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SEBI

Grade A - (Phase 1 & 2)

Securities and Exchange Board of India (SEBI)

Volume - 2

General Awareness

SIERRA INNOVATIONS

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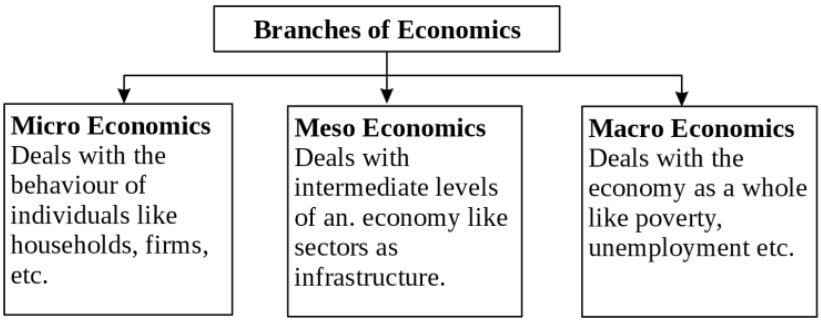
1 CHAPTER

Basic Concepts of Economy

Economics is a social science concerned with the production, distribution and consumption of goods and services.



Types Of Economy

- **Capitalist Economy**: Based on **laissez faire** with minimal government intervention. Private enterprises decide production, pricing, and supply based on market demand, and prices are determined by supply and demand forces. Examples include Hong Kong, Singapore, USA
- **Socialist Economy**: The government controls output and pricing, focusing on distributing goods based on need rather than affordability. Essential services like health care are provided free to citizens. Examples include the USSR.
- **Mixed Economy**: Combines elements of both capitalism and socialism. The government intervenes to achieve social goals, redistributes wealth through taxes, and promotes social objectives alongside private sector activity. Examples include India, China.
- **Open Economy**: Engages in economic relations with the rest of the world. The demand for domestic goods includes domestic consumption, investment, government spending, and exports minus imports. Exports provide an additional demand for domestic goods and services. Examples include the member countries of WTO.
- **Closed Economy**: Has no economic interactions with other countries. In a closed economy, saving, investment, GDP, and GNP are equal, while in an open economy, these may differ due to international trade. Examples include North Korea partially.
- **Dual Economy**: An economy where two distinct sectors coexist, One is a **modern, industrialized sector** (capital-intensive, high productivity, often export-oriented) and the other is a **traditional, subsistence-based sector** (labor-intensive, low productivity, often agriculture-based). Examples include India and other developing countries.

Schools of Economic Thought

- **Classical View:** Believes in free markets as the most efficient way to allocate resources and advocates for limited government involvement, acting only as a fair and strict referee. Key work-*Wealth of Nations* (1776) by Adam Smith (also known as Father of Economics).
- **Keynesian View:** Argues that markets alone cannot efficiently allocate resources and it supports active government intervention to reallocate resources and stabilize the economy. Key work- *The General Theory of Employment, Interest and Money* (1936) by John Maynard Keynes.

- **Marxist View:** Beliefs in Class struggle, exploitation of labor, surplus value, historical materialism and **advocates** socialism/communism. Key work- *Das Kapital* (1867) by Karl Marx.
- **Behavioral View:** It combines psychology and economics to study how people actually behave, rather than how they are supposed to behave according to traditional economic theory. Key work- The Prospect Theory (2002) by Daniel Kahneman.

Structural Composition of an Economy

- **Primary Sector**: Refers to industries involved in the extraction of natural resources or the production of raw materials. Examples include fishing, farming, and more.
- **Secondary Sector:** Encompasses industries involved in the manufacturing of usable or finished goods. Examples include heavy industries such as steel, automotive and light industries such as food and cosmetics.
- **Tertiary Sector:** Refers to industries that offer services to businesses or end consumers. Examples include healthcare, insurance and more.
- **Quaternary Sector:** Involves industries focused on the creation and dissemination of knowledge. Examples include research and development, education etc.
- **Quinary sector:** Involves the highest levels of decision-making in an economy. Examples include NITI Aayog members, scientists, Judges, Nobel laureates etc.

Sectors of Economy

- **Formal Sector:** This sector consists of businesses that are officially registered with the government and are governed by various regulations, such as the Companies Act, Factories Act and Labour laws etc.
- **Informal Sector:** This sector consists of businesses that operate without legal regulation or the maintenance of regular financial records. Examples include landless laborers, farmers and vendors.

DID YOU KNOW

The **Real sector** of an economy drives economic output and GDP growth, encompassing activities like farming or textile production, which directly contribute to the economy's productivity and meet aggregate demand. It is essential for economic sustainability. In contrast, the **Financial sector** includes institutions providing financial services such as banks, insurance companies and investment firms, which generate revenue through loans and mortgages.

Goods

- Goods are products or services that satisfy people's needs and wants. They can be physical items, services, or a mix of both, and anything that offers value to consumers is considered a good.

Types of Goods in an Economy:

1. **Based on Excludability and Rivalry**
   - ✓ **Public goods**: Goods that are non-rivalrous (one person's consumption doesn't reduce availability for others) and non-excludable. When the government provides a commodity for free, the opportunity cost shifts from the consumers to taxpayers. This means that while individuals receive the good at no cost, the expense is covered by the general population through taxes. Example: Parks, defense.
   - ✓ **Private goods**: Goods that are both rivalrous (one person's consumption limits others') and excludable (can be restricted to specific users). Example: Club membership, houses.
   - ✓ **Club goods-** Goods that are Excludable (access can be restricted) but not Rivalrous (multiple people can use simultaneously). **Examples**: Netflix, OTT platforms, private parks, toll roads.

- ✓ **Common Resources (Common Pool Goods)-** Not Excludable (difficult to exclude users) Rivalrous (overuse can deplete the resource). **Examples:** Fisheries, forests, groundwater, grazing land.

2. **Based on Usage and Production Purpose**
   - ✓ **Intermediate goods:** Products used by producers as inputs in the production process. Example: Rubber for tyres.
   - ✓ **Final goods:** Items intended for final consumption, without further transformation or production. Example: Bicycle.
   - ✓ **Consumer goods:** Goods purchased by consumers for personal use. Example: Sugar.
   - ✓ **Capital goods**: Durable items utilized in the production process, such as machinery and tools.
3. **Based on Consumer Behavior and Income Effect**
   - ✓ **Luxury goods**: Products for which demand increases with higher income levels. Example: Gold.
   - ✓ **Complementary goods**: Goods that are used together. Example: Bread and butter, pen and refill.
   - ✓ **Substitute goods**: Products that serve as alternatives to each other. Example: Tea and coffee.
   - ✓ **Veblen (Snob) goods**: Goods for which demand increases as their price rises, often because people perceive them as better. Example: A rolex watch, private jets.
   - ✓ **Giffen goods**: Goods where demand increases as prices rise, often considered inferior goods. Example: Bajra.
4. **Based on Impact on Society:**
   - ✓ **Merit goods**: Goods with positive externalities, **Example:** education or healthcare.
   - ✓ **Demerit goods**: Goods with negative externalities. Example: liquor, cigarettes.

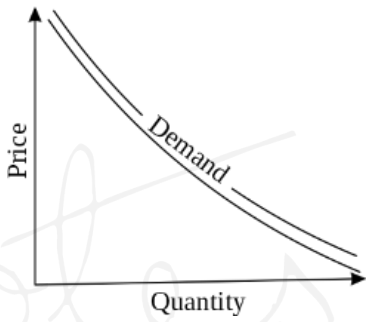
Stock and Flows

- ➢ Stocks refer to assets or goods that are present at a particular moment in time, while flows represent the quantities occurring over a specified period.
- ➢ Capital goods, like machinery, are considered stocks, whereas the changes in capital goods over time are classified as flows like investment.

Law of Demand

- ➢ The Law of Demand states that, assuming all other factors are unchanged, when the price of a good or service increases, the quantity demanded by consumers decreases, and vice versa.
- ➢ For example, if smartphone prices fall, consumers are more likely to buy more. This inverse relationship between price and demand is a key principle in economics. However, this law applies only to normal goods.

1. **Demand Curve**
   - ✓ A price change usually leads to an inverse change in quantity demanded, with the demand curve sloping downward.



   - ✓ In some cases, a price decrease can reduce demand, and a price increase can boost it, causing the curve to slope upward.
   - ✓ The Speculative Effect can also reverse this trend, as consumers anticipate future price hikes.
   - ✓ Factors such as changes in income, prices of related goods and preferences can shift the demand curve.
   - ✓ An increase in these factors shifts the curve rightward, while a decrease shifts it leftward.
2. **Elasticity of Demand**
   - ✓ It measures how responsive the quantity demanded of a good or service is to price changes. It reveals how sensitive consumers are to variations in price.

3. **Types of Elasticity of Demand**
   - ✓ **Perfectly Elastic (Ed = ∞)**: Infinite change in quantity for a small price change.
   - ✓ **Perfectly Inelastic (Ed = 0)**: No change in quantity regardless of price changes.
   - ✓ **Relatively Elastic (Ed < 1**: Large change in quantity for a small price change.
   - ✓ **Unitary Elastic (Ed =1)**: Proportional change in quantity and price.
   - ✓ **Relatively Inelastic (Ed >1)**: Small change in quantity for a large price change.

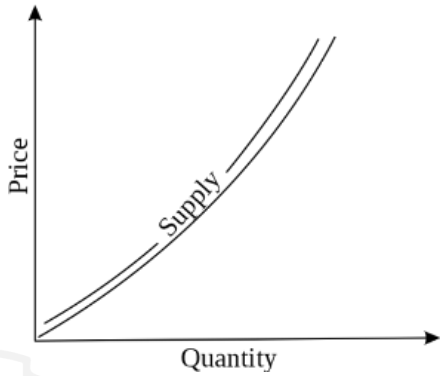
Law of Supply

- The Law of Supply states that as prices rise, the quantity supplied increases, and as prices fall, the quantity supplied decreases.
- For instance, higher coffee prices encourage farmers to grow more, while lower prices reduce production. This reflects the direct relationship between price and supply.

1. **Elasticity of Supply**
   - ✓ It measures how responsive the quantity supplied of a good or service is to price changes.
   - ✓ It helps understand how producers adjust their output in response to price fluctuations.
2. **Types of Elasticity of Supply**
   - ✓ **Relatively Elastic Supply (Es > 1)**: Quantity supplied changes more than proportionally to price. **Example:** Manufactured goods (cars, mobiles).
   - ✓ **Unitary Elastic Supply (Es = 1)**: Quantity supplied changes proportionally to price. **Example:** Agricultural products in the short run under normal conditions.
   - ✓ **Relatively Inelastic Supply (Es < 1)**: Quantity supplied changes less than proportionally to price. **Example:** Land, perishable goods, short-run farm produce.

Income and Cross Elasticity

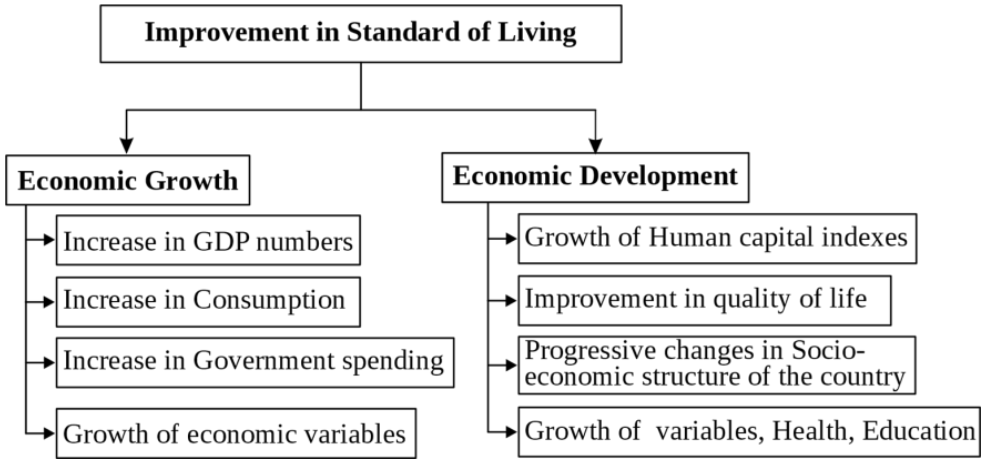
- **Income Elasticity**: Measures the response of quantity demanded or supplied to income changes.
- **Cross Elasticity**: Analyzes how the quantity demanded or supplied of one good responds to price changes of another good.



Economies of Scale

- Economies of scale occur when a company becomes more efficient in production, leading to cost advantages. Companies can lower product costs and increase production to achieve economies of scale.
- Example: Large supermarket chains benefit from economies of scale due to greater cash flow and a larger customer base. By purchasing groceries in bulk from suppliers, they reduce costs, enabling them to sell at lower prices compared to independent grocers.

Economic Growth V/s Economic Development



2 CHAPTER

National Income Accounting

- National Income Accounting offers a system for evaluating the overall economic activity within a country.
- It employs several key indicators to assess the economy's performance, production, income, and spending. Key metrics used in this process include: 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).

DID YOU KNOW

The economist who first scientifically determined National Income in India was **V.K.R.V. Rao.**

Economic Territory

- It refers to the area under a country's governance where people, goods and capital move freely.
- It encompasses political borders, including territorial waters and airspace, as well as embassies, consulates and military bases abroad (excluding those within the country's political boundaries).
- It also includes ships, aircraft, and other transport operated by residents internationally, such as Air India's global services, as well as fishing vessels, oil rigs, and floating platforms operated in international waters or areas where the country holds exclusive operational rights and Special economic zones (SEZs) and offshore drilling platforms under control.
- Excludes:
  - ✓ Foreign embassies, consulates, and military bases within the country.
  - ✓ These are part of the economic territory of the country that owns them.

Normal Residents V/s Indian Citizens

- **Normal Resident:** A person who lives in a country and has their economic interests centered there, including both nationals (e.g., Indians in India) and foreigners (e.g., non-nationals in India).
- **Citizens:** Indian nationals living within India or abroad.

GDP & National Income

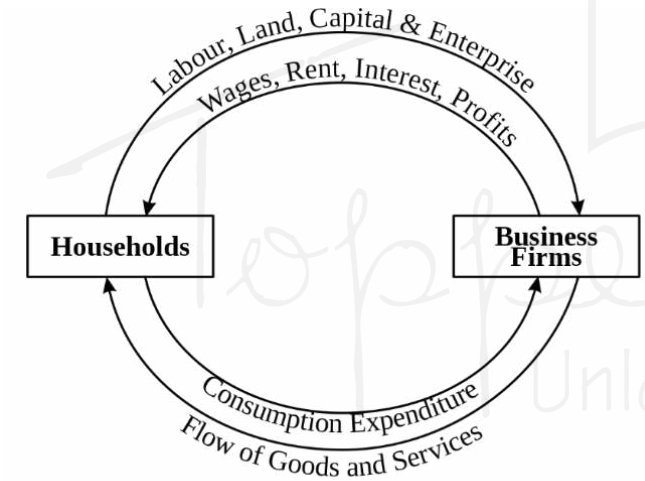
- **Gross Domestic Product (GDP):** It refers to the total market value of all final goods and services produced within a country's borders during a specific period (typically a year). It encompasses the output of both domestic and foreign companies operating within the country.
- **National Income (NI):** It is a measure of the total factor incomes earned by a country's citizens, regardless of whether they are earned domestically or internationally. **Example**:
  - ✓ If a Japanese company generates Rs 200 crore in India, it contributes to India's GDP but not to its National Income, as the earnings belong to the Japanese entity.
  - ✓ On the other hand, if an Indian company earns Rs 600 crore in Japan, it is included in India's National Income but not in GDP, as it was produced outside India.
- **Net Domestic Product (NDP):** It is calculated by deducting depreciation (the wear and tear on capital) from GDP.
  - ✓ **Formula**: NDP = GDP − Depreciation
  - ✓ **Example**: If GDP is Rs 5000 crore and depreciation is Rs 100 crore, then: NDP= 5000−100= Rs 4,900 crore.

Note:

- **Depreciation** refers to the decline in the value of an asset over time due to usage and obsolescence.

- **Product Taxes and Subsidies** are taxes and subsidies directly applied to goods and services. Product taxes raise market prices, while subsidies lower them.
- **Intermediate Consumption** refers to goods and services that are consumed during the production process and are not included in GDP to prevent double-counting.
- **Base year**- The year with relatively stable growth and whose prices are being used to calculate the real GDP
- **Net Factor Income from Abroad (NFIA)**: It represents the difference between the factor income earned by Indian residents abroad and the factor income earned by non-residents in India.
  (NFIA = Factor Income from Abroad to India – Factor Income from India to Abroad)

Circular Flow of Income



Circular Flow of Income in a Simple Two Sector Economy

- Circular flow of income refers to the continuous movement of goods, services, production, earnings, and expenditure in an economy.
- Money circulates from producers to workers as wages, then back to producers as payments for goods.
- Factors of Production include land, labor, capital and entrepreneurship.
- Payments made for each factor are rent (for land), wages (for labor), interest (for capital), and profit (for entrepreneurship).

Capital Output Ratio

- The Capital Output Ratio (COR) measures the amount of capital needed to produce one unit of output.
- It reflects the relationship between investment levels and the resulting increase in GDP, as well as the value of capital invested relative to the value of output produced.

- **Fixed capital** refers to long-term assets like buildings, machinery, and equipment, which provide ongoing benefits over time and support sustained operations. For example, a farmer's plough or a computer are considered fixed capital.
- In contrast, the **Working capital** pertains to short-term financial resources needed for daily operations, such as raw materials like petrol and yarn, which are used within a single production cycle.

Concepts Related to GDP

- **Nominal GDP:** It refers to the production of final goods and services in the current year, valued at the prices prevailing in that same year. No adjustments are made regarding the prices.
- **Real GDP:** It represents the current year's production of goods and services valued at base-year prices, which remain constant. This method provides a more accurate measure of GDP, as it avoids inflationary distortions that can inflate GDP figures in a given year due to high inflation rates.
- **Preston Curve:** It is a visual representation that illustrates the correlation between a country's per capita income (typically measured as GDP per capita) and its average life expectancy.
- **GDP Deflator:** The GDP deflator, also known as the implicit price deflator, is a measure of inflation. It represents the ratio of the value of goods and services produced in a specific year at current prices to the value of those goods and services at base-year prices.

$$\text{GDP Deflator} = \frac{\text{Nominal GDP}}{\text{Real GDP}} \times 100$$

If **GDP Deflator = 1**, there is no change in price level in the current year.
If **GDP Deflator > 1**, it indicates an increase in the price level in the current year.

If **GDP Deflator < 1**, it indicates a decrease in the price level in the current year.

Methods of GDP Calculation

- **Product/Value Added Method:**
  - ✓ It is the method to calculate GDP by summing the value added by each firm, which is the difference between a firm's output value and the cost of intermediate goods.
  - ✓ **Example**: A farmer produces wheat worth Rs 100, and a biscuit manufacturer uses Rs 50 worth of this wheat to produce biscuits worth Rs 200. The value added by the farmer is Rs 100, and the value added by the biscuit maker is Rs 150 (Rs 200 - Rs 50). Therefore, Gross Value Added = 100 + 150 = 250
    Formula: GDP = ∑(Value Added of All Firms)
- **Expenditure Method:**
  - ✓ The Expenditure Method calculates GDP by summing total spending in the economy, including consumption (C), investment (I), government spending (G) and net exports (X - M), where X represents exports and M represents imports.
  - ✓ **Example:** If consumers spend Rs 200 on domestic goods, businesses invest Rs 300, the government spends Rs 400, exports are Rs 200 and imports are Rs 100, then:
    GDP = 200 + 300 + 400 + (200−100) = Rs 1000.
    Formula: GDP = {C + I + G + (X-M)}
- **Income Method:**
  - ✓ The Income Method calculates GDP by summing all incomes earned by residents and firms, including Rent (for land), Wages (for labor), Interest earned (for capital), and profit (for entrepreneurship).
    Formula: GDP = ∑(Wages + Interest + Profit + Rent)

Price Concepts

- **Factor Cost (FC):** It is the production cost that excludes taxes and subsidies, reflecting the income earned by producers. It encompasses wages, rent, interest and profits.
- **Basic Price:** It includes the factor cost along with production taxes (such as property taxes on factories) minus production subsidies (like government assistance for factory operations).
  - ✓ **Example**: If a manufacturing unit's factor cost is Rs 100 crore, with Rs 15 crore in production taxes and Rs 10 crore in subsidies, the basic price would be:100 +15 − 10 = Rs 105 crore
  - ✓ Basic Price = Factor Cost + Production Taxes − Production subsidies
- **Market Price (MP):** It includes the basic price, plus product taxes (such as VAT or sales tax), minus product subsidies, representing the final price paid by consumers.
  Market Price = Basic Price + Product Taxes − Product Subsidies.
  - ✓ **Example**: If an item's basic price is Rs 500, with Rs 50 in product taxes and Rs 20 in product subsidies, then: Market Price = 500 + 50 − 20 = Rs 530.

DID YOU KNOW

Marginal cost is the additional cost incurred in the production of one more unit of a good or service.

Income Metrics

- Macroeconomic identities and concepts, such as Gross National Product (GNP), Net National Product (NNP), National Income (NI), Personal Income (PI) and Personal Disposable Income (PDI), are essential for understanding income distribution in an economy.
- These metrics also reflect the impact of factors like depreciation, taxes, subsidies and transfers.

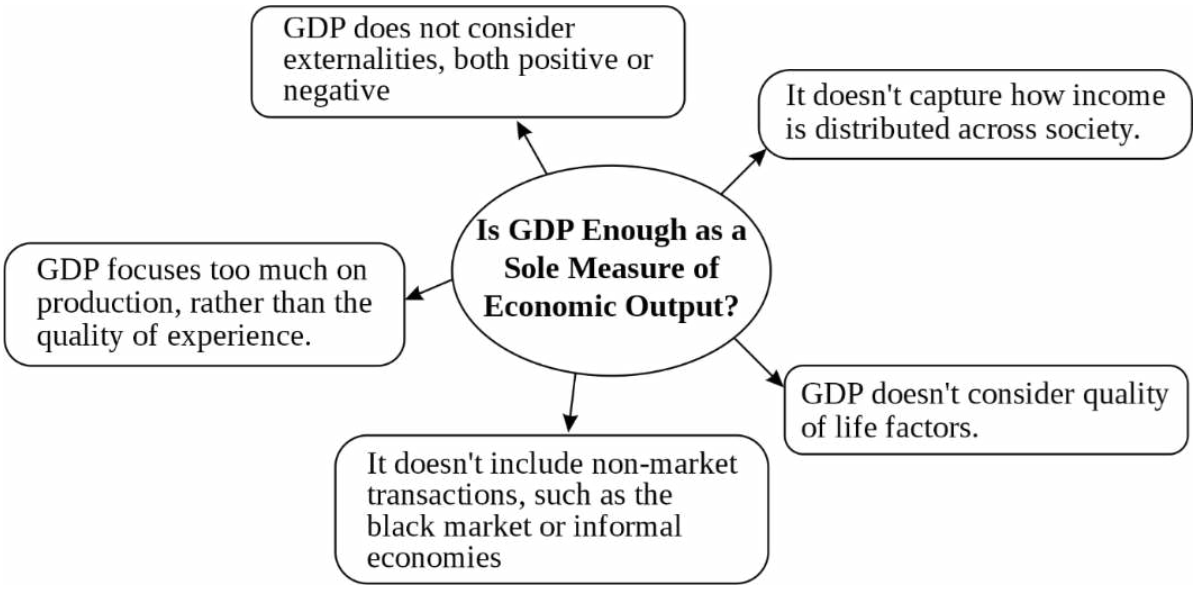
1. **Gross National Product**: GNP measures the total economic output of a country, including income earned by its domestic factors of production abroad, minus income earned by foreign factors within the country. It is calculated as GDP plus net factor income from abroad.
   Formula: GNP = GDP + Net Factor Income from Abroad.

2. **Net National Product:** NNP is calculated by deducting depreciation from GNP. NNP= GNP - Depreciation.
3. **National Income (NI):** It is the NNP evaluated at market prices, adjusted for indirect taxes and subsidies. It indicates the income earned by the factors of production within the country.
   Formula: NI = NNP at Market Prices − Net Indirect Taxes (Indirect Taxes - Subsidies) = NNP at Factor Cost
4. **Personal Income (PI):** It represents the income received by households from National Income and is calculated by subtracting undistributed profits, corporate taxes, and net interest payments made by households, while adding transfer payments received from the government and firms.
   - ✓ **Undistributed Profits** refer to the portion of profit earned by firms and government enterprises that is not distributed among the factors of production.
   - ✓ Households also receive transfer payments (e.g., prizes, pensions) from the government and firms, which are added to the calculation of Personal Income.

   Formula: PI = NI − Undistributed Profits − Net Interest Payments Made by Households − Corporate Tax + Transfer Payments
5. **Personal Disposable Income (PDI):** It refers to the income available to households after subtracting personal taxes (e.g., income tax) and non-tax payments (e.g., Fees) from Personal Income (PI). It represents the amount of income households can use for their consumption or savings.
   Formula: PDI = PI − Personal Tax Payments − Non-Tax Payments.

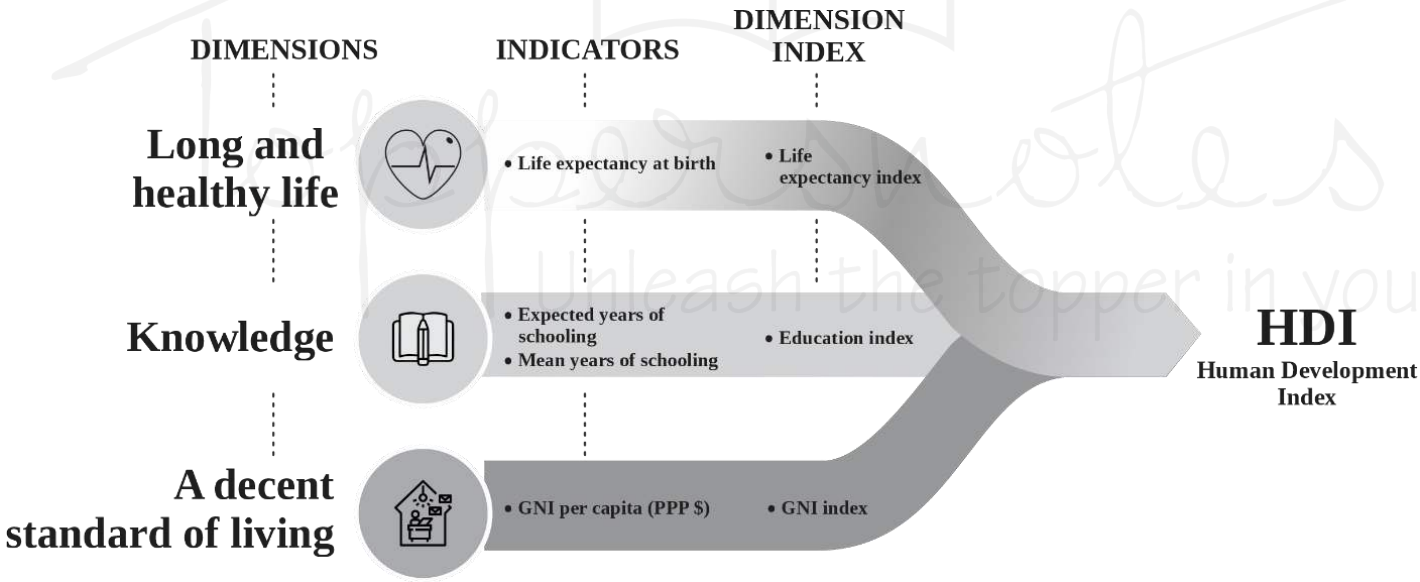
Difference Between GVA & GDP

Aspect	GVA	GDP
Definition	Value of goods and services produced after deducting intermediate goods and services.	Market value of all final goods and services produced within the country.
Focus	Insight from the input or supplier side.	Insight from the output or consumer side.
Calculation Approach	Generally calculated sector-wise.	Calculated for the whole economy.
Price Basis	Calculated at Basic Prices.	Calculated at Market Prices.



Other Methods to Gauge Economic Well-Being

- **Green GDP:** It is an economic measure that incorporates the environmental consequences of a nation's economic growth. It is determined by deducting the costs associated with environmental damage and the depletion of natural resources from the country's Net Domestic Product (NDP).
  - ✓ **Formula:** Green GDP = GDP−Environmental degradation costs−Natural resource depletion costs.
  - ✓ Himachal Pradesh is the First Indian state to calculate **Green GSDP** in collaboration with MoEFCC and GIZ (Germany)
- **Gross National Happiness (GNH):** It is a method of assessing a country's development by prioritizing the well-being of its people. It serves as an alternative to the traditional measure of GDP**.** Adopted first in Bhutan in the 1970s.
- **Genuine Progress Indicator (GPI):** GPI is proposed as an alternative or supplement to GDP for measuring economic growth. It assesses the impact of economic production and consumption on environmental and social factors. GPI considers whether these factors contribute positively or negatively to overall health and well-being.
- **Human Development Index (HDI):** It is a metric that evaluates a country's average performance in three key aspects of human development: health, education, and standard of living. Introduced in 1990 by Pakistani economist Mahbub ul Haq and Indian economist Amartya Sen. The UNDP is responsible for compiling the HDI & publishing human development reports.



DID YOU KNOW

- **The Greendex** is a survey by National Geographic & GlobeScan. Measures the environmental sustainability of consumer habits. Evaluates both personal lifestyle choices (e.g., energy use, food, transport) and externally influenced factors (e.g., infrastructure, availability). Compares countries on behaviors & attitudes toward sustainability.
- **Gender Inequality Index (GII)** -An index for Measurement of Gender Disparity was introduced in the 20th Human Development Report -2010 by the United Nations Development Programme (UNDP).

- **Child Development Index (CDI)-** A composite index that measures **child well-being** using simple and comparable indicators.
  - ✓ **Indicators (3 equally weighted)**:
    - **Health** – Under-5 Mortality Rate (probability of dying before age 5 per 1,000 live births).
    - **Nutrition** – % of under-5 children who are moderately or severely underweight.
    - **Education** – % of primary-school-age children not enrolled in school.
  - ✓ **Significance**:
    - Provides a simple measure of **child health, nutrition, and education outcomes**.
    - Helps track progress and compare regions/countries in terms of child well-being.

Feature / Aspect	**Social Development Index (SDI)**	**Social Progress Index (SPI)**
Developer / Agency	Developed by **Institute of Economic Growth (IEG)**	Developed by **Social Progress Imperative (USA)**
Focus Area	Measures **socio-economic development**	Measures **purely social and environmental progress**
Indicators Covered	Demographics, health, education, basic amenities, deprivation	Basic Human Needs, Foundations of Wellbeing, Opportunity
Includes Economic Variables	Yes (e.g., poverty, economic deprivation)	No (excludes GDP/income-based measures)
Objective	Evaluate **overall social and economic well-being**	Track **social progress independent of income**
Use in Indian Context	Used in **district/state-level planning and governance**	Used to **benchmark India globally**

National income accounting is essential for measuring a country's economic performance through indicators like GDP and GNP. It helps assess economic growth, income distribution, and well-being. Despite limitations, it remains crucial for policymaking and economic analysis.

3 CHAPTER

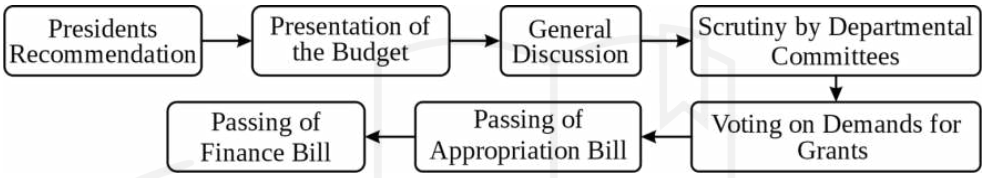
Government Budgeting

- Government budgeting is the process through which governments plan, allocate and oversee the use of public funds.
- It involves estimating revenues (from tax and non-tax sources) and determining the necessary expenditures to meet policy goals within a defined period, typically one year.

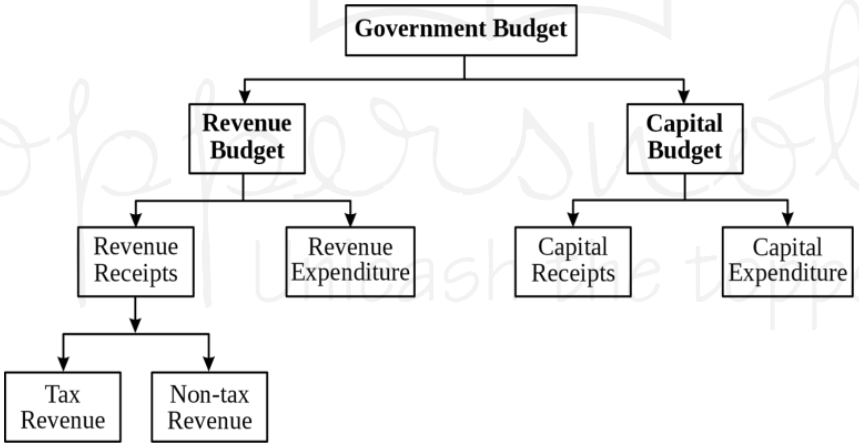
Government Budget

- The Union Budget, mandated by Article 112 of the Indian Constitution, is an annual financial statement presented to Parliament.
- It estimates the government's receipts and expenditures for the fiscal year, from April 1 to March 31st.
- It is prepared by the Department of Economic Affairs.

Procedure for Budget Enactment

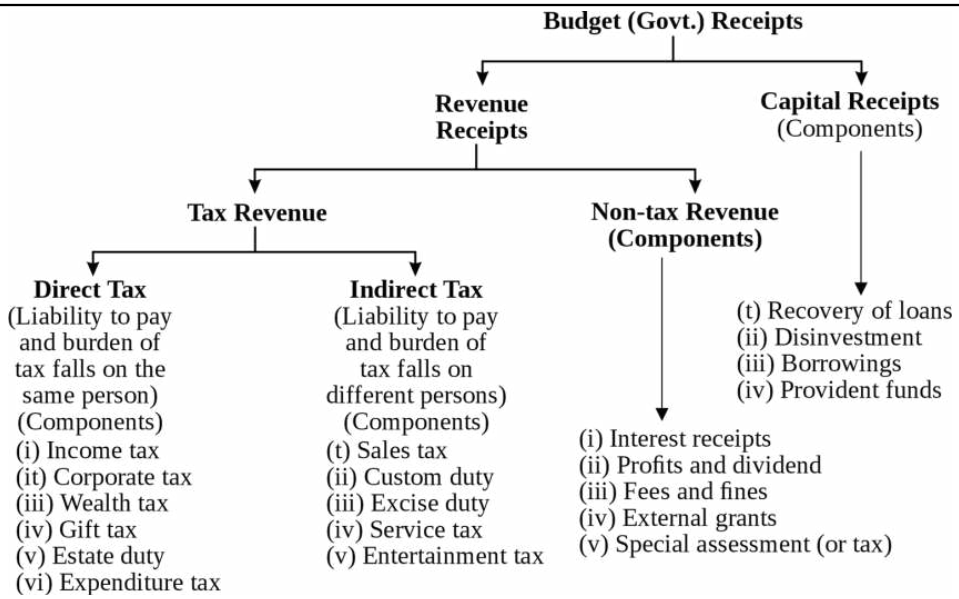


Segmentation of Budget Accounts



Budget (Government Expenditure)

Revenue Expenditure (Components) (Expenditure which neither creates assets nor reduces liabilities)	**Capital Expenditure** (Components) (Expenditure which creates assets or reduces liabilities)
(i) Payment of interest	(i) Construction of roads, bridges, buildings
(ii) Payment of salaries and pensions	(ii) Purchase of land and machinery
(iii) Grants and subsidies	(iii) Investment in shares
(iv) Education and health services	(iv) Loans to states and foreign government
(v) Defence services	(iv) Repayment of loans



1. **Revenue Budget:** Includes items related to the current financial year. It has two sub-parts namely as:
   - ✓ **Revenue Receipts**: Includes income that the government expects to receive within the fiscal year. They are of 2 types namely as:
     - **Tax Revenue:** It consists of Taxes and other duties that are levied by the central government consisting of Direct taxes like income and corporate taxes and Indirect taxes comprising Excise Taxes or Custom duties.
     - **Non-Tax Revenue:** It includes earning from sources other than taxes like Interest receipts on accounts of loans made by the central government, dividends and profits on investment made, fees levied, loans and grants from external sources like foreign countries or international organisations.
   - ✓ **Revenue Expenditure**: It includes expenditure incurred for purposes other than the creation of assets or reduction of liabilities. Major components include; salaries, pensions, interest payments, grants given to the state governments or various forms of services offered to the citizens.

2. **Capital Budget:** It accounts for the assets and liabilities of the government. It has two sub-parts namely as:
   - ✓ **Capital Receipts**: funds received by the government that create liabilities or reduce financial assets. They are classified into:
     - **Debt-Creating**: Includes loans (borrowings) and other liabilities raised by the government.
     - **Non-Debt Creating**: Includes proceeds from asset sales (disinvestment) and loan recoveries.
   - ✓ **Capital Expenditure**: It refers to government spending on long-term assets and investments that yield future benefits. It includes infrastructure development, investments in government companies, loans to states or foreign agencies and principal loan repayments.

- ➢ **Debts** are financial obligations to repay borrowed money, typically with interest.
- ➢ **Financial debt** refers to borrowing from institutions like banks or bondholders to raise capital for business activities, involving interest and principal repayments over time. Examples include loans, bonds, and debt securities.
- ➢ **Non-financial debt**, on the other hand, arises from transactions like trade credit, leasing, or deferred payments, often used to finance goods and services rather than business capital. It includes credit instruments issued by non-financial entities such as businesses, households, and governments.

Budget Types

- **Balanced Budget**: When receipts equal expenditures, meaning no surplus or deficit. It is suitable when the economy is near full employment.
- **Surplus Budget**: When receipts exceed expenditures. It helps reduce aggregate demand and is recommended during inflationary periods.
- **Deficit Budget**: When expenditures exceed receipts, leading to increased demand. It is suggested in times of economic depression.

Deficits in Government Budget

- **Budget Deficit**: The difference between total receipts and total expenditures.
- **Revenue Deficit**: When revenue expenditure exceeds revenue receipts, often leading to borrowing.

Revenue Deficit = Revenue Expenditure – Revenue Receipts

- **Effective Revenue Deficit (ERD)**: The actual revenue deficit after subtracting grants for capital assets.

Effective Revenue Deficit = Revenue Deficit – Grants for Creation of Capital Assets

- **Fiscal Deficit**: The excess of total expenditures over total receipts, excluding borrowings, indicating borrowing needs.

Fiscal Deficit = Total Expenditure – (Revenue Receipts + Non-Debt Creating Capital Receipts)

- **Gross Primary Deficit**: Fiscal deficit minus interest payments on past debt, reflecting current fiscal operations.

Gross Primary Deficit = Fiscal Deficit – Net Interest Liabilities

- **Monetized Deficit**: Part of the fiscal deficit financed by borrowing from or drawing cash from the RBI, leading to an increase in the money supply.

Types of Government Budgeting

- **Line-Item Budgeting:** Expenditures are categorized according to specific "line items." It offers centralized control and accountability but lacks detailed information about individual unit activities and outcomes.
- **Performance Budgeting**: Allocates funds based on performance data, aiming to improve efficiency and effectiveness. It focuses on the desired results and outcomes rather than just the resources needed.
- **Zero-Based Budgeting (ZBB)**: Every program is reviewed from scratch, starting at zero, requiring justification for all activities each year. Introduced in India in 1986 but not fully implemented.
- **Outcome Budgeting**: Shifts focus from inputs to measurable outcomes. It defines desired results, identifies interventions, and estimates the costs associated with achieving those outcomes. India's first Outcome Budget was introduced in 2005, with a comprehensive version in 2017-18.
- **Gender Budgeting**: Analyzes government budgets to assess their impact on gender equality and ensure that both men and women benefit equally from development initiatives. It was first introduced in India in 2005-06.

Key Concepts Related to Budget

- **Off-Budget Financing**: They are borrowings not reflected in the budget, though their repayment requires budgetary resources. They are typically taken by public institutions under government direction. OBBs are used to bypass fiscal deficit targets, borrowing limits under the FRBM Act and constitutional requirements and to avoid delays in central grants or reductions in revenue sources.
- **Monetization of Deficit**: The government finances its deficit by creating new money through the central bank, purchasing government bonds. This practice ended in 1997 and was replaced by the Ways and Means Advances (WMA) system.

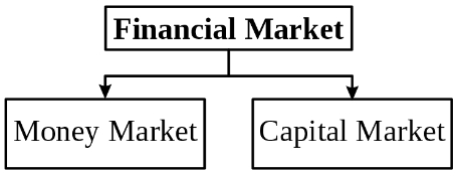
- **Fiscal Drag**: The process where higher income or inflation pushes taxpayers into higher tax brackets, reducing consumer spending and acting as an automatic stabilizer on the economy.
- **Pump Priming**: Government measures to stimulate economic activity, particularly during recessions, through increased spending, tax reductions, and lowered interest rates to boost demand.
- **Fiscal Neutrality**: Government actions on taxation, spending, or borrowing that have no net effect on the economy, where new spending is offset by increased revenues, keeping the budget balanced.
- **twin deficit- it refers to the simultaneous occurrence of a fiscal deficit (government spending exceeding revenue) and a current account deficit (a trade deficit where imports exceed exports)**
- **Deficit financing - occurs when a government's expenditure exceeds its revenue and the gap** is financed through borrowing or printing of money.

  Government budgeting is key to managing public finances, prioritizing spending, controlling inflation, and achieving growth. A well-planned budget promotes fiscal discipline, supports stability, and fosters public trust through transparency and balance.

4 CHAPTER

Financial Markets

- A financial market is a platform where buyers and sellers trade financial assets like equities, bonds, currencies, and derivatives.
- Its main function is to channel funds from investors with surplus capital to borrowers in need of capital.
- These markets are usually marked by transparent pricing, basic trading regulations, and market-driven prices for securities.



Money Market

- The money market is a segment of the financial market where short-term, highly liquid financial assets with maturities of up to one year are traded.
- It addresses the short-term borrowing needs for working capital. Key institutions include commercial banks, RRBs and bill markets operating in these markets.

Money Market Instruments:

Money market instruments are used by governments, financial institutions and corporations to manage their short-term funding needs. Common money market instruments include:

1. **Treasury Bills:**
   - ✓ They are short-term debt securities issued by the Indian government at a discount and redeemed at face value at maturity, with no interest.
   - ✓ Issued by the RBI on behalf of the central government through auctions, T-bills can be bought in primary auctions, secondary markets or online platforms by individuals, trusts, institutions and banks.
   - ✓ Presently issued in three tenors, namely, 91 days, 182 days and 364 days.

DID YOU KNOW

The gilt-edged market is also known as the government securities market. As the securities are risk free, they are known as gilt-edged i.e. the best quality securities.

2. **Cash Management Bills:**
   - ✓ They are issued by the Government in collaboration with the RBI to address short-term cash requirements.
   - ✓ They have a maturity period of under 91 days.
3. **State Development Loans:**
   - ✓ They are issued by State Governments to raise funds from the market.
   - ✓ These are dated securities with semi-annual interest payments and principal repayment at maturity.
   - ✓ SDLs are eligible for Statutory Liquidity Ratio (SLR) and can be used as collateral for market repo and RBI's Liquidity Adjustment Facility (LAF).
4. **Ways and Means Advances (WMA):**
   - ✓ They are short-term borrowings by the Government from the RBI to address temporary cash flow mismatches.
   - ✓ The loan is repayable within three months, with the repo rate applied.
   - ✓ If the repayment exceeds 90 days, a penal overdraft rate of 2% is charged.
5. **Commercial Paper:**
   - ✓ Commercial paper is an unsecured, short-term debt instrument issued by corporations to fund payroll, accounts payable, inventories, and other short-term obligations.

- ✓ It usually has maturities of a few days to a maximum of 270 days and is issued at a discount to its face value, based on prevailing market interest rates.
- ✓ In India, Commercial Papers (CPs) can be issued in denominations of ₹5 lakh or multiples thereof, as per the Reserve Bank of India (RBI) guidelines.
- ✓ Draft, Cheques and Promissory Notes are some of the types of commercial papers.

6. Commercial Bill:

- ✓ Commercial Bills are short-term negotiable instruments issued by sellers (drawers) to buyers (drawees) for goods supplied.
- ✓ Maturity periods are usually 30, 60 or 90 days.

7. Certificate of Deposit:

- ✓ A Certificate of Deposit (CD) is a negotiable, unsecured money market instrument offering higher interest in exchange for a fixed-term deposit.
- ✓ Issued by banks and financial institutions, the minimum amount is Rs. 5 lakh.
- ✓ Bank CDs mature in 7 days to one year, while financial institution CDs range from 1 to 3 years.

8. Inter-Bank Call Money Market:

- ✓ The call money market is a short-term money market where large financial institutions borrow and lend at interbank rates, typically for up to a week.
- ✓ The funds can be borrowed or raised for a maximum period from 2-14 days called Notice Money.
- ✓ The period for term money is 14 days to 1 year.
- ✓ These loans help banks meet reserve requirements & are used by other financial institutions, mutual funds, corporations and insurance companies as well.

9. Collateralized Borrowing and Lending Obligation (CBLO):

- ✓ It is a money market instrument issued by the Clearing Corporation of India Ltd. (CCIL) for short-term borrowing and lending, with maturities ranging from 1 to 19 days.
- ✓ It is secured by collateral, such as securities or cash, providing protection to the lender.
- ✓ The borrower offers collateral in exchange for cash and repays the loan with interest at the end of the borrowing period.

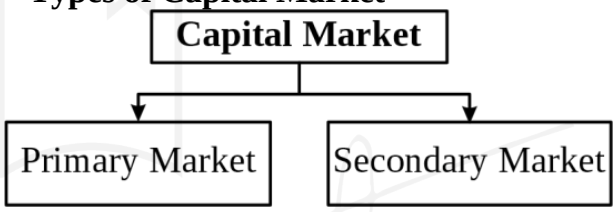
10. Promissory Note:

- ✓ A Promissory Note is a legal document in which the issuer agrees to repay a specified amount of money to the payee under defined terms and conditions.

Capital Market

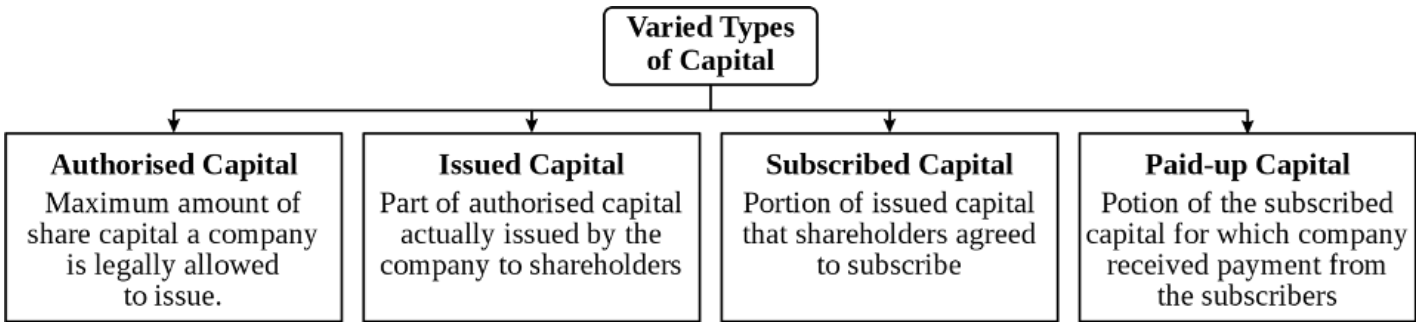
- ➢ It is a segment of the financial market that deals with the borrowing and lending of medium to long-term funds for a period of over one year.
- ➢ It supports financing for long-term projects and investments, enabling the mobilization and allocation of funds with extended maturity periods.

1. Types of Capital Market



Primary Market Vs Secondary Market

Primary Market	Secondary Market
Issuers raise capital by issuing securities to investors for the first time.	It facilitates trade in already-issued securities only.
Creates financial assets.	Makes the assets marketable.
Promotes capital formation directly, as the flow of funds is directly from savers to investors.	Promotes capital formation indirectly by enhancing the liquidity of the shares.
Only buying of securities takes place here; securities can't be sold here.	Both buying and selling take place here.
Prices are decided and determined by the company/issuing authority.	Prices are determined by the demand and supply of the security.



2. Capital Market Instruments:

- **Shares:** Shares represent units of ownership in a corporation or financial asset, entitling holders to an equal share of any declared profits, usually paid as dividends. The two primary types of shares are:
  - ✓ **Common Shares**: It offers profit through rising share prices and dividends. Holders have voting rights, but in case of bankruptcy, they are paid last.
  - ✓ **Preferred Shares**: It offers a fixed dividend, lacks voting rights, and has priority over common stock in liquidation.

DID YOU KNOW

Sweat Equity shares - are granted to employees as a form of compensation for their contributions to the company

- **Debentures:** A debenture is an unsecured debt instrument backed solely by the issuer's creditworthiness and reputation. Both corporations and governments issue debentures to raise capital.
- There are two types of debentures:
  - ✓ **Convertible Debentures**: They are bonds that can be converted into equity shares of the issuing corporation after a set period.
  - ✓ **Non-convertible Debentures**: They are regular debentures that cannot be converted into the issuer's equity.
- **Bond:** A bond is a loan secured by a physical asset, while a debenture is backed only by the issuer's promise to repay. Bonds typically offer lower interest rates than debentures. Bondholders are considered to be relatively at lower risk than stockholders. Types of Bonds:
  - ✓ **Masala Bonds**: They are Indian Rupee-denominated bonds issued by Indian entities abroad. The term, coined by the IFC, reflects India's culture and cuisine, offering low-cost borrowing and diversified funding.
  - ✓ **Panda Bonds:** Yuan-denominated bonds issued in the Chinese mainland market by an overseas entity.
  - ✓ **Maharaja Bonds:** Rupee-denominated bonds issued by International Finance Corporation in India's domestic market.
  - ✓ **Sovereign bonds:** They are debt securities issued by a national government to raise money in Domestic or Foreign (e.g., USD, Euro) varying from short-term to long-term, often 5–30 years. Considered low-risk due to government backing. Examples- G-sec, T-bills, SGB, Green sovereign bonds.
  - ✓ **Zero Coupon Bonds**: They are debt securities that don't pay interest but are sold at a significant discount, providing a profit at maturity when redeemed at face value. They tend to have more price fluctuation compared to coupon bonds.
  - ✓ **Inflation-Indexed Bonds (IIBs):** They are securities created to shield investors from inflation. These bonds are linked to inflation, causing both principal and interest payments to adjust with inflation rates. Through IIBs, the government can lower coupon rates on its borrowings.