a budget, it would be easy to make better decisions.

Identify Income and Expenses: It helps in determining the area where the spending needs to be controlled.

Coordination: It encourages officers or managers to build relationships with the other parts of the organisation and understand how the various departments interact with each other. This maintains coordination among various departments in an organisation.

Union Budget

The Annual Financial Statement under Article 112 of the Indian Constitution

The President shall, every financial year, cause to lay an annual financial statement before both Houses of Parliament, a statement of the estimated receipts and expenditure of the Government of India for that year.

The term "Budget" is not explicitly mentioned in the Constitution.

Nodal Agency: The Budget Division of the **Department of Economic Affairs** (Ministry of Finance) is responsible for its preparation.

The budget is used as a tool to manage the country's financial resources and to achieve the government's economic and social policies.

The budget also helps to identify potential economic risks and opportunities and to make informed decisions about spending and taxation.

Union Budget

It contains a detailed account of the estimated receipts and expenditures of the government for a particular fiscal year that runs from 1st April to 31st March.

The data contained in the **Union Budget of India** can be categorized into the following three categories:

- Budget Estimates of receipts and expenditures for the upcoming fiscal year (also known as the Budget Year)
- Revised Estimates of receipts and expenditures for the current fiscal year.
- Provisional Actuals of receipts and expenditures for the previous fiscal year.

Important Facts about the Union Budget of India

The first Budget for independent India was presented on **November 26, 1947**, by R.K. Shanmukham Chetty.

Morarji Desai holds the record for presenting the most budgets (10 times).

From the budget year 2017-18 and onwards, the **Union Budget** is presented by the Union Finance Minister on **February 1** of every year.

Prior to the budget year 2017-18, the Budget was presented in the last week of February as per the colonial practice.

The **Railway Budget was merged** with the General Budget from the **fiscal year 2017-18** based on the recommendation of the **Bibek Debroy Committee.**

The Railway Budget was separated from the General Budget by the British in 1924 on the recommendations of the Acworth Committee.

Budget Formulation → Preparation

This phase begins around September/October, roughly six months before the budget presentation.

Circular Issuance: The Finance Ministry issues a circular to all other ministries, states, and autonomous bodies, requesting them to prepare their estimated expenditure and revenue for the upcoming fiscal year.

Estimates Review: Ministries and departments provide their detailed estimates, which are then scrutinised and consolidated by the Finance Ministry in consultation with the NITI Aayog.

Stakeholder Consultations: The Finance Minister holds pre-budget meetings with various stakeholders, including economists, industry leaders, and trade unions, to gather suggestions and demands.

Finalisation: The Finance Ministry makes the final decisions on resource allocation and tax proposals, with any disagreements escalated to the Union Cabinet or Prime Minister for resolution.

Budget Enactment → Legislative Approval

This stage begins with the presentation of the Budget in Parliament, typically on **February 1**. The process involves several stages in the Parliament (specifically the Lok Sabha):

Presentation: The Finance Minister presents the budget with a "Budget Speech" in the Lok Sabha, and it is then laid before the Rajya Sabha for discussion.

General Discussion: A general discussion on the budget's principles takes place in both Houses, but no voting occurs at this stage.

Scrutiny by Committees: Parliament adjourns for a few weeks, during which departmental standing committees examine the "Demands for Grants" of specific ministries in detail and submit their reports.

Voting on Demands for Grants: The Lok Sabha (and only the Lok Sabha) discusses and votes on the Demands for Grants, which are presented ministry-wise. Members can move "Cut Motions" to reduce demands.

Passing of Appropriation Bill: Once the demands are approved, the Appropriation Bill is introduced and passed to authorize the government to withdraw funds from the Consolidated Fund of India.

Passing of Finance Bill: The Finance Bill, containing the new tax proposals, is introduced and passed, legalizing the revenue side of the budget after receiving the President's assent.

Budget Execution ➡ Implementation

Once the Appropriation Act and Finance Act are passed, the executive government is authorized to collect revenue and spend the allocated funds according to the approved plan. The Ministry of Finance, through its various departments like the Department of Revenue and Department of Expenditure, oversees this phase.

Legislative Review. ➡ Audit and Oversight

The final stage involves a post-budget audit and scrutiny to ensure accountability. The Comptroller and Auditor General of India (**CAG**) audits the government's accounts and submits annual reports to Parliament.

The Public Accounts Committee (PAC) of the Parliament then examines these reports to verify that the money was spent legally and for the intended purpose.

Procedure for Budget Enactment

The enactment of the **Union Budget** forms the most crucial part of the **government budgeting** process. The whole process of enactment of the Union Budget is described in chronological order as follows:

President's Recommendation: As per Rule 204 (1) of the Rules of Procedure and Conduct of Business in the Lok Sabha, the Budget is presented to the Parliament on such date as is fixed by the President. Thus, the recommendation of the President of India is taken for introduction and consideration of the budget in the Lok Sabha.

Presentation of the Budget: The Union Finance Minister presents the **Union Budget** in the Lok Sabha with a speech known as Budget Speech.

General Discussion on the Budget: A few days after the presentation, the general discussion on the budget begins in both houses of the Parliament.During the general discussions, the House is at liberty to discuss the budget as a whole or any question of principle involved therein, but no motion can be moved nor can the budget be submitted to the vote of the House.

Scrutiny by Departmental Committees: After the general discussion on the budget is over, the Houses are adjourned for some perio, during which the demands for grants are scrutinized thoroughly by the Departmental Standing Committees. The committees, then, submit their reports to the Parliament.

Voting on Demands for Grants: In the light of the reports submitted by the departmental standing committees, the Lok Sabha debates and votes on the demands for grants. Once duly voted upon and passed by the Lok Sabha, a demand becomes a grant.
The Rajya Sabha can discuss the budget but has no power to vote on the demands for grants. This is the exclusive privilege of the LS.

Cut Motion: During the stage of Voting on Demands for Grants, the MPs can move cut motions to reduce any demand for grant.

Passing of Appropriation Bill: After the demands for grants are approved, the Appropriation Bill is introduced, debated, and voted upon.

- After Presidential assent, the Appropriation Bill becomes the Appropriation Act and authorizes withdrawals from the Consolidated Fund of India to meet the government's expenditure.

Passing of Finance Bill: The Finance Bill, containing the government's tax proposals, is introduced immediately after the presentation of the Budget.

- The passing of the Finance Bill is mandatory to legalize the income side of the budget.
- With passing of the Finance Bills, the process of the enactment of the budget gets completed.

Basis	Direct Taxes	Indirect Taxes
Imposition	Levied on income, profit, or wealth.	Levied on goods and services.
Payer	Paid directly by the taxpayer to the government.	Paid by the consumer to the seller (intermediary), who then pays the government.
Burden Transfer	Not transferable.	Transferable to the final consumer.
Nature	Progressive (higher income means higher tax rate).	Regressive (same rate for everyone, regardless of income).
Evasion	Evasion is possible through fraudulent practices.	Evasion is difficult as it's included in the product price.

Types of Budget

The government budget (central budget or state budget) can be of three types

Balanced Budget

Surplus Budget

Deficit Budget

A **Balanced Budget** increases the level of aggregate demand in the economy moderately. Hence, it is recommended in a situation when the economy is close to achieving full employment.	**Revenue equals expenditure**
A **Surplus Budget** reduces the aggregate demand. Hence, it is recommended in an economic situation when there is a large inflationary gap	**Revenue exceeds expenditure (often to control inflation)**
A **Deficit Budget** increases the aggregate demand. Hence, it is recommended in an economic situation of depression.	**Expenditure exceeds revenue (common during recessions)**

Union Budget 2026-27

The Union Budget for 2026-27 was presented by Finance Minister Nirmala Sitharaman on **1 February 2026** in parliament and it is the first budget prepared in newly named **Kartavya Bhawan.**

Anchored in the theme of **Viksit Bharat**, the budget is guided by three "Kartavyas" (duties): -

Accelerating economic growth

Fulfilling people's aspirations

Ensuring inclusive participation.

Highlights

Expenditure: The government is estimated to spend Rs 53,47,315 crore in 2026-27, 7.7% higher than the revised estimate of 2025-26. Interest payments account for 26% of the total expenditure, and 40% of revenue receipts.

Receipts: The receipts (other than borrowings) in 2026-27 are estimated to be Rs 36,51,547 crore, about 7.2% higher than the revised estimate of 2025-26. Tax revenue which forms major part of the receipts is also expected to increase by 8% over the revised estimate for 2025-26.

Deficits: Revenue deficit in 2026-27 is targeted at 1.5% of GDP. This is similar to the revised estimate of 1.5% in 2025- 26. Fiscal deficit in 2026-27 is targeted at 4.3% of GDP, lower than the revised estimate of 4.4% of GDP in 2025-26.

GDP Growth: The Budget assumes a **Nominal GDP growth of 10.5%** for FY 2026-27, with Real GDP growth projected at **around 7%**.

Debt-to-GDP Ratio: Estimated to decline to **55.6%** in BE 2026-27 (from 56.1% in RE 2025-26).

- The government aims to bring this ratio down to **50% by 2030-31** to free up resources for development.

2026-27 UNION BUDGET

Public Capital Expenditure: Increased to a record **₹12.2 lakh crore** to drive infrastructure-led growth.

Macroeconomic Fundamentals Highlighted in Union Budget 2026-27

Fiscal Deficit: The target for **Budget Estimate (BE) 2026-27** is set at **4.3% of GDP**, adhering to the glide path of reducing it below 4.5%. It has improved from **4.4%** in the **Revised Estimates (RE) of 2025-26**.

Budget Estimates 2026–27: Non-debt receipts are estimated at **Rs 36.5 lakh crore**, with **net tax receipts of Rs 28.7 lakh crore**, while total expenditure is projected at **Rs 53.5 lakh crore**.

Capital Expenditure (Capex): The government continues to use public investment as the primary driver of economic growth.

Capex Allocation has been increased to **Rs 12.2 Lakh Crore** for FY 2026-27 (approx. 3.1% of GDP) (up from Rs 11.2 Lakh Crore).

When grants-in-aid to states for capital assets are included, the **Effective Capital Expenditure** stands at **Rs 17.1 Lakh Crore** (approx. 4.4% of GDP).

Interest Payments: Estimated at **₹14.04 lakh crore**, accounting for **26%** of total expenditure.

Main Tax Proposals in the Finance Bill

No change in income tax slabs: Tax structure for assessment year 2026-27 remains unchanged from the previous year.

New Tax Regime (Default)

The following slabs apply to all individual taxpayers, regardless of age:

- **Up to ₹4,00,000**: Nil
- **₹4,00,001 – ₹8,00,000**: 5%
- **₹8,00,001 – ₹12,00,000**: 10%
- **₹12,00,001 – ₹16,00,001**: 15%
- **₹16,00,001 – ₹20,00,000**: 20%
- **₹20,00,001 – ₹24,00,000**: 25%
- **Above ₹24,00,000**: 30%

Key Benefits-

Zero Tax up to ₹12 Lakh: Due to an enhanced rebate under **Section 87A** (up to ₹60,000), resident individuals with taxable income up to ₹12 lakh pay no tax.

Salaried Taxpayers: With a standard deduction of **₹75,000**, the effective tax-free limit for salaried employees is **₹12.75 lakh**.

Section 87A of the Income Tax Act provides a **tax rebate** to resident individuals, effectively making income up to a certain limit **tax-free**. It directly reduces your total tax liability rather than reducing your taxable income.

Key Benefits for FY 2025-26 (AY 2026-27)

For the current financial year (starting April 1, 2025), the rebate limits are as follows:

New Tax Regime:

Income Limit: Taxable income up to **₹12,00,000**.
Max Rebate: Up to **₹60,000**.
Effect: Individuals with income up to ₹12 lakh (or ₹12.75 lakh including the standard deduction) pay **zero tax**.

Old Tax Regime:**Income Limit**: Taxable income up to **₹5,00,000**.
Max Rebate: Up to **₹12,500**.
Effect: Individuals with taxable income up to ₹5 lakh pay **zero tax**.

Revised Slab Rates AY 2026-27	
Total Income	Rate of Tax
Up to Rs 4,00,000	Nil
Rs 4,00,001 to 8,00,000	5%
Rs 8,00,001 to 12,00,000	10%
Rs 12,00,001 to 16,00,000	15%
Rs 16,00,001 to 20,00,000	20%
Rs 20,00,001 to 24,00,000	25%
Above Rs 24,00,000	30%

	Existing Slab Rates AY 2025-26	
Sl. No	Total Income	Rate of Tax
1	Up to Rs 3,00,000	Nil
2	Rs 3,00,001 to 7,00,000	5%
3	Rs 7,00,001 to 10,00,000	10%
4	Rs 10,00,001 to 12,00,000	15%
5	Rs 12,00,001 to 15,00,000	20%
6	Above Rs 15,00,000	30%

Revision in Rebate of Income Tax under section 87A: Proviso to section 87A provide rebate of income-tax up to Rs.25,000/-, in cases where the total income of individual taxpayers is chargeable to tax under section 115BAC(1A) i.e. under new regime, and the total income does not exceed Rs. 7,00,000/-, and marginal relief where the total income exceeds Rs. 7,00,000/-. The tax on incomes chargeable at special rates (for e.g. capital gains u/s 111A, 112, 112A etc.) are not included while determining the rebate of income-tax. It has been amended to enhance the limit of rebate from Rs. 25,000/- to Rs. 60,000/- and limit of total income for rebate from Rs. 7,00,000/- to Rs. 12,00,000/- with marginal relief where the total income exceeds Rs. 12,00,000/-. (Effective from AY 2026-27).

Where the Rupee Comes In (Receipts)

Borrowings & Other Liabilities: 1

Income Tax: 21%

Corporation Tax: 18%

GST & Other Taxes: 15%

Non-Tax Revenue: 10%

Union Excise Duty: 6%

Customs: 4%

Non-Debt Capital Receipts: 2%

Where the Rupee Goes Out (Expenditure)

Interest Payments: 26%

States' share of taxes and duties: 20%

Central Sector Schemes: 16%

Centrally Sponsored Schemes: 9%

Defence: 8%

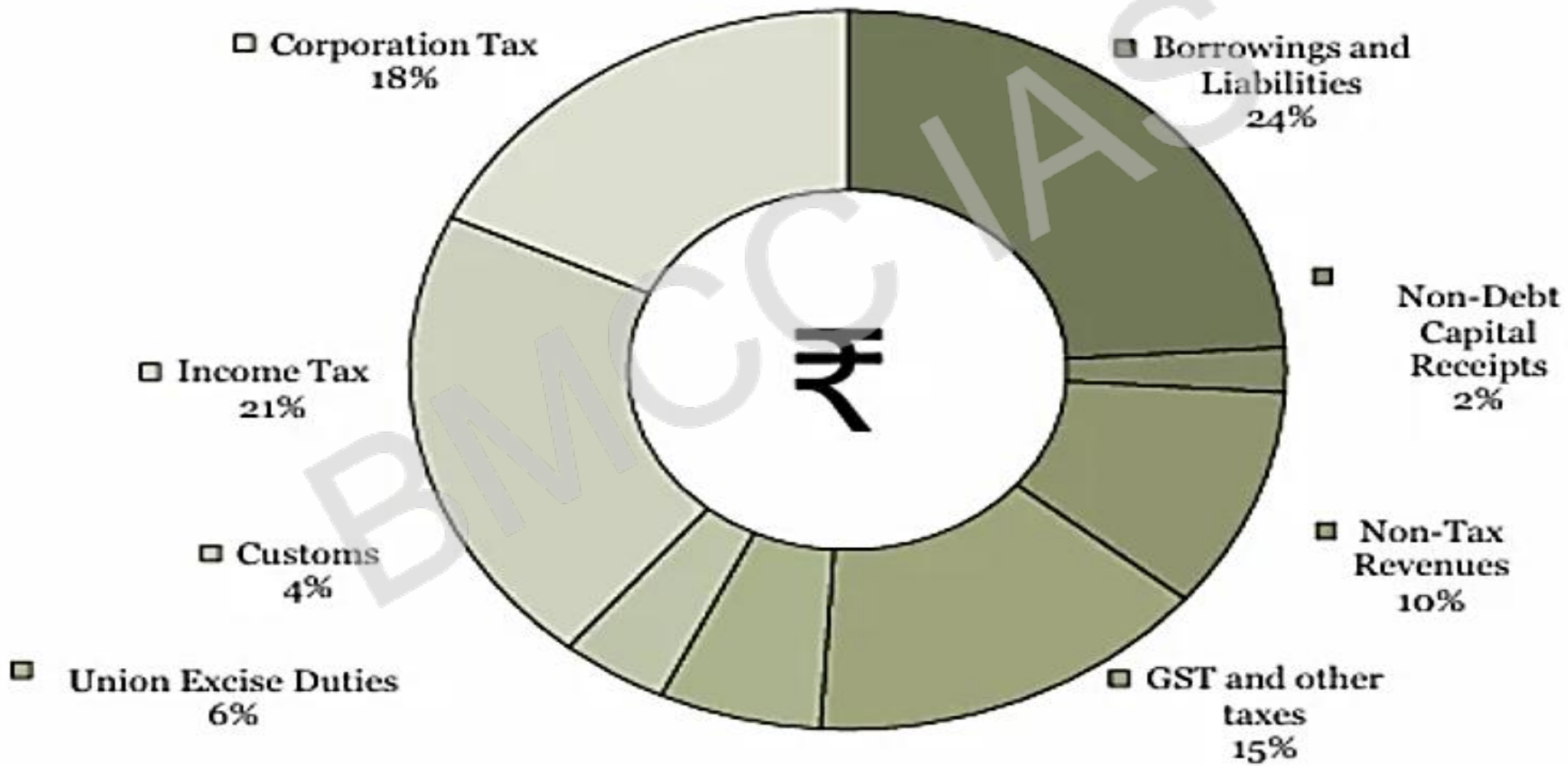
Subsidies: 7%

Finance Commission & Other Transfers: 7%

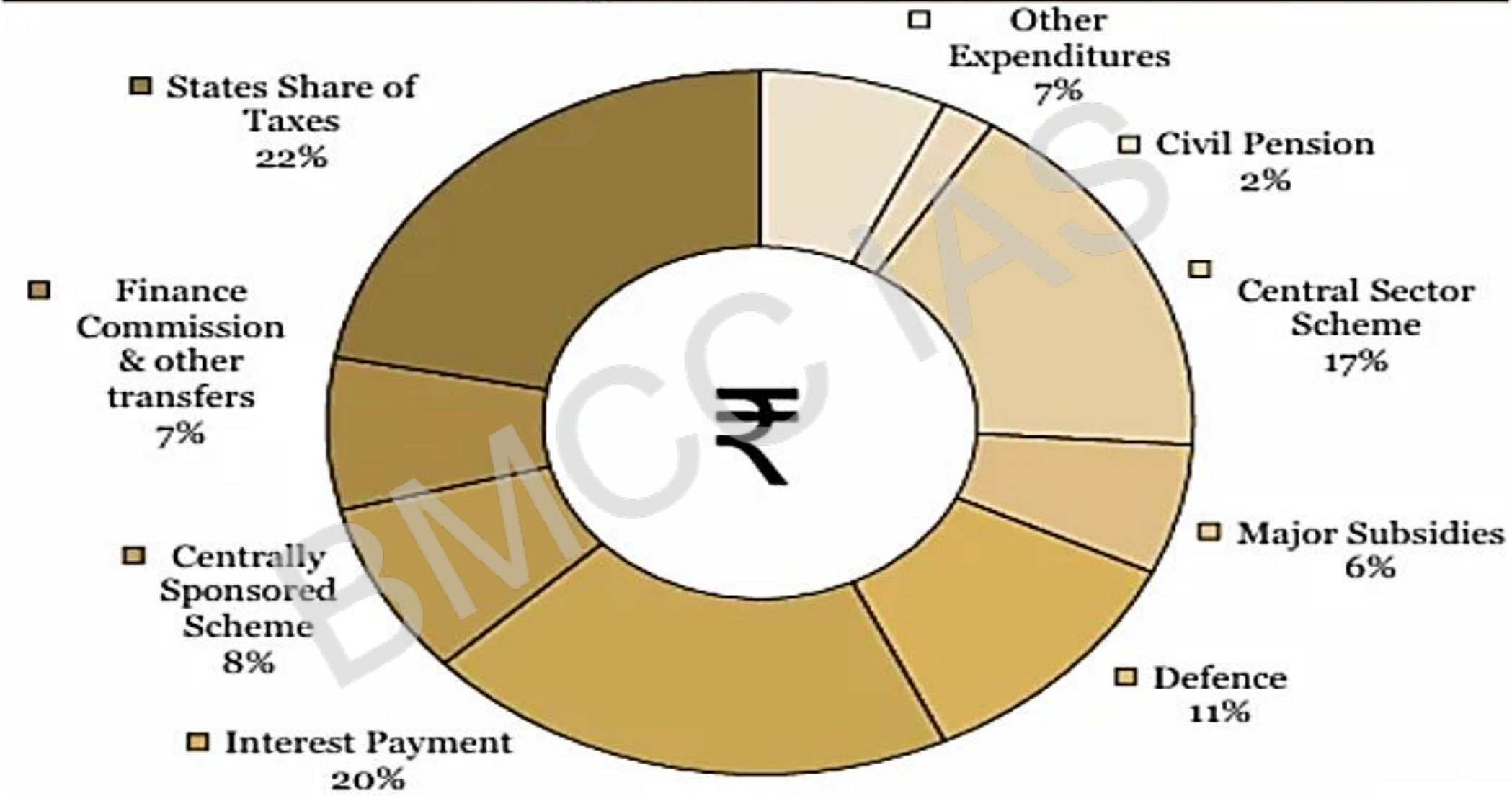
Pension: 4%

Other Expenditure: 3%

Rupee Comes From



Rupee Goes To



Fiscal Policy in India

Fiscal Policy refers to the policy decisions of the government concerning public expenditure, taxation, and public borrowing.

It is based on the principles of Keynesian economics, which basically states that governments can influence macroeconomic productivity levels by increasing or decreasing tax levels and public spending.

It is the mechanism through which the government adjusts its spending and taxation levels to influence a nation's overall economic activity.

Fiscal Policy

Major Tools → **Key Instruments of Fiscal Policy**

Government Spending

Taxation

Public Borrowing

Government Spending: Direct investment in infrastructure (roads, bridges), public services (education, healthcare), and social welfare (subsidies, pensions) to stimulate demand.

During slowdowns, higher public spending on rural employment or infrastructure creates jobs and boosts demand.

Taxation: Adjusting direct taxes (income, corporate) and indirect taxes (GST, VAT) to influence disposable income and consumer behavior.

Reducing Taxes: Increases consumption and investment, spurring growth.

Increasing Taxes: Helps curb inflation and reduce excessive demand.

Public Borrowing: Financing deficits by issuing government bonds and securities to the public or international lenders.

2026 Context → **Fiscal deficit in 2026-27 is targeted at 4.3% of GDP, lower than the revised estimate of 4.4% of GDP in 2025-26.**

2025 Context → **India:** The government is on a path of **fiscal consolidation**, aiming to reduce the fiscal deficit to **4.4% of GDP** for FY 2025-26, down from 4.8% in RE 2024-25.

Objectives of Fiscal Policy in India

- To mobilise additional resources into socially necessary lines of development
- To maintain the growth rate of the economy.
- To achieve and maintain economic stability
- To raise the standard of living of the citizens of the country.
- To stabilize the price level.
- To reduce extreme inequality in income and wealth
- To maintain equilibrium in the balance of payments.
- To provide the necessary incentives to the private sector for its healthy growth.

Primary Types of Fiscal Policy

- Expansionary
- Contractionary/Tight
- Neutral

Expansionary

Fiscal policy that increases aggregate demand directly through an increase in government spending is called expansionary.

The objective of Expansionary Fiscal Policy is to reduce unemployment and also results in better GDP.

This type of policy is usually undertaken during recessions to increase the level of economic activity.

It can cause some inflation.

Contractionary/Tight

Fiscal policy that reduces demand via lower spending is called contractionary or tight.

The objective of Contractionary Fiscal Policy is to reduce inflation.

This type of policy is usually undertaken during inflationary periods to control excess money supply.

It can trigger some unemployment.

Neutral

A neutral fiscal policy refers to a strategy by which the government's budget is designed to neither stimulate nor restrain economic growth.

The objective of Neutral Fiscal policy is to maintain the status quo in the economy.

This type of fiscal policy is usually followed when an economy is in equilibrium.

It may lead to degradation due to inaction in prevailing conditions.

India's fiscal policy for FY 2026-27

Key Insights

Fiscal Deficit & Debt: The fiscal deficit is targeted at 4.3% of GDP, down from 4.4% in 2025-26, with a long-term goal of reducing total debt to 50% of GDP by 2031.

Debt-to-GDP Ratio: Estimated at **55.6%** for 2026-27, with a medium-term goal to reach **50% (±1%) by 2030-31**.

GDP Growth: The Budget assumes a **Nominal GDP growth of 10.5%** for FY 2026-27, with Real GDP growth projected at **around 7%**.

Manufacturing & Industrial Growth: A "Make in India" focus is maintained through the Semiconductor Mission (ISM) 2.0, Biopharma SHAKTI, and incentives for critical minerals.

MSME Support: A dedicated ₹10,000 crore SME Growth Fund has been introduced to create champions and improve access to equity and risk finance.

India's fiscal policy for FY 2025-26

Fiscal policy for FY **2025-26**, managed by the Ministry of Finance, is primarily focused on **fiscal consolidation**, achieving a fiscal deficit target of **4.4% of GDP**, and driving economic growth through significant capital expenditure on infrastructure.

Key Insights

Fiscal Consolidation: The government is on a path to reduce the fiscal deficit, aiming for below **4.5% by FY 2026** and further lowering the central government debt-to-GDP ratio from **56.1%** in FY26.

Economic Growth: The policy emphasizes high capital expenditure, especially on **infrastructure**, to stimulate growth, create jobs, and enhance long-term productivity.

Inflation Management: Alongside the Reserve Bank of India's monetary policy efforts, fiscal policy measures such as supply-side interventions for food items and GST reforms aim to maintain price stability and keep inflation within the target band.

Social Welfare: The government continues to prioritize social welfare through targeted programs like the PM Awas Yojana, increased spending on health and education, and schemes for employment and skilling.

Fiscal Indicators - Rolling Targets as a Percentage of GDP

	Revised Estimates	Budget Estimates	
	2024-25	2025-26	2026-27
1. Fiscal Deficit	4.8	4.4	4.3%
2. Revenue Deficit	1.9	1.5	1.5%
3. Primary Deficit	1.3	0.8	0.7%
4. Tax Revenue (Gross)	11.9	12.0	11.2%
5. Non-Tax Revenue	1.6	1.6	1.7%
6. Central Government Debt	57.1	56.1	55.6%

Macroeconomic Fundamentals Highlighted in Union Budget 2026-27

Fiscal Deficit: The target for **Budget Estimate (BE) 2026-27** is set at **4.3% of GDP**, adhering to the glide path of reducing it below 4.5%. It has improved from **4.4%** in the **Revised Estimates (RE) of 2025-26**.

Debt-to-GDP Ratio: Estimated to decline to **55.6%** in BE 2026-27 (from 56.1% in RE 2025-26).

- The government aims to bring this ratio down to **50% by 2030-31** to free up resources for development.

GDP Growth: The Budget assumes a **Nominal GDP growth of 10.5%** for FY 2026-27, with Real GDP growth projected at **around 7%**.

Budget Estimates 2026–27: Non-debt receipts are estimated at **Rs 36.5 lakh crore**, with **net tax receipts of Rs 28.7 lakh crore**, while total expenditure is projected at **Rs 53.5 lakh crore**.

Capital Expenditure (Capex): The government continues to use public investment as the primary driver of economic growth.

Capex Allocation has been increased to **Rs 12.2 Lakh Crore** for FY 2026-27 (approx. 3.1% of GDP) (up from Rs 11.2 Lakh Crore).

When grants-in-aid to states for capital assets are included, the **Effective Capital Expenditure** stands at **Rs 17.1 Lakh Crore** (approx. 4.4% of GDP).

Interest Payments: Estimated at **₹14.04 lakh crore**, accounting for **26%** of total expenditure.

2026-27 UNION BUDGET

Fiscal Deficit: Targeted at **4.3%** of GDP for BE 2026-27, down from 4.4% in the previous year.

Debt-to-GDP Ratio: Estimated to decline to **55.6%** in BE 2026-27.

Total Expenditure: Pegged at **₹53.5 lakh crore**, a 7.7% increase over the 2025-26 revised estimates.

Public Capital Expenditure: Increased to a record **₹12.2 lakh crore** to drive infrastructure-led growth.

Taxation and Compliance Reforms: A new Income Tax Act, 2025, takes effect from April 2026, featuring simplified rules, redesigned forms for easier compliance, and reduced TCS rates (down to 2%) for foreign travel, education, and medical purposes.


FISCAL
DEFICIT

Fiscal Deficit

Basic Formula

Fiscal Deficit= Total Expenditure- Total Receipts (excluding borrowings)

Fiscal Deficit is usually expressed as a percentage of GDP to assess its impact on the broader economy.

It indicates how much the government needs to borrow to meet its expenses when its income is insufficient.

NOTE

Fiscal Deficit: Targeted at **4.3%** of GDP for BE 2026-27, down from 4.4% in the previous year.

India has set the fiscal deficit target for 2025/26 at 4.4% of the GDP, or 15.7 trillion rupees.

In FY 2024–25 fiscal deficit stood at **Rs 15.77 lakh crore, amounting to 4.8% of GDP.**

Implications of Fiscal Deficit

Negative Implications

A higher fiscal deficit increases **borrowing needs,** leading to a **rising debt burden and inflationary pressures**.

Higher Interest Rates: Large government borrowing increases the demand for credit, which can drive up interest rates for both businesses and individuals. This makes it more expensive for the private sector to borrow money and invest.

Crowding Out Private Investment: High government borrowing can "crowd out" private sector access to available funds, limiting private investment and potentially slowing long-term economic growth. When the government borrows heavily, interest rates rise, making it costlier for businesses to borrow and invest

When the government borrows heavily, interest rates rise, making it costlier for businesses to borrow and invest.

Increased Public Debt: Persistent deficits add to the national debt, increasing the financial burden for future generations who will face higher taxes or reduced government services to repay the debt.

Positive ImplicationsC

Economic Stimulus: During economic downturns or recessions, deficit spending (e.g., on infrastructure projects or social welfare programs) can boost aggregate demand, stimulate economic activity, and create jobs, helping the economy recover.

Funding Productive Investments: Borrowing to finance long-term, productive capital expenditures like roads, education, and healthcare can enhance the economy's productive capacity, leading to sustained future growth and development.

Social Welfare Support: Deficits allow governments to fund essential social programs and subsidies aimed at reducing poverty and inequality, which can improve the standard of living for citizens.

NOTE

Fiscal Deficit: Targeted at **4.3%** of GDP for BE 2026-27, down from 4.4% in the previous year.

India has set the fiscal deficit target for 2025/26 at 4.4% of the GDP, or 15.7 trillion rupees.

In FY 2024–25 fiscal deficit stood at **Rs 15.77 lakh crore, amounting to 4.8% of GDP.**

Fiscal Consolidation

Fiscal Consolidation refers to the responsible management of government finances to ensure long-term economic stability.

It aims to **balance revenue (tax and non-tax) with expenditure**, minimizing fiscal deficits and maintaining sustainable public debt.

It promotes **macroeconomic stability** by controlling inflation and exchange rate volatility, reduces the debt burden on future generations, builds investor confidence, and ensures efficient use of public resources for development.

India’s Initiatives to Achieve Fiscal Consolidation

- Legislative Framework
- Glide Path for Fiscal Deficit Reduction
- Prioritizing Capital Expenditure (Capex)
- Revenue Mobilization
- State-Level Fiscal Responsibility

Legislative Framework

Fiscal Responsibility and Budget Management (FRBM) Act, 2003: It was enacted to institutionalize **financial discipline by setting targets** for fiscal deficits and public debt.

FRBM Act amended in 2018, it defined the **debt-to-GDP ratio (total debt of a country relative to its GDP)** as the primary fiscal anchor, aiming to reduce the **fiscal deficit** and the **debt-to-GDP ratio.**

The government aims to lower the Central debt-to-GDP ratio to approximately **54.5–55% by FY27**, down from an estimated 56.1% in FY26.

Glide Path for Fiscal Deficit Reduction

Glide Path for Fiscal Deficit Reduction: Following the Covid-19 pandemic, India adopted a **"glide path" approach to fiscal consolidation**, in line with the recommendations of the **N.K. Singh Committee (2017).**

This approach aims for a **gradual reduction of the fiscal deficit**, balancing the need for economic support with long-term fiscal discipline.

It led to a planned decrease in the fiscal deficit from **6.7% of GDP in 2020-21 to 4.8% in 2024-25**.

Prioritizing Capital Expenditure (Capex)

India has significantly increased its **capital expenditure (capex)** over the past few years, rising from 1.6% of GDP in FY 2014-15 to a planned 3.1% of GDP in FY 2025-26.

This focus on infrastructure development aims to stimulate economic growth and improve long-term fiscal health.

Revenue Mobilization

Efforts to enhance revenue collection include implementing the **Goods and Services Tax (GST)** to create a unified tax base and digitizing the tax system.

As a result, India's direct tax collections rose **16.15% year-on-year to Rs 25.86 lakh crore in FY 2024-25**.

India's total tax receipts for FY 2025-26 are estimated at ₹28.37 lakh crore, with strong growth driven by robust direct tax collections.

State-Level Fiscal Responsibility

States have been encouraged to adopt their own fiscal responsibility legislations (FRLs) to complement the central government's efforts.

Capex Allocation has been increased to **Rs 12.2 Lakh Crore** for FY 2026-27 (approx. 3.1% of GDP) (up from Rs 11.2 Lakh Crore).

Debt-to-GDP Ratio: Estimated to decline to **55.6%** in BE 2026-27 (from 56.1% in RE 2025-26).

- The government aims to bring this ratio down to **50% by 2030-31** to free up resources for development.

NOTE

Fiscal drag

Fiscal drag is an economic term whereby inflation or income growth moves taxpayers into higher tax brackets. It occurs mainly due to Progressive Taxation, whereby individuals are moved into higher tax brackets because of inflation or increased income.

Pump priming

Pump priming is the action taken to stimulate an economy usually during a recessionary period, through government spending, and interest rate and tax reductions. Pump priming involves introducing relatively small amounts of government funds into a depressed economy in order to spur growth.

Economic stimulus

An economic stimulus is the use of monetary or **fiscal policy** changes to kick start growth during a recession. Governments can accomplish this by using methods such as lowering interest rates, increasing government spending and quantitative easing, to name a few.
In the wake of COVID-19 Pandemic, the Government announced 3 tranches of economic stimulus under the Atma Nirbhar Bharat Programme.

Cyclicality of Fiscal Policy

The cyclicality of fiscal policy refers to how government spending and taxation policies change in response to the fluctuations of the economic or business cycle.

The goal of sound fiscal policy is generally to be **countercyclical**, which helps stabilize the economy; however, policy often ends up being **procyclical**, which can exacerbate economic fluctuations.

Monetary Policy

Controlled by the Central Bank

Prime Objective	➡	To influence the money supply and interest rates.
Major Tools	➡	Bank Rate, Cash Reserve Ratio, Statutory Liquidity Ratio etc.

Money

Money is anything generally accepted by society as a **medium of exchange** and which can act as a **unit of account, a store of value,** and be **used for repayment of debt.**

Functions of Money

Medium of Exchange: Its primary function is to facilitate the buying and selling of goods and services, eliminating the inefficiencies of a barter system.

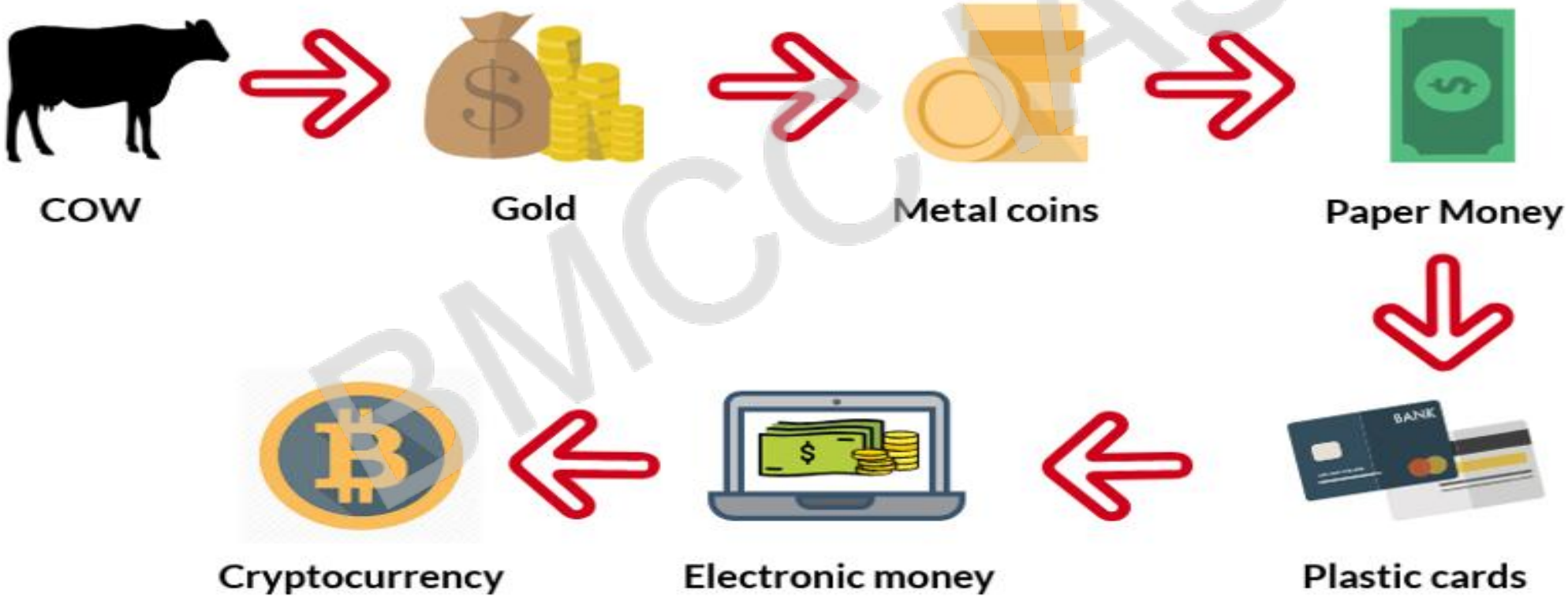
Unit of Account: Money provides a common standard for measuring and comparing the market value of different goods, services, and assets, which helps in setting prices and managing accounts.

Store of Value: It allows individuals to save their purchasing power and transfer it to the future, as its value is expected to remain relatively stable over time.

Standard of Deferred Payment: Money is an accepted way to settle debts and contractual obligations, facilitating credit and lending in the modern financial system.

Evolution of Money

From Livestock to Digital Currencies



Fiat money

Fiat money is a type of currency issued by a government that is **not backed by a physical commodity** like gold or silver. Instead, its value is derived from government decree and the public's collective trust and confidence in the issuing country's economy and central bank.

The term "fiat" comes from the Latin for "let it be done" or "it shall be".

When you use an Indian Rupee note, you're using "money by order" (fiat) of the Indian government, not because it's made of precious metal, relying on the nation's economic strength and legal framework.

The **Reserve Bank of India (RBI)** has the sole right to issue currency notes (except for the one rupee note, issued by the Ministry of Finance) and controls the money supply to manage inflation and economic stability.

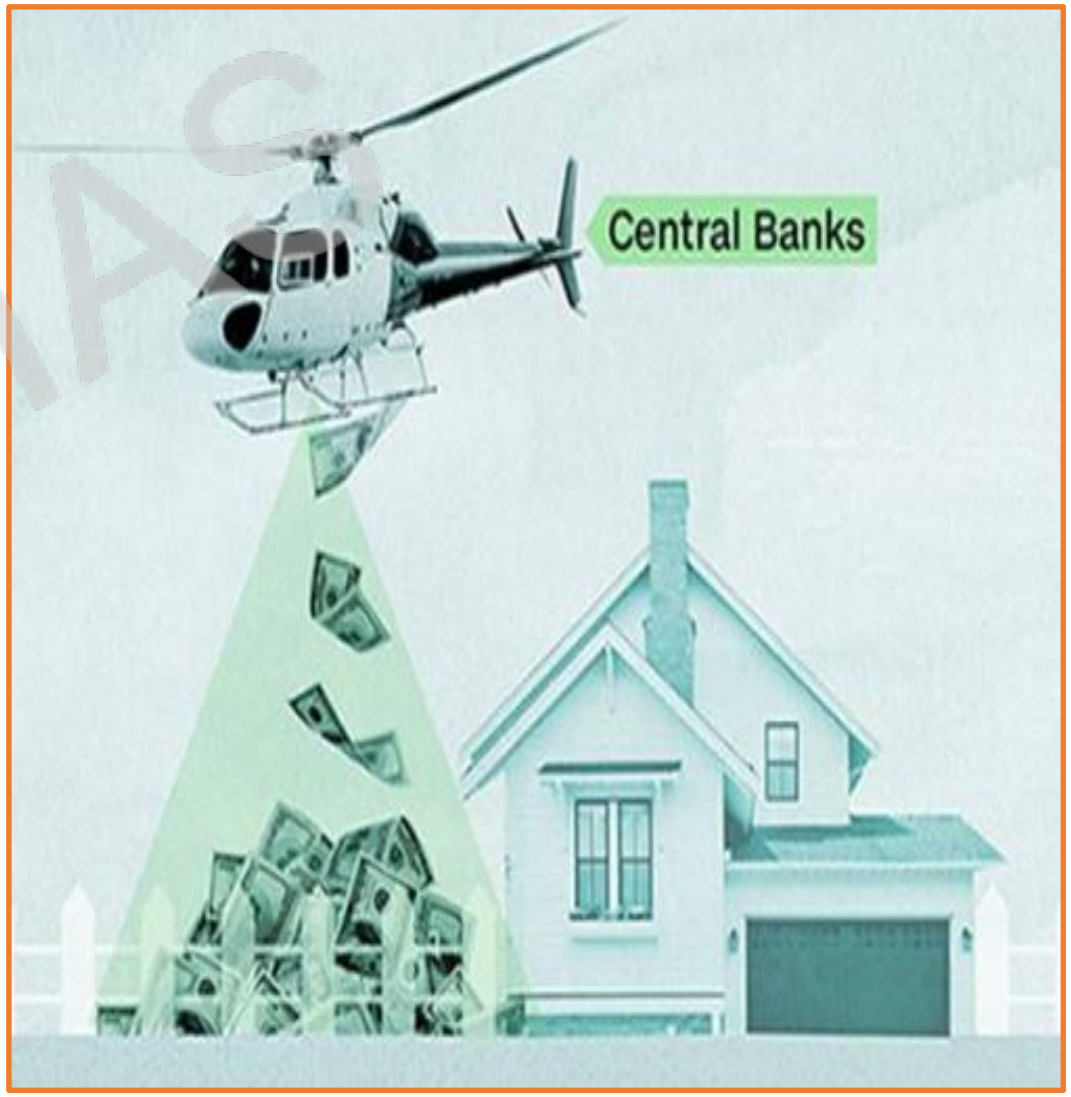
Not Fiat money

Helicopter money

Helicopter money is an unconventional monetary policy in which a large sum of new money is printed and distributed directly to the public to stimulate the economy during a severe recession or a period of deflation.

The term was coined by **American economist Milton Friedman (1969).** It is a metaphor for an emergency measure to boost aggregate demand.

Economists generally view helicopter money as a last-resort tool to be used only when all other conventional monetary policies have failed to revive the economy.



Money Supply

The **total stock of money in circulation among the public** at a particular point of time is called **money supply.**

It needs to be noted that total stock of money is different from total supply of money.

Supply of money is only that part of total stock of money which is held by the public at a particular point of time.

The circulating money involves the **currency, printed notes, money in the deposit accounts** and in the **form of other liquid assets.**

RBI publishes figures for four alternative measures of money supply, viz. M1, M2, M3 and M4.

Different Measures of Money Supply

Old Monetary Aggregates

From 1977 to 1998,

M1→ CU+ DD
(Currency Notes and Coins +Demand Deposits of Commercial banks)

M2→ M1 +Savings Account with Post Office
(Currency Notes and Coins +Demand Deposits of Commercial Banks+ Savings Account of Post Office)

M3→ M1 + Net Time Deposit of Banks
(Currency Notes and Coins +Demand Deposits of Commercial Banks+ Term Deposits of Bank)

M4→ M3 + Total Deposits of Post Office (Excluding NSC)
(Currency Notes and Coins +Demand Deposits of Commercial Banks+ Term Deposits of Bank)+ All deposits of Post office

Key Insights

Liquidity: The sequence of liquidity is **M1 > M2 > M3 > M4**.

Common Usage: M3 is the primary measure used by the Reserve Bank of India (RBI) for formulating monetary policy and is also known as "aggregate monetary resources".

M3 is the most commonly used measure of money supply. It is also known as **aggregate monetary resources.**

Narrow vs. Broad: M1 and M2 are considered narrow money, while M3 and M4 are considered broad money.

Control: The RBI uses various tools like the Cash Reserve Ratio (CRR), Statutory Liquidity Ratio (SLR), and repo rate to control the money supply in the economy.

The New Monetary Aggregates (RBI, 1998)

Based on the Dr. Y.V. Reddy Committee report in 1998, the RBI introduced a new system of monetary aggregates (NM0, NM1, NM2, and NM3) to replace the older M1, M2, M3, M4 system.

These aggregates are based on the banking sector's balance sheet and are ranked by increasing liquidity. The specific definitions for NM0, NM1, NM2, and NM3, along with liquidity aggregates (L1, L2, L3) and international context, can be found in the Reserve Bank of India's sources.

The New Monetary Aggregates (RBI, 1998)

NM0 (Monetary Base/Reserve Money): The most liquid aggregate, including currency in circulation, bankers' deposits with the RBI, and "other" deposits with the RBI.

NM1 (Narrow Money): NM0 plus demand deposits with banks.

NM2: NM1 plus time liabilities of savings deposits, bank certificates of deposit, and certain short-term deposits.

NM3 (Broad Money): NM2 plus longer-term deposits and borrowings from non-depository financial corporations. M3 is widely used for policy analysis in India.

Weekly Statistical Supplement (WSS)

every **Friday at 5:00 PM IST**.

Fortnightly basis

Liquidity Aggregates – L1, L2, and L3

L1 – NM3 + All deposits with the post office savings banks (excluding National Savings Certificates).

L2- L1 + Term deposits with term lending institutions (FIs), Term borrowing by FIs, and Certificates of deposit issued by FIs.

L3 – L2 + Public deposits of non-banking financial companies.

Liquidity Aggregates – L1, L2, and L3

In addition to the monetary aggregates, the Working Group had recommended compilation of three liquidity aggregates namely, L1, L2 and L3, which include select items of financial liabilities of non-depository financial corporations such as development financial institutions and non-banking financial companies accepting deposits from the public, apart from post office savings banks.

L1 – NM3 + All deposits with the post office savings banks (excluding National Savings Certificates).

L2- L1 + Term deposits with term lending institutions (FIs), Term borrowing by FIs, and Certificates of deposit issued by FIs.

L3 – L2 + + Public deposits of non-banking financial companies.

Note: Data for L3 is typically compiled on a **quarterly basis**, whereas L1 and L2 are generally available monthly.

In short, there are two types of money.

1.Central bank money (M0)- obligations of a central bank, including currency and central bank depository accounts.

2.Commercial bank money (M1-M3) – obligations of commercial banks, including current accounts and savings accounts.

Velocity of Money

Standard formula

$$V = \frac{\text{Nominal GDP}}{\text{Money Supply (M)}}$$

NM3 (Broad Money)

Monetary Policy: The Reserve Bank of India (RBI) uses velocity data to understand money demand and manage inflation.

Financial Year 2025-26

The projected ratio of **Nominal GDP to M3 Money Supply** in India is approximately **1.19 to 1.20**.

Nominal GDP (FY26): Estimated at **₹357.14 lakh crore** according to the First Advance Estimates released by the National Statistical Office (NSO).

M3 Money Supply (2026): Projected to reach approximately **₹299.04 lakh crore** (trillion) as of early 2026

A ratio of ~1.20 suggests a relatively stable velocity compared to historical trends.

Velocity of Money

$$V = \frac{\text{Nominal GDP}}{\text{Money Supply (M1 or M3)}}$$

Monetary Policy: The Reserve Bank of India (RBI) uses velocity data to understand money demand and manage inflation.

Implications

Low Velocity: Suggests money is moving slower, possibly due to reduced consumer spending or increased saving, which can signal economic slowdown.

Can signal economic stagnation, increased hoarding, or a recessionary environment.

High Velocity: Indicates rapid money circulation, signifying high economic activity and confidence.

Indicates robust economic activity and high consumer confidence.

Current Status and Trends (2025–2026) ➡ India

Pro-cyclical Nature: Recent studies (up to late 2024 and early 2025) indicate that money velocity in India is **pro-cyclical**, meaning it generally rises during economic expansions and falls during slowdowns.

Recent Stability: After a long-term downward trend prior to 2009—common in emerging economies as they undergo "financial deepening"—the velocity of broad money (M3) in India has become relatively **stable** in recent years.

Historical Benchmark: For context, India's broad money velocity was roughly **1.47–1.48** in the early 2000s. By 2024–2025, while total currency in circulation reached approximately **₹38.1 lakh crore**, the velocity remains a critical metric for the Reserve Bank of India (RBI) to manage inflation targeting.

Reached an all-time high of approximately ₹40 lakh crore in January 2026.

How much money can RBI print in a year?

As per the **Indian Coinage Act of 1906**, Coins can be issued up to the denomination of ₹1000.

As per the **RBI Act of 1934**, Currency Notes can be issued up to the denomination of ₹10,000.

The **₹1 note is the only currency note** which bears the **signature of the Finance Secretary** of the Government of India, and not of the Governor of the RBI.
All other notes bear the signature of the Governor of the RBI.

The **1 Rupee note and the coins of all denominations** are minted and **issue by the Government of India,** not the RBI. But, they are **circulated by the RBI.**

The Reserve Bank of India (RBI) does not have a fixed monetary limit on the amount of money it can print in a year

Instead, the volume of currency printed is determined based on the actual transactional needs of the economy, expected GDP growth, inflation, and the requirement to replace soiled or damaged notes, all in consultation with the Government of India.

The RBI issues currency notes under a system called **Minimum Reserve System.**

Minimum Reserve System (MRS

Minimum Reserve System (MRS): India follows the MRS since 1956, which requires the RBI to maintain a minimum reserve of assets worth **₹200 crore** at all times (**₹115 crore** in gold and **₹85 crore** in foreign currency assets). Once this minimum is maintained, the RBI can print currency as needed by the economy, but not an unlimited amount in practice due to economic consequences.

Economic Factors

Economic Factors: The actual volume of notes printed is a function of a complex statistical modeling process that considers:

- Expected growth in Gross Domestic Product (GDP).
- Projected inflation rates and interest rates.
- The volume of notes already in circulation and their average lifespan.
- Growth of non-cash modes of payment (digital payments).
- Feedback from regional offices and commercial banks regarding cash demand.

Recent tussle between RBI and government over transfer of surplus reserves

Core of the Issue

The heart of the debate lies in Section 47 of the RBI Act, 1934, which mandates that the RBI transfer its surplus profits to the Central government after making provisions for bad debts, expenses, and a contingency fund.

The issue is not *whether* to transfer the surplus, but *how much* should be set aside in the RBI's reserves (specifically the Contingent Risk Buffer, or CRB) before the remainder is paid to the government.

A major dispute occurred in 2018–2019 when the government sought a larger share of the RBI's "contingency reserves" to fund infrastructure and bridge fiscal gaps. This led to the formation of the **Bimal Jalan Committee**, which eventually authorized a record transfer of ₹1.76 trillion to the government in 2019.

The Modi era has seen high-profile exits, including Governors **Raghuram Rajan** (who did not seek a second term) and **Urjit Patel** (who resigned mid-term citing personal reasons after public disagreements with the government). Since then, the government has largely appointed career civil servants (like **Shaktikanta Das**) to lead the bank, which some analysts suggest has led to smoother coordination.

The RBI Board's technical Committee, led by **Y H Malegam in 2013**, recommended a **higher transfer of reserves and surplus to the government**, which typically averages around **0.5% of the Gross Domestic Product (GDP)** with a few exceptions.

Reserve Bank of India

RBI acts as a **regulatory body,** responsible for the regulation of the **Indian banking system** as well as the control, issuing, and maintaining money supply in the Indian economy.

RBI was established on April 1, 1935, under the Reserve Bank of India Act, 1934. Originally a privately owned bank, it was nationalised in 1949 after India gained independence.

History

The Reserve Bank of India was established to tackle the economic turmoil that occurred after World War-I.

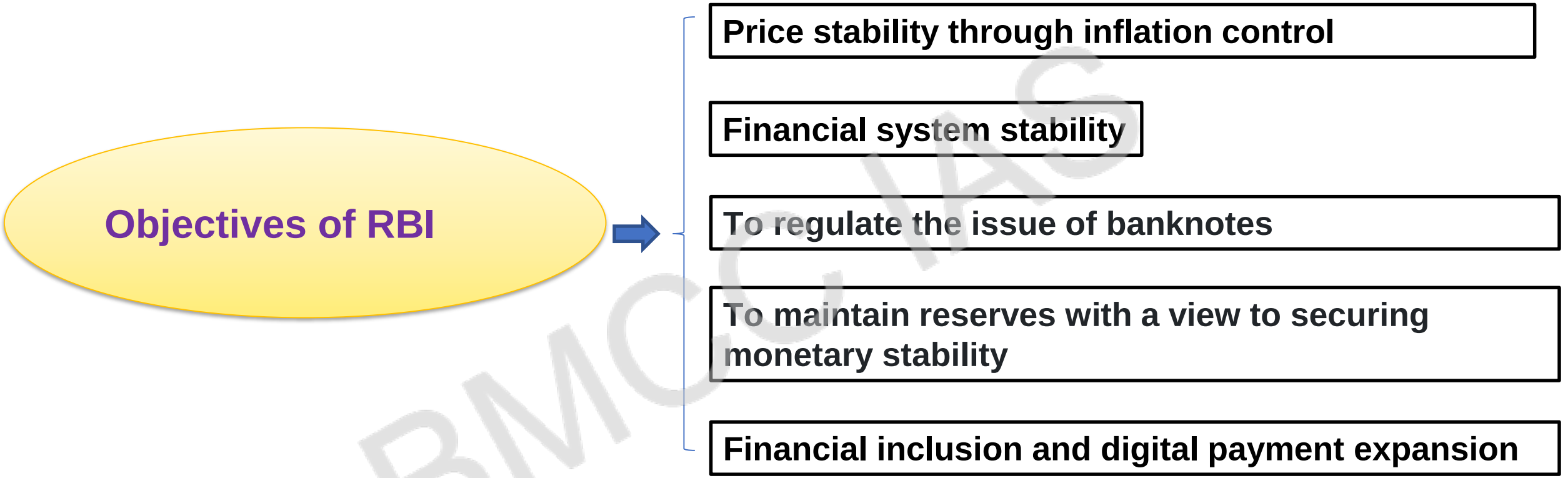
Nationalization of RBI

Reserve Bank of India nationalization refers to the transfer of the RBI's ownership from private shareholders to the Government of India. Initially established in 1935 as a privately owned institution, the RBI's shares were held by individuals and private institutions.

However, with the enactment of the Reserve Bank of India (Transfer to Public Ownership) Act, 1948, the government acquired full ownership.

The nationalization came into effect on January 1, 1949, making the RBI a completely state-owned entity.

Post-nationalization, it officially became the central bank of India, responsible for regulating the country's monetary and banking systems.


Objectives of RBI
Price stability through inflation control
Financial system stability
To regulate the issue of banknotes
To maintain reserves with a view to securing monetary stability
Financial inclusion and digital payment expansion

Current Leadership (as of 2026)

As of January 2026, the RBI is led by one Governor and four Deputy Governors

Position	Name	Background / Term Start
Governor	**Shri Sanjay Malhotra**	1990 batch IAS officer; took office on **December 11, 2024**.
Deputy Governor	**Shri T. Rabi Sankar**	Career central banker; overseeing payment systems and financial markets.
Deputy Governor	**Shri Swaminathan J.**	Former Managing Director of SBI; appointed **June 26, 2023**.
Deputy Governor	**Dr. Poonam Gupta**	Economist (ex-NCAER/World Bank); appointed **May 2, 2025**.
Deputy Governor	**Shri Shirish Chandra Murmu**	Career central banker; appointed **October 9, 2025**, succeeding M. Rajeshwar Rao.

Functions of the Reserve Bank of India

- Issuer of Currency Notes
- Supervisory Function
- Banker to other Banks
- Banker to the Government
- Foreign Exchange Management
- Promotional Functions of RBI
- Credit control

Credit control

Credit Control is a function performed by the Central Bank (Reserve Bank of India), to control the credit, i.e. the demand and supply of money or say liquidity in the economy.

Methods of Credit Control

- Qualitative (Selective) Methods
- Quantitative (General) Methods

Quantitative (General) Methods

Reserve Ratios	Cash Reserve Ratio (CRR)
	Statutory Liquidity Ratio (SLR)
Policy Rates	Bank Rate
	Repo Rate
	Reverse Repo Rate
	Marginal Standing Facility
Open Market Operations	

Quantitative (General) Methods

These tools regulate the total volume of money and credit in the banking system, affecting all sectors of the economy uniformly.

Cash Reserve Ratio (CRR): The mandatory percentage of total deposits (NDTL) that banks must keep with the RBI in liquid cash.

Statutory Liquidity Ratio (SLR): The percentage of deposits banks must maintain in liquid assets like gold or government securities.

Repo Rate: The benchmark interest rate at which the RBI lends short-term money to commercial banks.

Reverse Repo Rate: The rate at which the RBI absorbs excess liquidity by borrowing from commercial banks.

Bank Rate: The rate at which the RBI rediscounts bills of exchange or provides long-term loans to banks.

Marginal Standing Facility (MSF): An overnight borrowing window for banks to meet emergency liquidity shortages.

Open Market Operations (OMO): The direct buying or selling of government securities to inject or absorb liquidity from the market.

Qualitative (Selective) Methods

These tools target specific sectors or types of credit rather than the overall volume.

Margin Requirements: Adjusting the difference between the loan amount and the market value of collateral to discourage or encourage borrowing against specific assets.

Credit Rationing: Fixing ceilings on the maximum amount of credit for specific sectors or categories.

Moral Suasion: Persuading or pressuring commercial banks through informal advice or circulars to align their lending policies with RBI objectives.

Regulation of Consumer Credit: Setting terms for down payments and repayment periods for consumer durable loans.

Direct Action: Imposing penalties, restricting lending, or denying refinancing to banks that fail to comply with RBI directives.

Current RBI Policy Rates (April 2026)

The Monetary Policy Committee (MPC)

- **Cash Reserve Ratio (CRR):** 3.00%
- **Statutory Liquidity Ratio (SLR):** 18.00%
- **Repo Rate:** 5.25%
- **Reverse Repo Rate:** 3.35%
- **Bank Rate:** 5.50%
- **Marginal Standing Facility (MSF) Rate:** 5.50%

Open Market Operations (OMO)

The direct buying or selling of government securities to inject or absorb liquidity from the market.

Government securities (G-Secs)

Government securities (G-Secs) are tradable debt instruments issued by central or state governments to borrow money, primarily to finance fiscal deficits and development projects.

Issuers: In India, both the Central and State Governments issue these securities, with the Reserve Bank of India (RBI) managing them.

Considered virtually risk-free with sovereign backing, they provide investors with regular interest payments (coupons) or are issued at a discount, offering a secure, low-risk investment option.

Types of Government Securities

Treasury Bills (T-Bills): Short-term instruments with maturities of 91, 182, or 364 days. They do not pay interest but are issued at a discount and redeemed at face value.

Cash Management Bills (CMBs): Ultra-short-term instruments (less than 91 days) used to bridge temporary cash flow gaps.

Dated Securities: Long-term bonds with tenures ranging from 5 to 40 years, offering fixed or floating interest rates.

State Development Loans (SDLs): Bonds issued specifically by state governments to fund local infrastructure and budgetary needs.

How Government Securities Control Money Supply

Contraction (Selling Securities): When the central bank sells G-Secs, commercial banks buy them using their reserves. This reduces the funds available for banks to lend, reducing the money supply and curbing inflation.

Expansion (Buying Securities): When the central bank purchases G-Secs, it deposits money into the banking system, increasing the reserves of commercial banks. This allows banks to increase lending, which expands the money supply.

Interest Rate Management: By affecting the supply of money, OMOs also influence short-term interest rates. A lower money supply (selling securities) makes borrowing more expensive, while higher supply (buying securities) lowers rates

NOTE

Manmohan Singh is the only **Prime Minister** of India who, till now, has **also served as the Governor** of the RBI.

The first Governor was Sir Osborne Smith (1935), and the first Indian Governor was Sir C. D. Deshmukh (1943).

Amitav Ghosh served the shortest tenure.

Sir Benegal Rama Rau had the longest tenure (1949–1957).

The Governor is appointed for a three-year term by the Appointments Committee of the Cabinet (ACC).

The **emblem** of the RBI is a **Tiger and a Palm Tree.**

Autonomy of Reserve Bank of India

Factors Hampering Autonomy of RBI

There is an ongoing concern that the government might view these transfers as a fiscal crutch, potentially pressuring the central bank and undermining its independent decision-making powers.

The Colonial-era RBI Act of 1934 provides the government sweeping powers to control the Reserve Bank of India the way it wants. For example:

- **Section 30** of the RBI Act allows the government to **supersede the RBI's Central Board.**
- **Section 58** circumscribes the powers of the Central Board to **make regulations only with the previous sanction of the Central Government.**
- **Section 7(1)** says that the **Union government can give directions** to the central bank, after consultation with the RBI Governor in the public interest.

According to a report, since independence, **many RBI Governors** have been **former Finance Ministry officials**. This raises the question of the independent functioning of the Reserve Bank of India.

The **issue of increasing RBI Surplus Transfer** has also been hampering the autonomy of RBI.

The Central Board of Directors, the highest decision-making body of the RBI, consists of 21 members, of which **12 members are nominated by the Union government.** This gives the government a large say in the functioning of the Reserve Bank of India.

The **government frequently asks the Reserve Bank of India to ease lending rules** under its Prompt Corrective Action (PCA) Framework, as it could help reduce pressure on MSMEs and Power Companies through credit availability. This jeopardizes the RBI's efforts to deal with the country's Non-Performing Asset (NPA) Crisis.

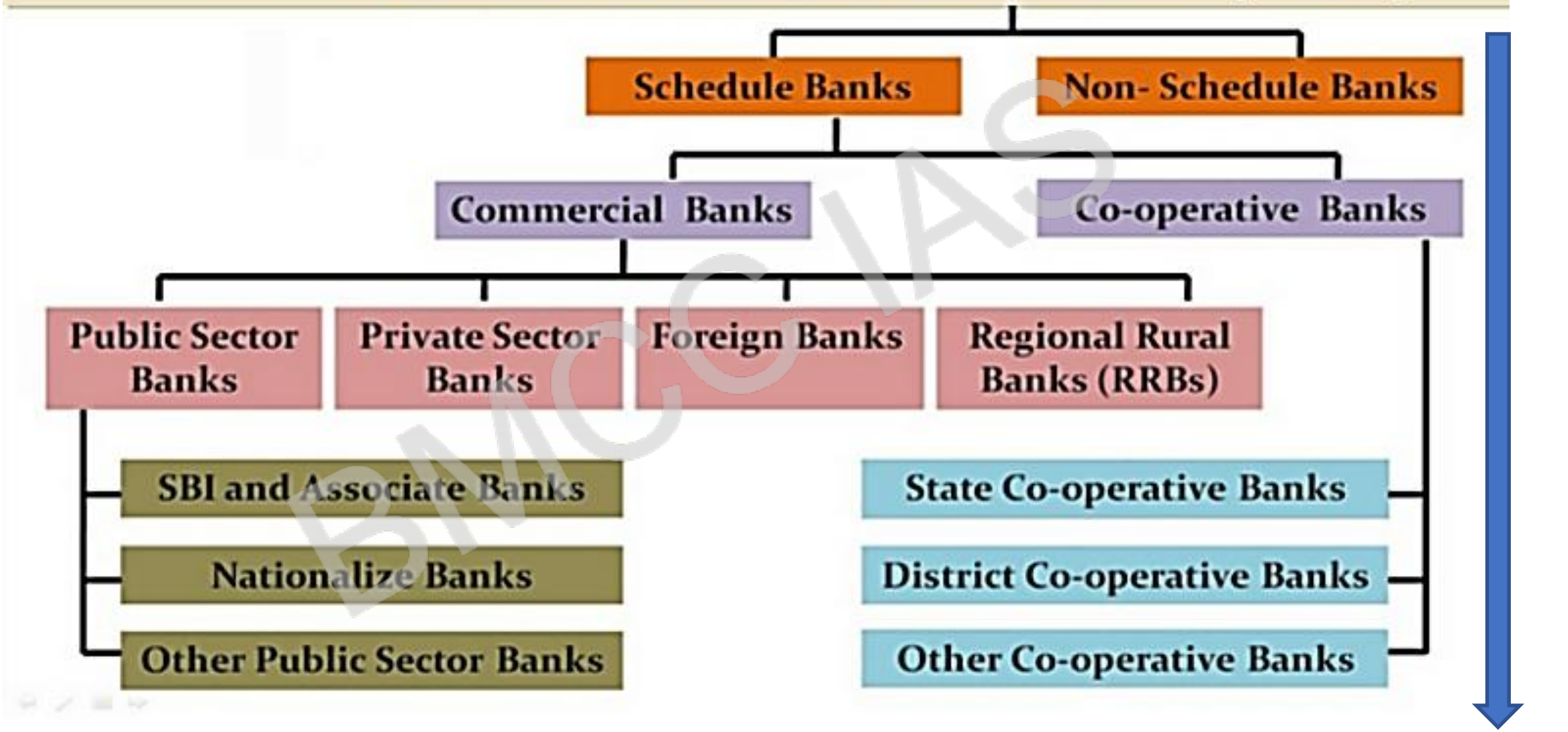
India's banking system

India has a robust banking sector with several listed public and private banks.

It is multi-layered structure regulated by the **Reserve Bank of India (RBI)**, which acts as the central bank and monetary authority.

Banking Regulation Act of 1949 clarifies in section 5(b) that banking means accepting deposits from the public which are repayable on demand, withdrawal of cheques, lending loans etc.

Reserve Bank of India (RBI)



Non-Banking Finance Companies (NBFCs)

Listed under the **Second Schedule of the RBI Act, 1934**.

Scheduled Banks and Non-Scheduled Banks

Most of the banks under the Banking System in India are Scheduled Banks. For example, Commercial Banks, Private, and Public Sector Banks.

Only a few types of banks under the Banking System in India are Non-Scheduled Banks. For example, Local Area Banks (LABs), and some Urban Cooperative Banks (UCBs).

Scheduled banks are financial institutions listed in the **Second Schedule of the Reserve Bank of India (RBI) Act, 1934**, while non-scheduled banks are not. This primary distinction leads to differences in regulation, access to central banking facilities, and operational scope.

Non-Banking Financial Company

NBFC stands for a **Non-Banking Financial Company**, is a financial institution that offers services similar to a traditional bank but does not hold a full banking license.

NBFCs are typically involved in providing loans, credit facilities, and investment services, and are primarily regulated by the Reserve Bank of India (RBI) in India.

NBFC is a **company registered under the Companies Act, 1956**

NOTE

In 2026, foreign direct investment (FDI) limits in India for the **banking sector** remain capped at **74%** for private banks (with a 49% automatic route limit) and **20%** for public sector banks. For the **NBFC sector**, **100% FDI** is permitted under the automatic route for regulated activities.

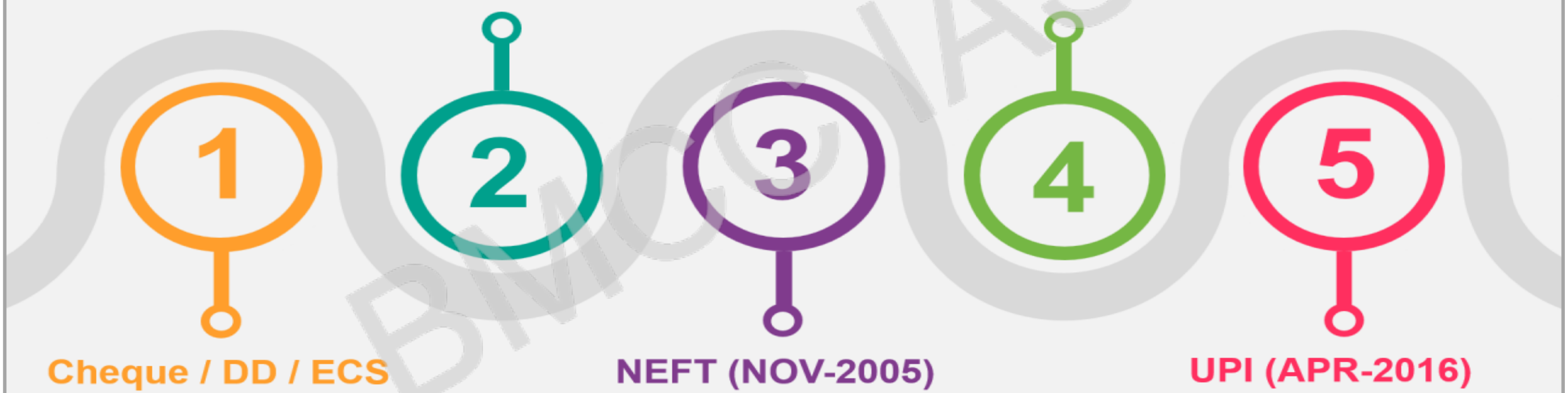
NOTE

Old Banks in India

Oudh Commercial Bank	Founded in 1881, it was the first limited liability bank in India but failed in 1958.
Established in 1865, it is the oldest joint stock bank in India.	Allahabad Bank
Punjab National Bank	Established in 1895, it was the first bank managed solely by Indians.

Banking evolution in India

– a random thought around major products



ECS: Electronic Clearing Service

RTGS: Real-Time Gross Settlement, a system for instant, high-value money transfers between banks.

NEFT: National Electronic Funds Transfer, an electronic funds transfer system for one-to-one bank transfers processed in batches.

IMPS: Immediate Payment Service, a 24/7 instant interbank electronic fund transfer service in India.

UPI: Unified Payments Interface, a mobile-first instant payment system.

ATM: Automated Teller Machine, a machine for cash withdrawals and deposits.

IFSC: Indian Financial System Code, an 11-digit alphanumeric code that uniquely identifies bank branches for electronic funds transfers.

PIN: Personal Identification Number.

MICR: Magnetic Ink Character Recognition, a code found on cheques used for faster and secure clearance processes.

CIBIL: Credit Information Bureau (India) Limited

EMI: Equated Monthly Installment

NPA: Non-Performing Asset

KYC: Know Your Customer

Types of banks

The primary types of banks include **central banks, commercial banks, cooperative banks, and specialized banks**.

central banks

The Official Central Bank: Reserve Bank of India (RBI)

commercial banks

SBI (largest), HDFCBank,ICICI Bank,Axis Bank,PNB etc

cooperative banks

Bihar State Co-operative Bank Ltd,
Andhra Pradesh State Co-operative Bank Ltd etc

specialized banks

SIDBI (for small industries), **EXIM Bank** (for exports/imports), **NABARD** (for agriculture/rural development) etc

Established to cater to the specific financial needs of particular economic sectors, such as agriculture, industry, or foreign trade.

They differ from commercial banks by focusing on medium and long-term financing and not relying on individual deposits for capital.

specialized banks

- National Bank for Agriculture and Rural Development (NABARD)
- Small Industries Development Bank of India (SIDBI)
- Export-Import Bank of India (EXIM Bank)
- National Housing Bank (NHB)
- Industrial Finance Corporation of India (IFCI)

National Bank for Agriculture and Rural Development (NABARD)

This is the apex institution for rural and agricultural credit, providing finance and support for agricultural activities, cottage industries, and rural development projects.

Founded on **July 12, 1982**, under the NABARD Act 1981, following the recommendations of the **B. Sivaraman Committee**.

It is **100% owned by the Government of India** (Ministry of Finance).

Located in **Mumbai**, Maharashtra, with 31 regional offices across India.

Small Industries Development Bank of India (SIDBI)

The **Small Industries Development Bank of India (SIDBI)** is the principal financial institution in India dedicated to the promotion, financing, and development of the **Micro, Small, and Medium Enterprise (MSME)** sector.

Initially a subsidiary of IDBI Bank, later delinked in 2000.

Set up on **April 2, 1990**, under an Act of the Indian Parliament.

Originally a wholly-owned subsidiary of IDBI, it is now owned by the Government of India and 22 other institutions, including the State Bank of India.

Export-Import Bank of India (EXIM Bank)

The **Export-Import Bank of India (EXIM Bank)** is the premier, wholly-owned financial institution of the Government of India for **financing, facilitating, and promoting the country's international trade**.

Established in **1982** under the Export-Import Bank of India Act, 1981, EXIM Bank aims to integrate foreign trade and investment with India's economic growth.

The bank is a statutory corporation, wholly owned by the Government of India, and is regulated by the Reserve Bank of India (RBI).

The Export-Import Bank of India (**Exim Bank**) headquarters is located in **Mumbai, Maharashtra**, India.

National Housing Bank (NHB)

The **National Housing Bank (NHB)** is the apex financial institution for the housing sector in India. Established on July 9, 1988, under the National Housing Bank Act, 1987, it operates as a wholly-owned subsidiary of the Government of India

It is a regulatory body for overall regulation and licensing of housing finance companies in India. It is under the jurisdiction of Ministry of Finance, Government of India.

Industrial Finance Corporation of India (IFCI)

The **Industrial Finance Corporation of India (IFCI)** is a Systemically Important Non-Deposit taking Non-Banking Finance Company (NBFC-ND-SI) in the public sector, established in **1948** as India's first development finance institution to provide medium and long-term finance to the industrial sector. It is a public limited company listed on the NSE and BSE.

IFCI provides financial support for diverse industries including manufacturing, infrastructure (airports, roads, power, telecom), and services, as well as advisory services to corporate and government sectors.

The headquarters of the Industrial Finance Corporation of India (**IFCI**) are located in **New Delhi**.

Basel Norms / Basel Accords

International banking regulations designed to strengthen the global financial system by setting standards for capital adequacy, risk management, and transparency.

Basel norms (or Basel Accords) are international banking regulations designed to ensure that financial institutions maintain enough capital to absorb unexpected losses and remain stable during economic stress. They are formulated by the **Basel Committee on Banking Supervision (BCBS)**, which is headquartered in Basel, Switzerland, at the Bank for International Settlements (BIS).

Evolution of Basel Norms

The accords have evolved over decades to address emerging financial risks:

Basel I (1988): Focused almost exclusively on **credit risk**. It introduced the requirement for banks to maintain a minimum **Capital Adequacy Ratio (CAR)** of **8%** relative to their risk-weighted assets (RWA).

Basel II (2004): Refined the 8% capital requirement and introduced a **Three-Pillar Approach**:

Basel III (2010): Developed in response to the 2008 global financial crisis. It introduced stricter capital requirements, new liquidity standards (**LCR** and **NSFR**), and a non-risk-based **leverage ratio**.

Basel IV (Basel III Endgame): Finalized in 2017 to reduce excessive variability in how banks calculate risk-weighted assets. Full global implementation is scheduled to be phased in by **2028**.

Agriculture in India

Cropping patterns in India

Kharif (June–October)	Rabi(October–March)	Zaid (April–June)
Rice, Maize, Cotton, Groundnut, Jowar, Bajra, Soybean, Jute	Wheat, Barley, Gram (Chickpea), Mustard, Peas, Potato	Watermelon, Muskmelon, Cucumber, Vegetables, Fodder crops
West Bengal, Uttar Pradesh, Punjab, Andhra Pradesh, Maharashtra	Punjab, Haryana, Himachal Pradesh, Uttar Pradesh, Rajasthan	Northern and North-western states

Agriculture in India

Its share of the national GDP remains approximately 18%

The sector continues to be the primary stabilizer for the rural economy, employing nearly 46% of the total workforce.

Growth Rate: The agriculture and allied sector is estimated to grow by **3.1% in FY26**.

sector is undergoing a strategic transition from a subsidy-centric model to one driven by **technology, high-value diversification, and resilient allied sectors**.

Budgetary Allocation: The Ministry of Agriculture and Farmers Welfare was allocated ₹1.41 lakh crore, a 5.4% increase from the previous year's revised estimates.

Production Estimates (2025-26 into 2026-27)

Latest advance estimates for the current cycle (leading into the 2026-27 marketing season)

- **Rice (Kharif):** 123.9 million metric tonnes (LMT).
- **Wheat (Rabi):** 120.2 LMT.
- **Pulses:** Gram (11.7 LMT) and Lentil (1.7 LMT).

- **Sugarcane:** Record 500.1 LMT.

Minimum Support Prices (MSP) for 2026-27

The MSP is the "floor price" at which the government guarantees it will purchase crops from farmers if market rates fall below this level

Crops Covered: The government sets MSP for **22 mandated crops**, including 14 Kharif, 6 Rabi, and 2 commercial crops (Jute and Copra).

Mechanism: Recommendations are made by the **Commission for Agricultural Costs and Prices (CACP)** and final decisions are taken by the **Cabinet Committee on Economic Affairs (CCEA)**.

The government has increased MSP for Rabi crops to ensure at least a 50% margin over the cost of production

Announcement: Declared twice a year before the sowing seasons for **Kharif** (monsoon) and **Rabi** (winter) crops.

Mandated Crops (22 Crops + Sugarcane)

Category	Crops Included
Cereals (7)	Paddy, Wheat, Maize, Sorghum (Jowar), Pearl Millet (Bajra), Barley, and Ragi
Pulses (5)	Gram (Chana), Arhar/Tur, Moong, Urad, and Lentil (Masur)
Oilseeds (7)	Groundnut, Rapeseed-Mustard, Soybean, Sunflower, Sesamum, Safflower, and Nigerseed
Commercial (4)	Raw Cotton, Raw Jute, Copra, and Sugarcane (covered under **FRP**)

Note: For sugarcane, the government declares a Fair and Remunerative Price (FRP), which is legally binding for sugar mills to pay

Latest MSP Rates (per quintal)

As per the latest updates for the upcoming marketing seasons:

- **Rabi Marketing Season (RMS) 2026–27:**
  - **Wheat:** ₹2,585 (₹160 increase)
  - **Barley:** ₹2,150 (₹170 increase)
  - **Gram:** ₹5,875 (₹225 increase)
  - **Lentil (Masur):** ₹7,000 (₹300 increase)
  - **Rapeseed & Mustard:** ₹6,200 (₹250 increase)
  - **Safflower:** ₹6,540 (₹600 increase)
- **Kharif Marketing Season (KMS) 2025–26:**
  - **Paddy (Common):** ₹2,369
  - **Paddy (Grade A):** ₹2,389
  - **Maize:** ₹2,400
  - **Tur (Arhar):** ₹8,000
  - **Moong:** ₹8,768

As of April 2026, the Government of India **has not yet officially announced** the nationwide Minimum Support Prices (MSP) for the **Kharif Marketing Season (KMS) 2026-27**. National Kharif MSPs are typically finalized and announced by the Union Cabinet in **June**.

Implementation Agencies

The Food Corporation of India (FCI) is the nodal agency for procuring cereals (wheat and paddy). Other agencies like NAFED and NCCF handle pulses and oilseeds under thePM-AASHA umbrella scheme.

NAFED (National Agricultural Cooperative Marketing Federation of India) and NCCF (National Cooperative Consumers' Federation of India) are premier Indian government-backed cooperatives that play a key role in agricultural procurement, price stabilization, and supply management.

Pradhan Mantri Annadata Aay SanraksHan Abhiyan (PM-AASHA) is an umbrella scheme aimed at ensuring remunerative prices for farmers, protecting them from price volatility in pulses, oilseeds, and copra.

Role in Procurement & Pricing: NAFED and NCCF are actively involved in purchasing commodities like pulses (arhar, urad, masoor) and onions (e.g., procurement of 2 lakh tonnes in 2026) directly from farmers at Minimum Support Price (MSP).

Direct-to-Consumer Supply: They often sell essential goods like pulses and onions at lower prices in city markets to control inflation.

Minimum Support Price (MSP) Calculation Formula

For the 2026-27 marketing season, the Minimum Support Price (MSP) for crops in India is calculated using the **A2+FL formula**, ensuring a minimum return of **50% over the cost of production**.

The Core Calculation Formula

The government uses the following specific cost components to arrive at the final MSP:

- **A2 (Paid-out Costs):** Includes all actual expenses incurred by the farmer in cash and kind.
  - Cost of seeds, fertilizers, and pesticides.
  - Hired human, bullock, or machine labour.
  - Irrigation charges and fuel/electricity for pump sets.
  - Rent paid for leased-in land.
- **FL (Family Labour):** The imputed value of unpaid family labour.
- **Final MSP Calculation:** $MSP = (A2 + FL) \times 1.5$.

Factors Considered in 2026

The **Commission for Agricultural Costs and Prices (CACP)** recommends these prices after evaluating:

Demand and Supply	Current and projected market balance for each crop
Price Trends	Both domestic and international market price movements
Inter-crop Parity	Ensuring a balanced incentive structure so farmers don't shift entirely to one crop.
Terms of Trade	The relationship between agricultural and non-agricultural sector prices

Public Distribution System (PDS) in India

Public Distribution System (PDS) in India

One of India's most extensive social welfare networks, designed to ensure food security for millions of citizens.

PDS provides essential commodities at subsidized rates to vulnerable populations.

India's **Public Distribution System (PDS)** is one of the world's largest food security networks, providing essential commodities like rice and wheat to nearly **81.35 crore** people as of 2025.

Administered by the **Ministry of Consumer Affairs, Food and Public Distribution.**

How the PDS Functions

Managed through a joint responsibility between the Central and State/UT Governments

Central Government: Responsible for procuring food grains from farmers at a **Minimum Support Price (MSP)**, storing them, and transporting them to state-level depots via the Food Corporation of India (FCI).

State Governments: Handle the final distribution to consumers through approximately **5.45 lakh Fair Price Shops (FPS)**, identify eligible households, and issue ration cards.

Current Entitlements (as of early 2026)

In 2026, the Public Distribution System (PDS) in India, primarily operating under the **Pradhan Mantri Garib Kalyan Anna Yojana (PMGKAY)**, continues to provide **free foodgrains** to approximately 81.35 crore beneficiaries.

Category	Monthly Entitlement	Central Issue Price (Pre-2023)
Antyodaya Anna Yojana (AAY)	35 kg per household	Free (Previously ₹3/kg rice, ₹2/kg wheat)
Priority Households (PHH)	5 kg per person	Free (Previously ₹3/kg rice, ₹2/kg wheat)

Key 2026 Updates & Initiatives

Bulk Distribution: In March 2026, the government announced a one-time **three-month advance distribution** of grains (for April, May, and June) to improve efficiency and reduce the need for multiple visits to ration shops.

Fortified Rice: As of March 2024, 100% of the rice supplied under central schemes like PMGKAY is **fortified** with Iron, Folic Acid, and Vitamin B12. This universal supply is approved to continue until December 2028.

Major Technological Reforms

The government has implemented several digital initiatives to improve transparency and reduce leakages:

One Nation One Ration Card (ONORC): Allows beneficiaries, particularly migrant workers, to access their rations from any FPS in India using biometric authentication.

Aadhaar Seeding: Over **99.9%** of ration cards are now linked with Aadhaar to eliminate "ghost" or duplicate beneficiaries.

Automation: Approximately **99.8%** of FPS are equipped with electronic Point of Sale (ePoS) devices for real-time tracking.

Rice Fortification: Since March 2024, 100% of rice supplied under central schemes is fortified with iron, folic acid, and Vitamin B12 to combat malnutrition.

Evolution and historical background

Pre-independence era (1939-1947): Introduced as a war-time rationing measure in Bombay and later extended to other cities

Initial post-independence period (1947-1960s): Continued as a universal system with limited coverage predominantly in urban areas

Green Revolution period (1960s-1990): Expanded significantly alongside India's efforts to achieve self-sufficiency in food production

Targeted PDS (post-1997): Transformed from universal coverage to a targeted approach focusing on Below Poverty Line (BPL) households

National Food Security Act (2013): Legally entrenched food security as a right, covering up to 75% of rural and 50% of urban population