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APSC Economics

Complete Notes

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APSC CCE

Prelims

Mains

Practice Sets

Revision

Rise with Purpose

PREPARED BY

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Student-friendly Indian Economy notes for APSC - simple language, exam-oriented, with MCQs and Mains questions

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CHAPTER 1

Understanding Economics

What it means

Economics is simply the study of how people, businesses and governments use limited resources to satisfy unlimited wants. The word comes from the Greek 'Oikos' (household) and 'Nomos' (rules/management) - literally 'managing the household'. Today that 'household' is the whole nation.

In simple words

Think of your family budget. You have limited pocket money but many things you want - food, recharge, clothes, savings. Deciding what to buy first, what to skip, and how to save is exactly what economics does, only for an entire country.

Key concepts

Economics vs Economy (don't mix them up)

Economics is the SUBJECT - the theory and study of how wealth is produced, distributed and consumed. The Economy is the REAL SYSTEM in action - the farms, factories, banks, shops and people of a region working together. In one line: economics is the theory, the economy is the practice.

Father of Economics

Adam Smith is called the Father of Economics. In 1776 his book 'An Inquiry into the Nature and Causes of the Wealth of Nations' (short name: 'The Wealth of Nations') made economics a separate subject for the first time.

What is an Economy

An economy is a living system that provides the means of livelihood to the people of a region. It is made of economic activities (farming, manufacturing, services), economic agents (people, firms, government) and institutions, all linked together.

Three pillars of any economy (Tantra, Yantra, Mantra)

A simple Indian way to remember the parts of an economy: Tantra = the SYSTEM (capitalism, socialism or mixed), Yantra = the STRUCTURE (base sectors plus supportive regulators like RBI, SEBI, IRDAI, TRAI, PFRDA), and Mantra = the MECHANISM (how prices and decisions are actually made).

Strategic vs Non-Strategic sectors (Yantra / structure)

Type	Who controls it	Example
Strategic	Fully under the government	Atomic energy, defence
Non-strategic	Both government and private	Banking, insurance, telecom
Supportive (regulators)	Watch over strategic sectors	RBI, SEBI, IRDAI, TRAI, PFRDA

APSC Exam Tips

Score boosters

- Remember the Oikos + Nomos origin - APSC loves word-origin questions.
- Adam Smith - 1776 - Wealth of Nations is a near-guaranteed factual hook; link all three.
- Be ready to tell economics (theory) apart from economy (practice) in a statement question.

Quick Revision**Understanding Economics - recap**

- Economics = study of managing scarce resources; Economy = the real working system.
- Adam Smith = Father of Economics; Wealth of Nations (1776).
- Economy pillars: Tantra (system), Yantra (structure), Mantra (mechanism).
- Regulators (RBI, SEBI, IRDAI, TRAI, PFRDA) = supportive structure.

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CHAPTER 2

Economic Systems

What it means

Every country must answer three questions: what to produce, how to produce, and for whom to produce. The way it answers them decides its economic system - capitalist, socialist or mixed.

In simple words

Imagine a school canteen. If students freely decide what to sell and buy, that's capitalism. If the principal decides everything, that's socialism. If students run most stalls but the principal fixes a few rules and prices, that's a mixed economy - which is what India follows.

Key concepts

Capitalism (free market / laissez-faire)

Means of production are privately owned. Prices are set by demand and supply in the market. Government interferes the least. Examples: USA, Canada, Italy. Strength: efficiency and choice. Weakness: inequality.

Socialism (command / controlled economy)

Means of production are owned by society/state. Prices are administered (fixed) by the government, which controls almost everything through licensing. Examples: erstwhile USSR/Russia, Cuba, North Korea. Strength: equality. Weakness: less efficiency and choice.

Mixed economy (India's model)

A blend of capitalism and socialism. Some sectors are private, some are government, and the state keeps selective control through licensing. India chose this path so it could grow with both efficiency and social justice.

Capitalism vs Socialism vs Mixed at a glance

Feature	Capitalism	Socialism	Mixed
Ownership	Private	State/Social	Both
Price decided by	Market (demand-supply)	Government (administered)	Mostly market, some govt
Govt control	Least	Full	Selective licensing
Example	USA	North Korea	India

APSC Exam Tips

Score boosters

- Match-the-country questions are common: USA=capitalist, North Korea=socialist, India=mixed.
- 'Laissez-faire', 'administered price' and 'selective licensing' are keyword triggers - learn which system each belongs to.
- India being a mixed economy is the reason public-sector RBI/PSUs coexist with private firms.

Quick Revision

Economic Systems - recap

- Capitalism: private ownership, market prices, least control (USA).
- Socialism: state ownership, administered prices, full control (North Korea).
- Mixed: blend, selective licensing (India).
- Keywords: laissez-faire=capitalism, command economy=socialism.

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CHAPTER 3

National Income Accounting

What it means

National income accounting is how a country adds up the value of everything it produces in a year. It is done at two levels - micro (a single firm) and macro (the whole nation) - and it gives us the famous numbers GDP, GNP, NNP and National Income.

In simple words

Picture a potato-chips company. It buys potatoes, oil, packaging (these are 'intermediate' costs) and adds its own work to turn them into chips worth more than the raw materials. That extra worth is 'value added'. Add up the value added by every firm in India and you get the country's income.

Key concepts

Fixed input vs Variable input

Fixed input: resources whose cost stays the same during the year (machines, building) - also called fixed capital.

Variable input: resources whose cost rises or falls with how much you produce (potatoes, fuel, packaging) - the cost here is variable cost.

Gross Value Added (GVA) - the building block

GVA = Total Receipts (TR) minus Intermediate Cost (IC). It is the genuine NEW value a firm creates. Summing GVA of all firms gives the country's GDP, which avoids double-counting the same potato twice.

Market Price (MP) vs Factor Cost (FC)

Market price is what you pay in the shop (it includes taxes). Factor cost is what producers actually earn (taxes removed, subsidies added). Bridge formula: $FC = MP - \text{Indirect Tax} + \text{Subsidy}$, and $MP = FC + \text{Indirect Tax} - \text{Subsidy}$.
 Net Indirect Tax (NIT) = Indirect Tax - Subsidy.

The big aggregates

GDP (Gross Domestic Product) = value of all final goods and services made INSIDE the country in a year. GNP = GDP + Net Factor Income from Abroad (NFIA). NDP = GDP - Depreciation. NNP = GNP - Depreciation. National Income (NI) = NNP at factor cost.

NFIA and Per Capita Income

NFIA = income Indians earn abroad MINUS income foreigners earn in India. Per Capita Income (PCI) = National Income / total population - the average income of a citizen.

Nominal vs Real GDP

Nominal GDP is measured at current (this year's) prices, so inflation inflates it. Real GDP is measured at base-year prices, so it removes inflation and shows true growth. Current base year: 2011-12.

Three ways to calculate GDP

1) Income method - add up all factor incomes (wages, rent, interest, profit). 2) Expenditure method - $GDP = C + I + G$

+ Nx (Consumption + Investment + Government spending + Net exports). 3) Production/Output method - add up value added by every sector.

Related ideas you must know

IIP (Index of Industrial Production) tracks growth of mining, manufacturing, electricity etc.; compiled by NSO (earlier CSO); base year 2011-12. Eight Core Industries (remember C3FERNS) make up about 40.27% of IIP. PPP (Purchasing Power Parity) compares what money can actually buy across countries. Green GDP subtracts the cost of environmental damage. Transfer payments (pension, scholarship) are EXCLUDED from GDP because nothing new is produced in return.

The value-added chain (how a firm's receipts become profit)

Step	Formula	Meaning
1	$TR - IC = GVA(MP)$	New value created at market price
2	$GVA(MP) - NIT = GVA(FC)$	Remove net indirect tax
3	$GVA(FC) - \text{Depreciation} = NVA(FC)$	Net value added at factor cost
4	$NVA(FC) - COE = GOS$	Remove employee pay, get operating surplus
5	$GOS - \text{Primary Cost} = PBT$	Profit before tax
6	$PBT - \text{Corporate Tax} = PAT$	Profit after tax

Key national-income formulas

Aggregate	Formula
GDP (expenditure)	$C + I + G + Nx$
GNP	$GDP + NFIA$
NDP	$GDP - \text{Depreciation}$
NNP	$GNP - \text{Depreciation}$
National Income (NI)	$NNP \text{ at Factor Cost} = NNP(MP) - NIT$
FC ↔ MP	$FC = MP - IT + \text{Subsidy}$
Per Capita Income	$\text{National Income} / \text{Population}$

Eight Core Industries - C3FERNS

Letter	Industry
C, C, C	Coal, Cement, Crude Oil
F	Fertiliser
E	Electricity
R	Refinery Products
N	Natural Gas
S	Steel

APSC Exam Tips

Score boosters

- Learn the GVA chain in order - APSC can give you numbers and ask for any missing step.
- $GNP = GDP + NFIA$ and $NNP = GNP - \text{Depreciation}$ are the two bridges that unlock most numericals.
- Simon Kuznets developed the modern GDP concept (1934); base year is 2011-12; IIP is by NSO.
- Remember what is EXCLUDED from GDP: second-hand sales and transfer payments (pension, scholarship).

Quick Revision**National Income Accounting - recap**

- $GVA = TR - IC$; sum of GVA = GDP (no double counting).
- $GNP = GDP + NFIA$; $NDP = GDP - \text{Dep}$; $NNP = GNP - \text{Dep}$; $NI = NNP(FC)$.
- $FC = MP - IT + \text{Subsidy}$; $NIT = IT - \text{Subsidy}$.
- Real GDP = base-year prices (2011-12); Nominal = current prices.
- Three methods: Income, Expenditure ($C+I+G+N_x$), Production.
- Core industries = C3FERNs (~40.27% of IIP).

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CHAPTER 4

Government Budget

What it means

The Union Budget is the government's yearly financial statement - an estimate of how much money it will earn (receipts) and how much it will spend (expenditure) in the coming financial year (1 April to 31 March).

In simple words

It is exactly like your household's yearly plan: 'this much will come in from salary, this much I will spend on rent, food and savings.' The government just does it for 140 crore people, and Parliament must approve it.

Key concepts

A little history

India's first budget was presented in 1860 by James Wilson. P.C. Mahalanobis is the architect of India's planned economy (the Second Five Year Plan model) and a giant of Indian statistics and economic planning.

When is the budget presented

Since 2017 the Finance Minister presents it on 1 February (earlier it was the last working day of February). The 2017-18 reforms also merged the Railway Budget into the main budget, scrapped the plan/non-plan expenditure split, and removed the separate vote-on-account practice.

Two parts of the budget

Revenue Budget - day-to-day earning and spending (salaries, bus fares, interest). Capital Budget - money that creates assets or pays off liabilities (roads, buildings, loans). Capital budget is 'productive'; much of the revenue budget is 'unproductive' running cost.

Receipts and expenditure

Revenue receipts (tax + non-tax) do NOT create a liability or reduce assets. Capital receipts (borrowings, disinvestment, loan recovery) DO create a liability or reduce assets - split into debt and non-debt. External debt is managed by the Finance Ministry; internal debt by the RBI.

Six stages of the budget in Parliament

1) Presentation by the FM with the budget speech in Lok Sabha. 2) General discussion. 3) Scrutiny by 24 departmental standing committees. 4) Voting on demands for grants (only Lok Sabha votes; cut motions can be moved). 5) Passing of the Appropriation Bill (authorises spending). 6) Passing of the Finance Bill (authorises taxation).

Cut motions (a tool of MPs)

A cut motion reduces a demand for grants. Policy cut - reduce the demand to Rs 1 (disapproval of policy). Economy cut - reduce by a stated amount. Token cut - reduce by Rs 100 (to air a specific grievance).

Revenue Budget vs Capital Budget

Basis	Revenue Budget	Capital Budget
Nature	Day-to-day	Asset/liability changing

Receipts	Tax + non-tax	Borrowings, disinvestment, loan recovery
Creates asset?	No	Yes (productive)
Example spend	Salary, pension, interest	Roads, buildings, machinery

Appropriation Bill vs Finance Bill

Point	Appropriation Bill	Finance Bill
Deals with	Spending (expenditure)	Taxes (income side)
Amendments	Not allowed	Allowed
Becomes law by	President's assent	Completes budget enactment

APSC Exam Tips

Score boosters

- 1860 - James Wilson - first budget; 1 February since 2017 - all favourite APSC facts.
- Order of the six stages is frequently asked as a sequencing question - memorise it.
- Cut motions: Policy=Rs 1, Token=Rs 100, Economy=specified amount.
- Only Lok Sabha votes on demands for grants - a classic polity-economy crossover point.

Quick Revision

Government Budget - recap

- Budget = yearly statement of receipts + expenditure; FY = 1 Apr-31 Mar.
- First budget 1860 (James Wilson); presented 1 Feb since 2017.
- Revenue budget = day-to-day; Capital budget = asset/liability.
- 6 stages: Presentation, Discussion, Committees, Voting, Appropriation Bill, Finance Bill.
- Cut motions: Policy=Rs 1, Economy=specified, Token=Rs 100.

CHAPTER 5

Taxation

What it means

Taxes are the main way the government earns money to run the country. They are split into direct taxes (you pay them yourself) and indirect taxes (hidden in the price of things you buy).

In simple words

When income tax is cut from your salary, you feel it directly - that's a direct tax. When you buy a cold drink, a part of the price is GST that the shop collects and passes on - you paid a tax without even noticing. That's an indirect tax.

Key concepts

Direct tax

Paid by the very person on whom it is levied - the burden CANNOT be shifted to anyone else. Examples: income tax, corporation tax, and the now-abolished wealth tax (scrapped in 2015) and gift tax.

Indirect tax

Levied on goods and services; the burden CAN be shifted to the final consumer. Examples: GST, customs duty, excise duty. Key point: GST has subsumed (absorbed) almost all indirect taxes EXCEPT customs duty.

Tax revenue vs Non-tax revenue

Tax revenue is charged on income (direct) or on transactions of goods and services (indirect) - paying it is compulsory. Non-tax revenue is charged only when you USE a government service - examples: passport fee, driving licence fee, electricity and water bills, exam fees, dividends from PSUs.

Direct tax vs Indirect tax

Basis	Direct Tax	Indirect Tax
Burden shift	Cannot be shifted	Can be shifted to consumer
Levied on	Income/wealth	Goods and services
Examples	Income tax, corporation tax	GST, customs, excise
Paid by	The taxpayer himself	Ultimately the final buyer

APSC Exam Tips

Score boosters

- 'Burden can/cannot be shifted' is THE line that separates indirect from direct tax in statement questions.
- GST subsumed all indirect taxes except customs duty - a very common trap.
- Wealth tax was abolished in 2015 - watch for it being listed as a 'current' tax (it's wrong).
- Non-tax revenue = you pay only when you use a service (passport, licence).

Quick Revision

Taxation - recap

- Direct tax: burden not shiftable (income tax, corporation tax).
- Indirect tax: burden shiftable (GST, customs, excise).
- GST subsumed all indirect taxes except customs duty.
- Non-tax revenue: passport, licence, fees, PSU dividends.

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CHAPTER 6

Deficits and Deficit Financing

What it means

When the government spends more than it earns, the gap is called a deficit. How big that gap is, and how the government fills it, tells us a lot about the country's financial health.

In simple words

If your monthly expenses are bigger than your income, you face a 'deficit' and must borrow or dip into savings. The government is no different - it borrows from the market, from the RBI, or from abroad to cover the gap.

Key concepts

Three kinds of budget

Balanced Budget: Total Expenditure = Total Receipts. Surplus Budget: Receipts > Expenditure (rare). Deficit Budget: Expenditure > Receipts (most common for developing countries that need to spend on growth).

Budget deficit and monetized deficit (mostly historical)

Budget deficit = Total Budgeted Expenditure - Total Budgeted Receipts. Monetized deficit = the part financed by the RBI printing fresh notes. Both concepts were discontinued in India from the 1997-98 budget.

Deficit financing

Filling the gap using OUTSIDE resources - printing fresh currency or borrowing. Money printed by the RBI is called high-powered money or reserve money. Printing is the LAST resort, used only when the government can no longer borrow cheaply.

Effective Revenue Deficit (ERD)

ERD = Revenue Expenditure - Grants given to states for creating assets. Idea: grants that states use to build productive assets should not be counted as a 'bad' deficit. Introduced in the 2011 budget by then FM Pranab Mukherjee.

How the government finances a deficit

1) Taxation - collect more. 2) Borrowing - internal debt (market, RBI, banks) or external debt (foreign governments, institutions, NRI deposits). 3) Printing money - last resort. A failure to repay sovereign debt is called a Sovereign Default.

Why deficits matter

Heavy borrowing can trap the government in debt, push up interest rates, and cause a 'crowding out' effect - too little money left in the market for private businesses. But public debt is GOOD if the borrowed money builds assets and creates jobs.

Budget types

Type	Condition	Typical case
Balanced	TE = TR	Ideal, hard to achieve

Surplus	$TR > TE$	Rare, strong economy
Deficit	$TE > TR$	Common in developing nations

APSC Exam Tips

Score boosters

- ERD = Revenue Expenditure - Grants; introduced 2011 by Pranab Mukherjee - exam gold.
- Budget deficit and monetized deficit were dropped in 1997-98 - a frequent 'odd one out' fact.
- Crowding out = government borrowing leaves too little credit for private players.
- High-powered money / reserve money = money printed by the RBI.

Quick Revision

Deficits and Deficit Financing - recap

- Balanced ($TE=TR$), Surplus ($TR>TE$), Deficit ($TE>TR$).
- Budget & monetized deficit discontinued 1997-98.
- Deficit financing = printing money or borrowing; printing = last resort.
- ERD = Revenue Expenditure - Grants (2011, Pranab Mukherjee).
- Crowding out + debt trap = risks of heavy borrowing.

CHAPTER 7

Fiscal Policy

What it means

Fiscal policy is the government's plan for taxing and spending. By deciding how much to tax and how much to spend, the government steers the speed of the whole economy. It is run by the Finance Ministry.

In simple words

If the economy is sleepy (recession), the government can cut taxes and spend more, putting money in people's pockets so they buy more - like giving the economy an energy drink. If prices are rising too fast (inflation), it does the opposite to cool things down.

Key concepts

Objectives of fiscal policy

1) Economic growth - raise national and per capita income. 2) Price stability - control inflation. 3) Capital formation - boost investment to break the poverty cycle. 4) Resource allocation - direct spending to social infrastructure. 5) Reducing inequality - tax the rich more, protect the poor (redistribution).

Three types of fiscal policy

Balanced (TR = TE) - neutral effect, but no cure for recession or unemployment. Expansionary - LOWER taxes, MORE government spending - used to fight recession and create jobs. Contractionary - HIGHER taxes, LESS spending - used to fight inflation by reducing demand.

FRBM Act, 2003

The Fiscal Responsibility and Budget Management Act gave legal teeth to fiscal discipline - its main aim was to wipe out the revenue deficit and bring down the fiscal deficit. Three statements must be tabled with the budget: Macro-economic Framework, Medium-term Fiscal Policy, and Fiscal Policy Strategy. It was relaxed in 2008-09 because of the global recession.

N.K. Singh Committee (2016)

Set up to review the FRBM Act. It recommended targeting a fiscal deficit of 3% of GDP, with a glide path to lower it further in later years.

Fiscal stimulus

A package of tax rebates and extra spending to pull the economy out of a crisis. India used a stimulus in 2008-09 against the US recession, and a Rs 20 lakh crore package in May 2020 against the COVID-19 shock.

Expansionary vs Contractionary fiscal policy

Tool	Expansionary	Contractionary
Tax rate	Decrease	Increase
Govt spending	Increase	Decrease
Used to fight	Recession / unemployment	Inflation

Effect on demand

Raises demand

Lowers demand

APSC Exam Tips

Score boosters

- Expansionary = cut taxes + spend more (fights recession); reverse it for contractionary.
- FRBM 2003 - aim to remove revenue deficit and cut fiscal deficit; relaxed 2008.
- N.K. Singh Committee (2016) - 3% fiscal deficit target.
- Stimulus years to remember: 2008-09 (US recession) and 2020 (COVID, Rs 20 lakh crore).

Quick Revision

Fiscal Policy - recap

- Fiscal policy = taxing + spending, run by Finance Ministry.
- Expansionary: low tax, high spend (recession); Contractionary: high tax, low spend (inflation).
- FRBM Act 2003: kill revenue deficit, cut fiscal deficit.
- N.K. Singh Committee 2016: 3% of GDP fiscal-deficit target.
- Stimulus: 2008-09 and 2020 (Rs 20 lakh crore).

CHAPTER 8

Monetary Policy

What it means

Monetary policy is the RBI's plan to manage the supply of money in the economy. Its main purpose is to control inflation while still allowing growth. Where fiscal policy uses taxes and spending, monetary policy uses money supply and interest rates.

In simple words

Think of money in the economy like water in a tank. If there's too much water (money), prices rise (inflation), so the RBI tightens the tap by raising interest rates. If there's too little, growth slows, so it opens the tap by lowering rates.

Key concepts

What happens when money supply falls

Inflation goes down, interest rates go up, and credit (loans) becomes harder to get. The opposite happens when money supply rises. This is the central lever the RBI pulls.

Objectives of monetary policy

1) Accelerate growth by keeping enough liquidity. 2) Price stability - the primary goal, controlling inflation. 3) Exchange-rate stability - prevent wild swings of the rupee against the dollar. 4) Balance saving and investment through interest rates. 5) Generate employment via cheaper loans for priority sectors (agriculture, small industry).

Two types of monetary policy

Expansionary (easy money) - INCREASE money supply, LOWER interest rates to boost growth. Contractionary (tight money) - DECREASE money supply, RAISE interest rates to curb inflation.

Fiscal vs Monetary - don't confuse them

Fiscal policy = government (Finance Ministry), uses taxes and spending. Monetary policy = RBI, uses money supply and interest rates. Both aim for growth with stable prices, but with different tools.

Expansionary vs Contractionary monetary policy

Lever	Expansionary	Contractionary
Money supply	Increase	Decrease
Interest rate	Decrease	Increase
Goal	Boost growth	Control inflation

Fiscal policy vs Monetary policy

Basis	Fiscal Policy	Monetary Policy
Run by	Finance Ministry (Govt)	RBI
Tools	Taxes, spending	Money supply, interest rates
Main aim	Growth + equity	Price stability + growth

APSC Exam Tips

Score boosters

- If money supply falls: inflation down, interest up, credit tight - remember the chain.
- Price stability is the PRIMARY objective of monetary policy - a common single-answer fact.
- Match the policy to its owner: fiscal=Finance Ministry, monetary=RBI.
- Expansionary = more money + lower rates; contractionary = less money + higher rates.

Quick Revision

Monetary Policy - recap

- Monetary policy = RBI managing money supply to control inflation.
- Money supply down => inflation down, interest up, credit tight.
- Primary objective = price stability.
- Expansionary: more money, lower rates; Contractionary: less money, higher rates.
- Fiscal=Govt/taxes-spending; Monetary=RBI/money-rates.

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REFERENCE

Important Definitions

Crisp, exam-ready definitions of the core terms in this volume.

GDP (Gross Domestic Product)	Money value of all final goods and services produced inside a country in a year.
GNP (Gross National Product)	GDP + Net Factor Income from Abroad; output by a country's citizens anywhere.
NDP	GDP minus depreciation (wear and tear of capital).
NNP	GNP minus depreciation.
National Income	NNP measured at factor cost.
NFIA	Income earned by residents abroad minus income earned by foreigners at home.
Per Capita Income	National Income divided by total population - average income per person.
GVA (Gross Value Added)	Total receipts minus intermediate cost - the new value a firm creates.
Market Price	Price paid in the market, including indirect taxes.
Factor Cost	Earnings of producers after removing taxes and adding subsidies.
Depreciation	Fall in value of machinery and assets due to use and age.
Real GDP	GDP at constant (base-year) prices, adjusted for inflation.
Nominal GDP	GDP at current-year prices, not adjusted for inflation.
PPP (Purchasing Power Parity)	Theory that money should buy the same basket of goods across countries.
Green GDP	GDP after subtracting the cost of environmental damage.
Fiscal Policy	Government's policy of taxation and spending to steer the economy.
Monetary Policy	RBI's policy of managing money supply and interest rates.
Budget	Yearly statement of the government's estimated receipts and expenditure.
Direct Tax	Tax whose burden cannot be shifted (e.g. income tax).
Indirect Tax	Tax whose burden can be shifted to the consumer (e.g. GST).
Fiscal Deficit	Excess of total expenditure over total receipts (excluding borrowings).
Effective Revenue Deficit	Revenue expenditure minus grants used by states to create assets.
Deficit Financing	Filling the budget gap by printing money or borrowing.
Transfer Payment	Government payment with no good/service produced in return (pension, scholarship).
Crowding Out	Private investment squeezed because government borrowing absorbs available credit.

GLOSSARY

Important Economic Terms

A quick glossary of economic terms an APSC aspirant must know.

Laissez-faire	A free-market system with minimum government interference.
Administered Price	A price fixed by the government rather than by the market.
Command Economy	Another name for a fully state-controlled (socialist) economy.
Mixed Economy	An economy blending private and government ownership (e.g. India).
IIP	Index of Industrial Production - tracks output of mining, manufacturing, electricity.
Core Industries	Eight key industries (C3FERNS) making up about 40.27% of the IIP.
CSO / NSO	Statistics body that compiles IIP; CSO has been merged into the NSO.
Sovereign Default	When a government fails or refuses to repay its debt.
High-Powered Money	Reserve money created (printed) by the RBI.
Cut Motion	A parliamentary device to reduce a demand for grants.
Appropriation Bill	Bill that authorises government spending from the Consolidated Fund.
Finance Bill	Bill that gives effect to the government's tax proposals.
Vote on Account	Advance approval for spending; removed in the 2017-18 reforms.
Disinvestment	Government selling its stake in public-sector companies.
Internal Debt	Government borrowing within the country (managed by RBI).
External Debt	Government borrowing from abroad (managed by Finance Ministry).
Revenue Receipts	Income that creates no liability and reduces no asset.
Capital Receipts	Receipts that create a liability or reduce an asset (e.g. borrowings).
Fiscal Stimulus	A relief package of tax cuts and extra spending to revive the economy.
Liquidity	How easily money/assets are available in the economy.
Subsidy	Financial help from the government to lower the price of a good/service.
Net Indirect Tax (NIT)	Indirect Tax minus Subsidy.
Gross Operating Surplus	Profit-type income left after paying employees, in the GVA chain.
Base Year	The reference year (currently 2011-12) used to measure real values.
FRBM Act	2003 law to enforce fiscal discipline and cut deficits.

REVISION

Quick Revision Notes

The fastest pass over every chapter - ideal for the day before the exam.

1. Understanding Economics

- Economics = study of managing scarce resources; Economy = the real working system.
- Adam Smith = Father of Economics; Wealth of Nations (1776).
- Economy pillars: Tantra (system), Yantra (structure), Mantra (mechanism).
- Regulators (RBI, SEBI, IRDAI, TRAI, PFRDA) = supportive structure.

2. Economic Systems

- Capitalism: private ownership, market prices, least control (USA).
- Socialism: state ownership, administered prices, full control (North Korea).
- Mixed: blend, selective licensing (India).
- Keywords: laissez-faire=capitalism, command economy=socialism.

3. National Income Accounting

- $GVA = TR - IC$; sum of GVA = GDP (no double counting).
- $GNP = GDP + NFIA$; $NDP = GDP - Dep$; $NNP = GNP - Dep$; $NI = NNP(FC)$.
- $FC = MP - IT + Subsidy$; $NIT = IT - Subsidy$.
- Real GDP = base-year prices (2011-12); Nominal = current prices.
- Three methods: Income, Expenditure (C+I+G+N_x), Production.
- Core industries = C3FERNs (~40.27% of IIP).

4. Government Budget

- Budget = yearly statement of receipts + expenditure; FY = 1 Apr-31 Mar.
- First budget 1860 (James Wilson); presented 1 Feb since 2017.
- Revenue budget = day-to-day; Capital budget = asset/liability.
- 6 stages: Presentation, Discussion, Committees, Voting, Appropriation Bill, Finance Bill.
- Cut motions: Policy=Re 1, Economy=specified, Token=Rs 100.

5. Taxation

- Direct tax: burden not shiftable (income tax, corporation tax).
- Indirect tax: burden shiftable (GST, customs, excise).
- GST subsumed all indirect taxes except customs duty.
- Non-tax revenue: passport, licence, fees, PSU dividends.

6. Deficits and Deficit Financing

- Balanced ($TE=TR$), Surplus ($TR>TE$), Deficit ($TE>TR$).
- Budget & monetized deficit discontinued 1997-98.
- Deficit financing = printing money or borrowing; printing = last resort.
- ERD = Revenue Expenditure - Grants (2011, Pranab Mukherjee).
- Crowding out + debt trap = risks of heavy borrowing.

7. Fiscal Policy

- Fiscal policy = taxing + spending, run by Finance Ministry.
- Expansionary: low tax, high spend (recession); Contractionary: high tax, low spend (inflation).
- FRBM Act 2003: kill revenue deficit, cut fiscal deficit.
- N.K. Singh Committee 2016: 3% of GDP fiscal-deficit target.
- Stimulus: 2008-09 and 2020 (Rs 20 lakh crore).

8. Monetary Policy

- Monetary policy = RBI managing money supply to control inflation.
- Money supply down => inflation down, interest up, credit tight.
- Primary objective = price stability.
- Expansionary: more money, lower rates; Contractionary: less money, higher rates.
- Fiscal=Govt/taxes-spending; Monetary=RBI/money-rates.

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CONCEPTS

Frequently Asked Concepts

Twenty conceptual doubts APSC aspirants often raise, answered simply.

Q1. Why do we use GVA instead of just adding up sales?

A. Because adding every firm's sales would count the same potato many times. GVA (receipts minus intermediate cost) counts only the NEW value each firm adds, avoiding double counting.

Q2. What is the difference between GDP and GNP?

A. GDP counts output produced INSIDE the country; GNP counts output by the country's CITIZENS anywhere.
 $GNP = GDP + NFIA$.

Q3. Why is real GDP better than nominal GDP for measuring growth?

A. Nominal GDP rises just because prices rise. Real GDP uses fixed base-year prices, so it shows the true rise in quantity of goods, not inflation.

Q4. Why are transfer payments excluded from GDP?

A. Pensions and scholarships are not payments for any newly produced good or service, so including them would overstate production.

Q5. How is market price different from factor cost?

A. Market price includes indirect taxes (what you pay in the shop); factor cost is what producers actually receive ($FC = MP - IT + Subsidy$).

Q6. What separates a direct tax from an indirect tax?

A. Whether the burden can be shifted. Direct tax (income tax) stays with the payer; indirect tax (GST) is passed on to the final consumer.

Q7. Did GST replace all indirect taxes?

A. Almost - GST subsumed nearly every indirect tax EXCEPT customs duty.

Q8. What is the difference between fiscal and monetary policy?

A. Fiscal policy is the government's taxing-and-spending plan (Finance Ministry); monetary policy is the RBI's money-supply-and-interest-rate plan.

Q9. When does the government use expansionary policy?

A. During a recession - it cuts taxes and spends more (fiscal) or increases money supply and lowers rates (monetary) to boost demand and jobs.

Q10. What is the crowding-out effect?

A. When heavy government borrowing soaks up available credit, leaving too little (and costlier) credit for private businesses.

Q11. Why is public debt not always bad?

A. If the borrowed money builds productive assets and creates employment, it grows the economy and is beneficial.

Q12. What is the Effective Revenue Deficit?

A. Revenue expenditure minus grants that states use to create assets - it removes 'productive' grants from the revenue-deficit figure.

Q13. What are the eight core industries?

A. Coal, Cement, Crude Oil, Fertiliser, Electricity, Refinery Products, Natural Gas, Steel (C3FERNS) - about 40.27% of the IIP.

Q14. Who runs and presents the budget, and when?

A. The Finance Ministry prepares it and the Finance Minister presents it in Lok Sabha on 1 February (since 2017).

Q15. What is the role of the Appropriation Bill vs the Finance Bill?

A. Appropriation Bill authorises spending; Finance Bill authorises taxes. Together they complete the budget's legal enactment.

Q16. What is a mixed economy and why did India choose it?

A. A blend of private and government ownership with selective state control - India chose it to combine market efficiency with social justice.

Q17. What does the RBI do when inflation is high?

A. It runs a contractionary (tight money) policy - reducing money supply and raising interest rates to cool demand.

Q18. What is deficit financing?

A. Covering the budget gap with outside resources - printing fresh money (last resort) or borrowing.

Q19. Why was the FRBM Act passed?

A. To enforce fiscal discipline - mainly to eliminate the revenue deficit and bring down the fiscal deficit.

Q20. What is Purchasing Power Parity used for?

A. To compare living standards across countries by checking how much identical goods cost in each, instead of just using exchange rates.

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SUMMARY

Exam-Oriented Summary

Every must-remember fact of this volume, distilled into one place.

- Economics = study of scarce resources; Adam Smith (1776, Wealth of Nations) is its father.
- India = mixed economy (private + government + selective licensing).
- $GVA = TR - IC$; sum of GVA = GDP (avoids double counting).
- $GNP = GDP + NFIA$; $NDP = GDP - Dep$; $NNP = GNP - Dep$; $NI = NNP$ at factor cost.
- $FC = MP - Indirect\ Tax + Subsidy$; $NIT = IT - Subsidy$.
- Real GDP uses base year 2011-12; three methods: Income, Expenditure (C+I+G+N_x), Production.
- Core industries = C3FERNS (~40.27% of IIP); IIP now compiled by NSO.
- Budget: first in 1860 (James Wilson); presented 1 Feb since 2017; FY 1 Apr-31 Mar.
- Six budget stages end with the Appropriation Bill (spending) and Finance Bill (taxes).
- Direct tax burden can't shift; indirect tax can; GST subsumed all but customs duty.
- ERD = Revenue Expenditure - Grants (2011, Pranab Mukherjee); budget & monetized deficit dropped 1997-98.
- Fiscal policy = Finance Ministry (taxes/spending); FRBM 2003; N.K. Singh Committee 2016 (3% target).
- Monetary policy = RBI (money supply/interest); primary aim = price stability.
- Expansionary fights recession (cut taxes / more money); contractionary fights inflation.

LAST-MINUTE

Final Revision Section

One-line triggers for the last 30 minutes before the exam.

Rapid-fire recall

- Oikos + Nomos = household management = Economics.
- Tantra (system) / Yantra (structure) / Mantra (mechanism).
- Capitalism=USA, Socialism=North Korea, Mixed=India.
- GDP modern concept: Simon Kuznets, 1934.
- GDP (expenditure) = C + I + G + Nx.
- GNP = GDP + NFIA.
- Per Capita Income = National Income / Population.
- Eight core industries = C3FERNS, ~40.27% of IIP, base 2011-12.
- Wealth tax abolished 2015; GST spared only customs duty.
- Budget presented 1 February since the 2017-18 reforms.
- Railway budget merged with Union budget in 2017.
- Cut motions: Policy=Re 1, Economy=fixed amount, Token=Rs 100.
- Only Lok Sabha votes on demands for grants.
- Internal debt = RBI; External debt = Finance Ministry.
- High-powered money = reserve money printed by RBI.
- FRBM Act 2003; relaxed 2008; N.K. Singh Committee 2016 (3% of GDP).
- COVID stimulus: Rs 20 lakh crore, May 2020.
- Money supply down => inflation down, interest up, credit tight.

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PRELIMS PRACTICE
APSC-Style MCQs (with answers)

35 statement-based, conceptual and analytical MCQs - the modern APSC pattern. Each has four options, the correct answer, a full explanation and a difficulty rating.

Q1. Consider the following statements about the word 'economics':

MEDIUM

1. It is derived from the Greek words 'Oikos' and 'Nomos'.
2. 'Oikos' means law or custom while 'Nomos' means household.

Which is/are correct?

- (A) 1 only
- (B) 2 only
- (C) Both 1 and 2
- (D) Neither 1 nor 2

Answer: (A) 1 only

Explanation: Statement 1 is correct. In Statement 2 the meanings are swapped - 'Oikos' means household and 'Nomos' means law/custom. So only 1 is correct.

Q2. Which one of the following best distinguishes 'economics' from 'an economy'?

EASY

- (A) Economics is the real system; economy is the theory
- (B) Economics is the theory/study; economy is the theory applied in practice
- (C) Both mean exactly the same thing
- (D) Economics deals only with money; economy deals only with goods

Answer: (B) Economics is the theory/study; economy is the theory applied in practice

Explanation: Economics is the academic study of production, distribution and consumption. The economy is that theory in action - the actual working system of a region.

Q3. With reference to economic systems, consider:

MEDIUM

1. Under capitalism prices are determined by the market.
2. Under socialism the price mechanism is administered by the state.
3. A mixed economy uses selective licensing.

Which are correct?

- (A) 1 and 2 only
- (B) 2 and 3 only
- (C) 1 and 3 only
- (D) 1, 2 and 3

Answer: (D) 1, 2 and 3

Explanation: All three are correct. Market prices = capitalism, administered prices = socialism, and selective licensing is a hallmark of a mixed economy like India.

Q4. 'Laissez-faire' is most closely associated with which economic system?

EASY

- (A) Socialism
- (B) Capitalism
- (C) Mixed economy
- (D) Command economy

Answer: (B) Capitalism

Explanation: Laissez-faire means minimum government interference, the defining idea of capitalism / a free-market economy.

Q5. In the framework Tantra-Yantra-Mantra, the regulators RBI, SEBI and IRDAI form part of which element?

HARD

- (A) Tantra - the system
- (B) Yantra - the supportive structure
- (C) Mantra - the mechanism
- (D) None of these

Answer: (B) Yantra - the supportive structure

Explanation: Yantra is the structure of the economy; regulators like RBI, SEBI, IRDAI, TRAI and PFRDA are the supportive part of that structure overseeing strategic sectors.

Q6. Consider the value-added chain. If Total Receipts = 1000 and Intermediate Cost = 400, the Gross Value Added at market price is:

EASY

- (A) 1400
- (B) 600
- (C) 400
- (D) 1000

Answer: (B) 600

Explanation: $GVA(MP) = \text{Total Receipts} - \text{Intermediate Cost} = 1000 - 400 = 600$.

Q7. Which equation correctly links Gross National Product to Gross Domestic Product?

MEDIUM

- (A) $GNP = GDP - NFIA$
- (B) $GNP = GDP + NFIA$
- (C) $GNP = GDP - \text{Depreciation}$
- (D) $GNP = GDP + \text{Indirect Tax}$

Answer: (B) $GNP = GDP + NFIA$

Explanation: $GNP = GDP + \text{Net Factor Income from Abroad (NFIA)}$. NFIA is positive when residents earn more abroad than foreigners earn at home.

Q8. Consider the following:

HARD

1. $NDP = GDP - \text{Depreciation}$.
2. $NNP = GNP - \text{Depreciation}$.
3. $\text{National Income} = NNP$ at market price.

Which statements are correct?

- (A) 1 and 2 only
- (B) 2 and 3 only
- (C) 1 and 3 only
- (D) 1, 2 and 3

Answer: (A) 1 and 2 only

Explanation: Statements 1 and 2 are correct. Statement 3 is wrong - National Income is NNP at FACTOR COST, not market price.

Q9. The relationship between market price (MP) and factor cost (FC) is given by:

MEDIUM

- (A) $FC = MP + \text{Indirect Tax} - \text{Subsidy}$
- (B) $FC = MP - \text{Indirect Tax} + \text{Subsidy}$
- (C) $FC = MP - \text{Subsidy} + \text{Direct Tax}$
- (D) $FC = MP + \text{Subsidy} + \text{Indirect Tax}$

Answer: (B) $FC = MP - \text{Indirect Tax} + \text{Subsidy}$

Explanation: Factor cost removes indirect taxes and adds back subsidies: $FC = MP - \text{Indirect Tax} + \text{Subsidy}$.

Q10. Which of the following is NOT included while calculating GDP?

HARD

- (A) Value added by a new car factory
- (B) Services of a property agent on a resale
- (C) A government pension payment
- (D) Output of a software firm

Answer: (C) A government pension payment

Explanation: Pensions are transfer payments - no new good or service is produced in return, so they are excluded from GDP. (The agent's service on a resale IS counted, even though the second-hand good itself is not.)

Q11. The modern concept of GDP is credited to whom, and in which year?

MEDIUM

- (A) Adam Smith, 1776
- (B) Simon Kuznets, 1934
- (C) J.M. Keynes, 1936
- (D) P.C. Mahalanobis, 1955

Answer: (B) Simon Kuznets, 1934

Explanation: Simon Kuznets developed the modern concept of GDP in 1934.

Q12. With reference to Real and Nominal GDP, consider:

MEDIUM

1. Nominal GDP is measured at current prices.
2. Real GDP is measured at base-year prices.
3. The current base year in India is 2011-12.

Which are correct?

- (A) 1 and 2 only
- (B) 1 and 3 only
- (C) 2 and 3 only
- (D) 1, 2 and 3

Answer: (D) 1, 2 and 3

Explanation: All three are correct. Real GDP strips out inflation by using base-year (2011-12) prices, while nominal GDP uses current prices.

Q13. The eight core industries are remembered by 'C3FERNS'. Which of these is NOT one of them?

EASY

- (A) Fertiliser
- (B) Natural Gas
- (C) Automobiles
- (D) Refinery Products

Answer: (C) Automobiles

Explanation: Automobiles are not a core industry. The eight are Coal, Cement, Crude Oil, Fertiliser, Electricity, Refinery Products, Natural Gas and Steel.

Q14. The Index of Industrial Production (IIP) is currently compiled by which body?

MEDIUM

- (A) RBI
- (B) NITI Aayog
- (C) NSO (formerly CSO)
- (D) Ministry of Finance

Answer: (C) NSO (formerly CSO)

Explanation: The IIP is compiled by the National Statistical Office (NSO), into which the earlier Central Statistical Office (CSO) was merged.

Q15. Three methods of calculating GDP are income, expenditure and production. Under the expenditure method, GDP equals:

EASY

- (A) $C + I + G + Nx$
- (B) Wages + Rent + Interest + Profit
- (C) Sum of value added by all sectors
- (D) $TR - IC$ for one firm

Answer: (A) $C + I + G + Nx$

Explanation: The expenditure method sums all final spending: Consumption (C) + Investment (I) + Government spending (G) + Net exports (Nx).

Q16. Consider the following about India's Union Budget:

MEDIUM

1. The first budget was presented in 1860 by James Wilson.
2. Since 2017 it is presented on 1 February.
3. The Railway Budget was merged with it in 2017.

Which are correct?

- (A) 1 and 2 only
- (B) 2 and 3 only
- (C) 1 and 3 only
- (D) 1, 2 and 3

Answer: (D) 1, 2 and 3

Explanation: All three are correct - all were part of the budget's history and the 2017-18 reforms.

Q17. Which of the following was NOT a reform introduced in the Union Budget 2017-18?

HARD

- (A) Advancing the budget date to 1 February
- (B) Merging the Railway Budget with the general budget
- (C) Introducing the plan/non-plan expenditure classification
- (D) Removing the vote-on-account practice

Answer: (C) Introducing the plan/non-plan expenditure classification

Explanation: The 2017-18 reforms ELIMINATED the plan/non-plan distinction, they did not introduce it. The other three are genuine reforms.

Q18. Arrange the budget stages in correct order:

HARD

- A. Voting on demands for grants
- B. General discussion
- C. Passing of the Finance Bill
- D. Presentation of the budget

- (A) D-B-A-C
- (B) B-D-A-C
- (C) D-A-B-C
- (D) D-B-C-A

Answer: (A) D-B-A-C

Explanation: Correct order: Presentation (D) -> General discussion (B) -> (committee scrutiny) -> Voting on demands (A) -> Appropriation Bill -> Finance Bill (C).

Q19. Match the cut motion with its effect:

HARD

1. Policy cut 2. Token cut 3. Economy cut

- (A) 1->Re 1, 2->Rs 100, 3->specified amount
- (B) 1->Rs 100, 2->Re 1, 3->specified amount
- (C) 1->specified amount, 2->Re 1, 3->Rs 100
- (D) 1->Re 1, 2->specified amount, 3->Rs 100

Answer: (A) 1->Re 1, 2->Rs 100, 3->specified amount

Explanation: Policy cut reduces the demand to Re 1, Token cut reduces it by Rs 100, and Economy cut reduces it by a specified amount.

Q20. With reference to the Appropriation Bill, consider:

HARD

1. It authorises government expenditure.
2. Amendments can be freely moved to it.
3. It becomes an Act with the President's assent.

Which are correct?

- (A) 1 and 2 only
- (B) 1 and 3 only
- (C) 2 and 3 only
- (D) 1, 2 and 3

Answer: (B) 1 and 3 only

Explanation: Statements 1 and 3 are correct. Statement 2 is wrong - no amendments can be proposed to the Appropriation Bill.

Q21. Which statement about direct and indirect taxes is correct?

EASY

- (A) The burden of a direct tax can be shifted to another person
- (B) The burden of an indirect tax cannot be shifted
- (C) The burden of a direct tax cannot be shifted but that of an indirect tax can
- (D) Both burdens can always be shifted

Answer: (C) The burden of a direct tax cannot be shifted but that of an indirect tax can

Explanation: The defining test: a direct tax's burden stays with the payer; an indirect tax's burden can be passed on to the final consumer.

Q22. GST has subsumed almost all indirect taxes EXCEPT:

MEDIUM

- (A) Excise duty
- (B) Service tax
- (C) Customs duty
- (D) VAT

Answer: (C) Customs duty

Explanation: GST absorbed nearly every indirect tax except customs duty, which still applies on imports.

Q23. Which of the following is a NON-tax revenue of the government?

EASY

- (A) Corporation tax
- (B) Income tax
- (C) Passport fee
- (D) Customs duty

Answer: (C) Passport fee

Explanation: A passport fee is a charge for a service used, hence non-tax revenue. The others are compulsory taxes.

Q24. Consider:

MEDIUM

1. Revenue receipts create no liability and reduce no asset.
2. Capital receipts may create a liability or reduce an asset.

Which is/are correct?

- (A) 1 only
- (B) 2 only
- (C) Both 1 and 2
- (D) Neither

Answer: (C) Both 1 and 2

Explanation: Both are correct - this is the textbook distinction between revenue receipts (e.g. taxes) and capital receipts (e.g. borrowings, disinvestment).

Q25. The Effective Revenue Deficit is best defined as:

HARD

- (A) Total expenditure minus total receipts
- (B) Revenue expenditure minus grants used by states to create assets
- (C) Fiscal deficit minus interest payments
- (D) Capital expenditure minus revenue expenditure

Answer: (B) Revenue expenditure minus grants used by states to create assets

Explanation: ERD = Revenue Expenditure - Grants (for asset creation). It was introduced in the 2011 budget by then FM Pranab Mukherjee.

Q26. Which two concepts were discontinued in India from the 1997-98 budget?

HARD

- (A) Fiscal deficit and primary deficit
- (B) Budget deficit and monetized deficit
- (C) Revenue deficit and effective revenue deficit
- (D) Customs duty and excise duty

Answer: (B) Budget deficit and monetized deficit

Explanation: Both the budget deficit and the monetized deficit concepts were discontinued from the 1997-98 budget.

Q27. 'Crowding out' in public finance refers to:

MEDIUM

- (A) Too many taxpayers filing returns late
- (B) Private investment falling because government borrowing absorbs available credit
- (C) Excess money supply causing inflation
- (D) Foreigners buying domestic assets

Answer: (B) Private investment falling because government borrowing absorbs available credit

Explanation: When the government borrows heavily, less (and costlier) credit is left for private firms - their investment is 'crowded out'.

Q28. An expansionary fiscal policy typically involves:

EASY

- (A) Higher taxes and lower government spending
- (B) Lower taxes and higher government spending
- (C) Higher taxes and higher government spending
- (D) No change in taxes or spending

Answer: (B) Lower taxes and higher government spending

Explanation: Expansionary fiscal policy lowers taxes and raises spending to boost demand - used mainly to fight recession and unemployment.

Q29. With reference to the FRBM Act, 2003, consider:

MEDIUM

1. Its primary aim was to eliminate the revenue deficit and reduce the fiscal deficit.
2. It was relaxed in 2008-09 due to the global recession.

Which is/are correct?

- (A) 1 only
- (B) 2 only
- (C) Both 1 and 2
- (D) Neither

Answer: (C) Both 1 and 2

Explanation: Both are correct. The FRBM Act targeted fiscal discipline and was relaxed during the 2008-09 global financial crisis.

Q30. The N.K. Singh Committee (2016) recommended a fiscal deficit target of:

MEDIUM

- (A) 1% of GDP
- (B) 3% of GDP
- (C) 5% of GDP
- (D) 8% of GDP

Answer: (B) 3% of GDP

Explanation: The committee, set up to review the FRBM Act, recommended targeting a fiscal deficit of 3% of GDP with a glide path for further reduction.

Q31. India announced a fiscal stimulus of about Rs 20 lakh crore in May 2020 mainly to counter:

EASY

- (A) The 2008 US recession
- (B) The COVID-19 economic shock
- (C) A balance-of-payments crisis
- (D) A drought-led food crisis

Answer: (B) The COVID-19 economic shock

Explanation: The Rs 20 lakh crore package of May 2020 was aimed at countering the economic impact of the COVID-19 pandemic.

Q32. If the RBI decreases the money supply, what is the likely chain of effects?

MEDIUM

- (A) Inflation rises, interest rates fall, credit expands
- (B) Inflation falls, interest rates rise, credit tightens
- (C) Inflation falls, interest rates fall, credit expands
- (D) Inflation rises, interest rates rise, credit tightens

Answer: (B) Inflation falls, interest rates rise, credit tightens

Explanation: Less money supply => lower inflation, higher interest rates and tighter (harder to get) credit.

Q33. The PRIMARY objective of monetary policy in India is:

EASY

- (A) Maximising tax revenue
- (B) Price stability
- (C) Reducing the fiscal deficit
- (D) Increasing exports

Answer: (B) Price stability

Explanation: While growth and other goals matter, the primary objective of the RBI's monetary policy is price stability (controlling inflation).

Q34. Assertion (A): Fiscal policy and monetary policy are not the same.

MEDIUM

Reason (R): Fiscal policy is run by the Finance Ministry using taxes and spending, while monetary policy is run by the RBI using money supply and interest rates.

- (A) Both A and R are true and R is the correct explanation of A
- (B) Both A and R are true but R is not the correct explanation of A
- (C) A is true but R is false
- (D) A is false but R is true

Answer: (A) Both A and R are true and R is the correct explanation of A

Explanation: Both statements are true and R correctly explains why A is true - the two policies differ in who runs them and the tools they use.

Q35. Money printed by the RBI to finance a deficit is known as:

MEDIUM

- (A) Fiat reserve
- (B) High-powered (reserve) money
- (C) Sovereign money
- (D) Token money

Answer: (B) High-powered (reserve) money

Explanation: Money created by the RBI is called high-powered money or reserve money; using it to fund the deficit is the last resort of deficit financing.

MAINS PRACTICE

Descriptive (Mains) Questions

9 APSC Mains-style questions (10/15/20 marks) with model answers, key points, answer structure and conclusion.

Q1. Distinguish between GDP and GNP. Why is Net Factor Income from Abroad important in linking the two? 10 MARKS

GDP measures the money value of all final goods and services produced inside a country's geographical boundary in a year, regardless of who owns the factors of production. GNP shifts the focus from territory to nationality - it measures output produced by a country's residents wherever they are. The bridge between the two is Net Factor Income from Abroad (NFIA), which is the income Indians earn abroad minus the income foreigners earn in India. Hence $GNP = GDP + NFIA$. For a country like India, with a large diaspora sending remittances, NFIA is significant, so GNP can exceed GDP.

Key Points

- GDP - output produced within the country's borders.
- GNP - output produced by the country's citizens anywhere.
- NFIA = income of residents abroad minus income of foreigners at home.
- $GNP = GDP + NFIA$.
- For a labour-exporting country, NFIA can be sizeable.

Answer Structure

Define GDP and GNP -> explain NFIA -> give the linking formula -> short example -> conclude with relevance to India.

Conclusion

GDP captures domestic activity while GNP captures national income; NFIA is the precise adjustment that converts one into the other.

Q2. Explain the difference between direct and indirect taxes with suitable examples. Why is GST called a landmark indirect-tax reform? 10 MARKS

A direct tax is paid by the very person on whom it is levied and its burden cannot be passed on - income tax and corporation tax are classic examples. An indirect tax is levied on goods and services, and its burden is shifted to the final consumer through the price - GST, customs duty and excise duty are examples. GST is a landmark because it merged a tangle of central and state indirect taxes into a single tax, sparing only customs duty, thereby reducing the cascading 'tax on tax' effect and creating a unified national market.

Key Points

- Direct tax - burden cannot be shifted (income tax, corporation tax).
- Indirect tax - burden shifts to the consumer (GST, customs, excise).
- GST subsumed almost all indirect taxes except customs duty.
- GST created 'one nation, one tax', reducing cascading.

Answer Structure

Define both taxes -> table of examples -> explain burden-shifting -> discuss GST's unifying role -> conclude.

Conclusion

The shiftability of the burden separates the two categories, and GST's subsuming of most indirect taxes marks a major step toward a simpler, unified tax system.

Q3. What is a mixed economy? Why did India adopt this model after independence?
10 MARKS

A mixed economy combines the efficiency and choice of capitalism with the equity and control of socialism. Private firms operate in much of the economy, the government runs strategic sectors, and the state keeps selective control through licensing. India adopted this model because pure capitalism risked deep inequality in a poor society, while pure socialism risked inefficiency; the middle path allowed the state to build heavy industry and infrastructure while private enterprise drove other sectors.

Key Points

- Blend of capitalism and socialism.
- Coexistence of private and public sectors.
- Selective licensing by the state.
- Goal: growth with social justice.

Answer Structure

Define mixed economy -> contrast with pure capitalism/socialism -> reasons for India's choice -> examples -> conclude.

Conclusion

The mixed model let India pursue rapid growth without abandoning the goal of social justice, which is why it remains the basis of the Indian economy.

Q4. Describe the value-added chain through which a firm's total receipts are converted into profit after tax. Why is the concept of value added preferred over total sales in national-income accounting?
15 MARKS

A firm starts with Total Receipts (TR) and subtracts the cost of intermediate goods (IC) to get Gross Value Added at market price. Removing net indirect tax gives GVA at factor cost; removing depreciation gives Net Value Added at factor cost; removing employee compensation gives Gross Operating Surplus; removing primary cost gives Profit Before Tax; and removing corporate tax gives Profit After Tax. This chain matters because national income must add only the NEW value each firm creates. If we simply summed every firm's total sales, the same raw material - a potato that becomes a chip - would be counted at each stage, hugely overstating output. Using value added eliminates this double counting.

Key Points

- $TR - IC = GVA(MP)$.
- $GVA(MP) - NIT = GVA(FC)$.
- $GVA(FC) - Depreciation = NVA(FC)$.
- $NVA(FC) - Compensation\ of\ Employees = Gross\ Operating\ Surplus$.
- $GOS - Primary\ Cost = Profit\ Before\ Tax; PBT - Corporate\ Tax = PAT$.
- Value added avoids double counting.

Answer Structure

Introduce GVA -> walk through the six steps with a number example -> explain double-counting problem -> conclude on accuracy.

Conclusion

The value-added approach gives an accurate, non-duplicated measure of national output, which is why GDP is built by summing GVA rather than total sales.

Q5. Explain the objectives of fiscal policy in a developing economy like India.
15 MARKS

Fiscal policy is the government's use of taxation and public spending to influence the economy. In a developing country its objectives are: (1) accelerating economic growth so that national and per-capita income rise; (2) maintaining price stability by restraining inflationary pressure; (3) promoting capital formation by encouraging investment and breaking the vicious circle of

poverty; (4) allocating resources toward social and physical infrastructure through targeted spending, subsidies and incentives; and (5) reducing income inequality through progressive taxation that taxes the rich more and shields the poor. Together these guide scarce public resources toward inclusive development.

Key Points

- Economic growth - raise national and per-capita income.
- Price stability - control inflation.
- Capital formation - stimulate investment.
- Resource allocation - fund social infrastructure.
- Reducing inequality - redistributive taxation.

Answer Structure

Define fiscal policy -> list and explain each objective with an Indian angle -> conclude on its development role.

Conclusion

For India, fiscal policy is not just an accounting tool but a development instrument that balances growth with equity and stability.

Q6. Differentiate between fiscal policy and monetary policy. How do expansionary and contractionary stances of each work? 20 MARKS

Fiscal policy is operated by the government through the Finance Ministry using taxation and public expenditure, whereas monetary policy is operated by the RBI through money supply and interest rates. Both aim for growth with price stability but use different levers. An expansionary stance is used in a slowdown: fiscal policy cuts taxes and raises spending, while monetary policy increases money supply and lowers interest rates - both put more money into the economy. A contractionary stance is used to fight inflation: fiscal policy raises taxes and cuts spending, while monetary policy reduces money supply and raises interest rates - both pull money out.

Key Points

- Fiscal = government, taxes and spending.
- Monetary = RBI, money supply and interest rates.
- Expansionary fiscal: cut taxes, raise spending.
- Contractionary fiscal: raise taxes, cut spending.
- Expansionary monetary: more money, lower rates.
- Contractionary monetary: less money, higher rates.

Answer Structure

Define both policies -> comparison table in words -> expansionary vs contractionary for each -> conclude on coordination.

Conclusion

Fiscal and monetary policy are distinct but complementary; their coordinated use lets the government and the central bank stabilise the economy across the business cycle.

Q7. Discuss the structure of the Government Budget in India, covering its components, the budget stages in Parliament, and the role of the Appropriation and Finance Bills. 20 MARKS

The Union Budget is the government's annual statement of estimated receipts and expenditure for the financial year (1 April to 31 March). It has two components: the Revenue Budget, covering day-to-day receipts (tax and non-tax) and expenditure that creates no asset; and the Capital Budget, covering receipts that create liabilities or reduce assets (borrowings, disinvestment, loan recovery) and expenditure that builds assets. In Parliament the budget passes through six stages: presentation by the Finance Minister on 1 February, general discussion, scrutiny by departmental standing committees, voting on demands for grants (where only the Lok Sabha votes and MPs may move cut motions), passing of the

Appropriation Bill, and passing of the Finance Bill. The Appropriation Bill authorises the government to spend money, and no amendments may be moved to it; the Finance Bill gives legal effect to the tax proposals and completes the enactment of the budget.

Key Points

- Budget = yearly statement of receipts and expenditure (FY 1 Apr-31 Mar).
- Two parts: Revenue Budget and Capital Budget.
- Receipts: revenue (tax/non-tax) and capital (debt/non-debt).
- Six stages from presentation to the Finance Bill.
- Cut motions; only Lok Sabha votes on demands.
- Appropriation Bill = spending; Finance Bill = taxes.

Answer Structure

Define budget -> components (revenue/capital) -> receipts and expenditure -> six stages in order -> Appropriation vs Finance Bill -> conclude on parliamentary control.

Conclusion

The elaborate component structure and six-stage process ensure that both the spending and the taxation sides of the budget receive full parliamentary scrutiny and approval, safeguarding democratic control over public finance.

Q8. Examine the various measures of deficit and the methods of deficit financing available to the Government of India. What are the risks of excessive borrowing? 20 MARKS

A deficit arises when government expenditure exceeds its receipts. Budgets may be balanced ($TE = TR$), surplus ($TR > TE$) or, most commonly for a developing country, in deficit ($TE > TR$). India has used several deficit measures: the budget deficit and the monetized deficit (both discontinued from 1997-98) and the Effective Revenue Deficit, which removes grants used by states for asset creation, introduced in 2011 by then FM Pranab Mukherjee. The government finances a deficit through taxation, borrowing (internal debt from the market, banks and the RBI, managed by the RBI; external debt from foreign governments and institutions and NRI deposits, managed by the Finance Ministry) and, as a last resort, printing high-powered money. Excessive borrowing carries real risks: a debt trap as interest payments mount, a crowding-out of private investment as credit becomes scarce and dearer, upward pressure on tax rates, and inflation if the RBI prints money. Yet public debt is beneficial when the borrowed funds are spent on productive assets and employment generation.

Key Points

- Budget types: balanced, surplus, deficit.
- Budget deficit and monetized deficit (dropped 1997-98).
- Effective Revenue Deficit = $Rev\ Exp - Grants$ (2011).
- Financing: taxation, internal/external borrowing, printing money.
- Risks: debt trap, crowding out, higher interest, inflation.
- Public debt is good if it builds assets.

Answer Structure

Introduce deficits -> budget types -> measures of deficit -> methods of financing -> risks -> balanced conclusion.

Conclusion

Deficits are not inherently harmful; what matters is how the borrowed money is used. Prudent, asset-creating borrowing supports growth, while unproductive borrowing risks a debt trap - which is exactly why frameworks like the FRBM Act seek to keep deficits in check.

Q9. 'National income can be measured at current prices and at constant prices.' In this light, explain the concepts of Nominal GDP, Real GDP, and the importance of the base year, and outline the three methods of measuring GDP.

National income can be estimated at current prices (this year's prices) or at constant prices (a fixed base year's prices). Nominal GDP is output valued at current prices, so it rises even when only prices, not quantities, increase - it is therefore distorted by inflation. Real GDP values the same output at base-year prices, stripping out inflation and revealing the true change in the volume of goods and services; India's current base year is 2011-12. GDP itself can be measured three ways: the income method adds all factor incomes (wages, rent, interest, profit); the expenditure method sums final spending as $C + I + G + Nx$; and the production (output) method adds the value added by every sector. All three should, in principle, yield the same GDP.

Key Points

- Current price = nominal; constant price = real.
- Nominal GDP inflated by price rise.
- Real GDP removes inflation using base-year prices.
- Base year currently 2011-12.
- Three methods: income, expenditure ($C+I+G+Nx$), production.

Answer Structure

Explain current vs constant prices -> define nominal and real GDP -> role of base year -> three measurement methods -> conclude on why real GDP guides policy.

Conclusion

Because real GDP isolates genuine growth from mere price changes, it - not nominal GDP - is the figure policymakers rely on to judge economic performance, making the choice of base year and measurement method crucial.