Chapter 3: Sectors of Economy

Short Answers

CSM 05: Economic and Social Development-Sustainable Development, Poverty, Inclusion

Compiled by Prof. Ashok Vishandass

This chapter contains:

- **Sectors of Indian Economy**
- **Primary Sector**
- **Secondary Sector**
- **Tertiary Sector**
- **Quaternary and Quinary Sector**
- **Economic System**
- **Capitalist Economy**
- **Mixed Economy**
- **Capitalist and Socialist Economic System**
- **National Income Accounting**
- **Circular Flow of Income**

Contents

1. Sectors of Indian Economy

India is expected to be the world's second-largest economy by 2050. **Sectors of the Indian economy** are divided into three main sectors: **agriculture, manufacturing, and service.** According to the most recent **'World Economic League Table 2020'** report, India has surpassed both **France and the United Kingdom** to become the **world's fifth-largest economy in 2019.**

1.1 Economic Sectors

- Economic activities produce commodities and services, whereas sectors are groups of economic activity classified according to certain characteristics.
- On the basis of ownership, labor conditions, and the nature of the operations, the Indian economy can be divided into numerous sectors.
- When we produce a good by utilizing natural resources, we are engaged in **primary sector activity.**
- The **secondary sector** encompasses activities in which natural products are transformed into other forms via manufacturing methods associated with industrial activity.
- Following the primary and secondary sectors, there is a third category of activities that falls under the **tertiary sector** and is distinct from the first two. These are activities that contribute to the growth of the primary and secondary sectors.
- During the early stages of civilization, the primary sector accounted for all economic activity. People's demand for other items grew as a result of the surplus food production, resulting in the growth of the secondary sector.
- During the nineteenth century's industrial revolution, the secondary sector expanded its significance.
- To facilitate industrial activities, a support system was required. Certain industries, such as transportation and finance, were critical in sustaining industrial activity.

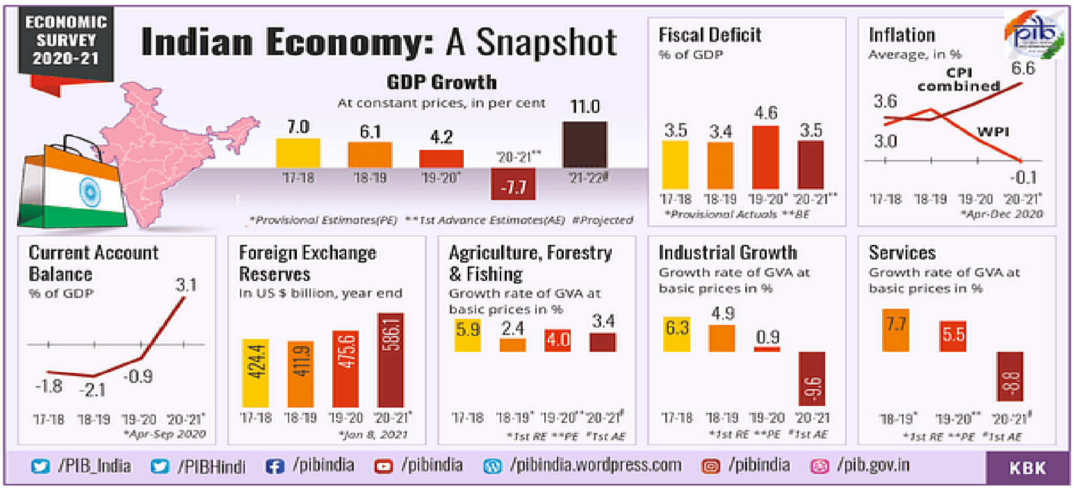


Figure 22.1: Indian Economy: A Snapshot

1.2 Bifurcation of India's Economic Sectors

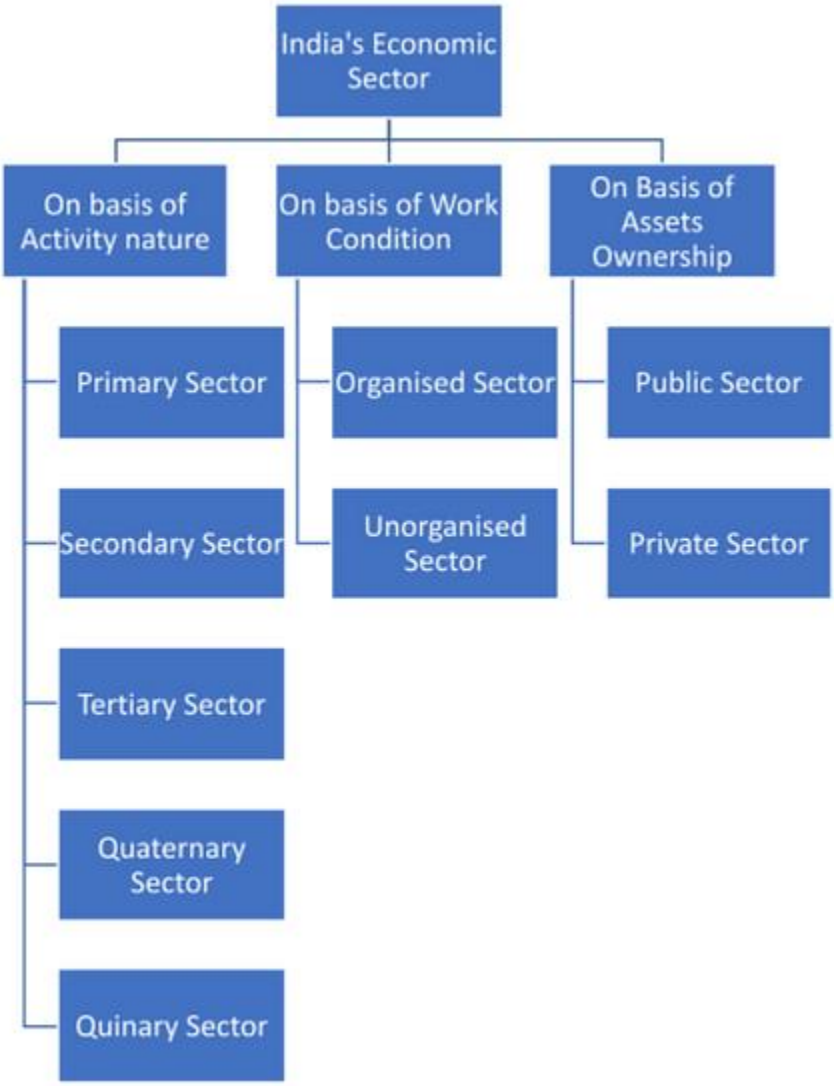


Figure 22.2: Bifurcation of India's Economic Sectors

1.3 On the Basis of Activity Nature

1.3.1 Primary Sector

- Activities in the primary sector of the economy are carried out by utilizing natural resources directly. Agriculture, mining, fishing, forestry, dairy, and other industries fall into this category.
- It is thus named because it serves as the foundation for all other items.
- About **54.6 percent** of the total workforce in the country is still engaged in agricultural and allied sector activities (Census 2011) which accounts for

approximately **17.8 percent** of the country's Gross Value Added (GVA) for the year 2019-20 (at current prices).

- It is also known as the **Agriculture and Allied Sector** since agriculture, dairy, forestry, and fishing provide the majority of the natural items we consume.
- Due to the nature of their profession, people who engage in primary activities are referred to as **red-collar employees.**
- While the difficulties created by COVID-induced lockdowns adversely affected the performance of the non-agricultural sectors, the agriculture sector came up with a robust **growth rate of 3.4 percent at constant prices** during **2020-21.**

Table 1: Share of Agriculture and Allied Sectors in Total GVA at current prices

	Year					
Items	**2014-15**	**2015-16**	**2016-17***	**2017-18#**	**2018-19@**	**2019-20****
Share of GVA of Agriculture & Allied Sector in GVA of Total Economy (per cent)	18.2	17.7	18.0	18.0	17.1	17.8
Share of Crops	11.2	10.6	10.6	10.4	9.4	NA
Share of Livestock	4.4	4.6	4.8	5.1	5.1	NA
Share of Forestry & logging	1.5	1.5	1.5	1.4	1.3	NA
Share of Fishing & aquaculture	1.0	1.1	1.1	1.2	1.2	NA

1.3.2 Secondary Sector

- It covers industries that manufacture finished goods from natural materials harvested in the primary sector.
- This sector includes operations such as industrial production, cotton fabric manufacture, sugar cane production, and so on.
- As a result, rather than producing raw materials, it is the sector of a country's economy that manufactures goods.
- This sector is often known as the **industrial sector** because it is involved with various types of industries.
- **Blue-collar employees** are those who engage in secondary activities
- As per the latest estimates on **Gross Value Added (GVA)**, the industrial sector is expected to record a growth of **-9.6 percent** with an overall **contribution in GVA of 25.8 percent in 2020-21 (FY21).**
- The contribution of the industrial sector has been constantly declining since 2011-12.
- The fall in share is across the board except in the case of **'Electricity, gas, water supply & other utility services'** whose share in GVA has increased from 2.3 percent in FY12 to 2.7 percent in FY21.

Figure 1: Share of Industry and its Components in GVA (Current Prices, Per cent)

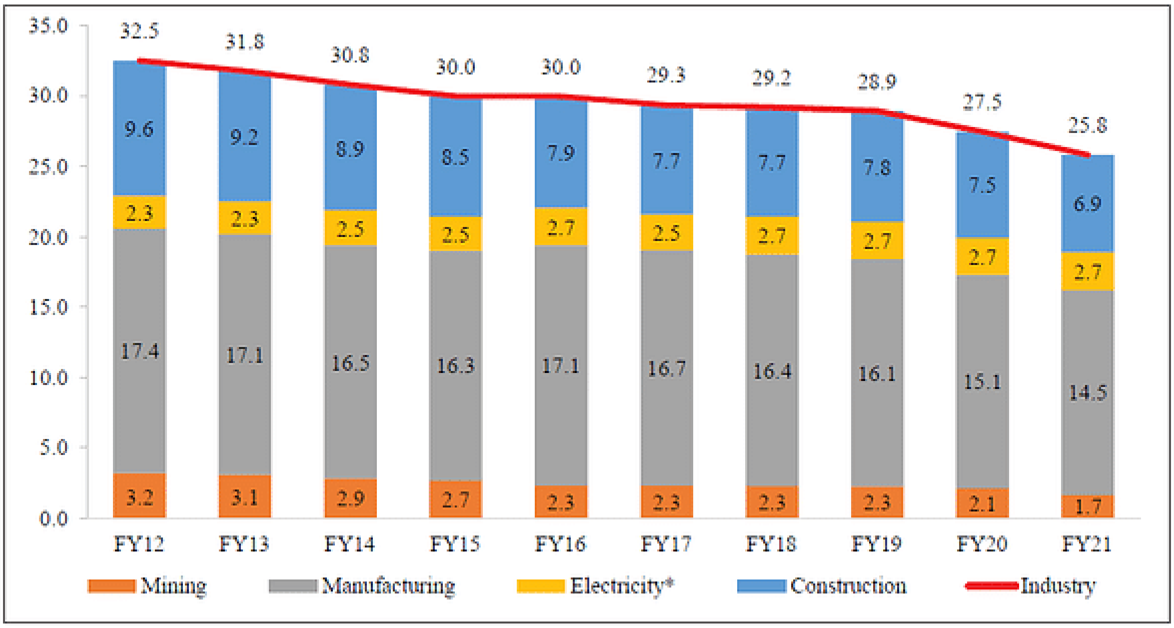


Table 1: Rate of Growth of GVA in Industry and Its Components (Per cent)

	FY13	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21
Industry	3.3	3.8	7.0	9.6	7.7	6.3	4.9	0.9	-9.6
Mining	0.6	0.2	9.7	10.1	9.8	4.9	-5.8	3.1	-12.4
Manufacturing	5.5	5.0	7.9	13.1	7.9	6.6	5.7	0.0	-9.4
Electricity*	2.7	4.2	7.2	4.7	10.0	11.2	8.2	4.1	2.7
Construction	0.3	2.7	4.3	3.6	5.9	5.0	6.1	1.3	-12.6

1.3.3 Tertiary Sector/Service Sector

- The services sector's significance in the Indian economy has been steady, with the sector now accounting for over **54 percent of the economy** and almost **four-fifths of total FDI inflows.**
- The activities of this sector contribute to the growth of the primary and secondary sectors.
- Economic activities in the tertiary sector do not produce things on their own, but they do help or assist production.
- The sector includes goods transported by trucks or trains, as well as banking, insurance, and finance.
- It adds value to a product in the same way that the secondary sector does.
- These sector jobs are called **white-collar jobs.**
- The first half of FY 2020-21 saw services sector **contract by** almost **16 percent YoY.**
- This decline was led by a **sharp contraction** in all sub-sectors particularly **'Trade, hotels, transport, communication & services related to broadcasting,** which contracted by **31.5 percent in H1 FY 2020-21.**

- As per the first advance estimates, the Gross Value Added (GVA) of the services sector is estimated to **contract by 8.8 percent in 2020-21**, whereas it grew by 5.5 percent in 2019-20.
- Interestingly, in spite of the global disruptions, **FDI inflows** into the services sector **increased by 34 percent YoY** during April-September 2020 to reach **US$ 23.61 billion.**

Table 1: Services Sector Performance in India's GVA

Sector	Share in GVA (per cent)	Growth (per cent YoY)					
	2020-21 (AE)	2018-19 (1st RE)	2019-20 (PE)	2020-21 (AE)	2020-21 (H1)	2020-21 Q1	2020-21 Q2
Total Services (Excluding construction)	54.3	7.7	5.5	−8.8	−15.9	−20.6	−11.4
Trade, hotels, transport, communication & services related to broadcasting	15.4	7.7	3.6	−21.41	−31.5	−47.0	−15.6
Financial, real estate & professional services	22.2	6.8	4.6	−0.82	−6.8	−5.3	−8.1
Public administration, defence & other services	16.7	9.4	10.0	−3.68	−11.3	−10.3	−12.2

Why did India shift from the primary sector to the services sector and not the secondary sector?

- A country's normal economic path is from agrarian to industrial to a service economy, but India has jumped ahead of the curve from agrarian to service economy.
- Diversification towards services has been a notable element of India's recent prosperity, with the services sector accounting for the majority of GDP.
- India has become a prominent services exporter thanks to its success in software and IT-enabled services (ITeS), with its share of global services exports rising from 0.6 percent in 1990 to 3.3 percent in 2013.
- Other factors for the country's quick expansion in the service industry include well-educated and vast human resources, fluency in English, and the availability of cheap labor.
- On the other hand, low growth in the Secondary sector can be attributed to:
    - The license Raj
    - Restrictions on foreign investment
    - Lack of measures to promote private industry
    - Power Deficit
    - Stringent Labour laws
    - Lack of skilled labour
    - Delays in Land Acquisition and environmental clearances
    - Import of cheap manufactured goods etc.

- Despite its low per capita income, India's percentage of GDP from services is approaching the worldwide norm. However, unlike the global average, the contribution of services to employment was much lower.
- Because the manufacturing sector is labour-intensive, greater emphasis on manufacturing through initiatives such as 'Make in India' would help to remedy this anomaly and increase employment in line with GDP growth.

1.3.4 Quaternary Sector

- These are specialised tertiary operations in the **'Knowledge Sector,'** therefore thus require their own classification.
- The intellectual side of the economy is the quaternary sector. It is the procedure that allows entrepreneurs to innovate and increase the economy's service quality.
- This category includes employees who work in office buildings, elementary schools, and university classrooms, hospitals and doctors' offices, theatres, accounting, and brokerage firms.
- Quaternary activities, like other tertiary functions, can be outsourced.

1.3.5 Quinary Sector

- The quinary sector is the segment of the economy that makes the highest-level decisions.
- This includes the government, which is in charge of enacting legislation. It also includes the most powerful decision-makers in industry, trade, and education.
- These are services that focus on the development, reorganisation, and interpretation of new and existing ideas, as well as data interpretation and the use and evaluation of new technology.
- Senior business executives, government officials, research scientists, financial and legal consultants, and other professionals in this category are often referred to as **'gold collar' professionals.**
- They represent another subdivision of the tertiary sector, representing special and highly paid skills of senior business executives, government officials, research scientists, financial and legal consultants, and others.

1.4 On the Basis of Work Condition

1.4.1 Organised Sector

- In this industry, employment terms are set and consistent, and employees are guaranteed work and social security.
- It can also be characterised as a sector that is registered with the government and is subject to a variety of laws. The organised sector includes schools and hospitals.
- Workers in the organised sector have more job security. They are only required to work a set amount of hours. If they work longer hours, the company must compensate them with overtime pay.

1.4.2 Unorganised Sector

- A home-based worker, a self-employed worker, or a wage worker in the unorganised sector is considered an unorganised worker, as is a worker in the organised sector who is not covered by any of the welfare schemes listed in Schedule-II of the **Unorganized Workers Social Security Act, 2008**.
- Due to the transient and seasonal nature of employment and the dispersed placement of businesses, wage-paid labour in this sector is typically non-unionized.
- Low wages, insecure and irregular employment, and a lack of protection from legislation or trade unions characterise this industry.
- The unorganised industry relies primarily on labour-intensive and locally developed technology.
- Workers in the unorganised sector are so dispersed that the legislation's execution is woefully inadequate and ineffectual. In this industry, there are few unions to function as watchdogs.
- However, as compared to the organised sector, the unorganised sector makes a significant contribution to **national income**.
    - It **contributes more than 60% of national income**, whereas the organised sector contributes about half of that, depending on the industry.

1.5 On the Basis of Assets Ownership

1.5.1 The Public Sector

- The government owns the majority of the assets in the sector, and it is the segment of the economy responsible for providing various governmental services.
- The public sector does not exist solely to make money. Governments raise funds through taxes and other means to cover the costs of the services they provide.

1.5.2 The Private Sector

- Asset ownership and service delivery are in the hands of private individuals or organisations in the private sector.
- It is also known as the **citizen sector**, and it is administered by private persons or groups, usually for profit, and is not governed but regulated by the government.
- The private sector's activities are guided by the desire to make money. We must pay money to these persons and companies in order to obtain such services.

1.6 Conclusion

The primary sector, secondary sector, and tertiary sector are the three most important sectors in the Indian economy. When it comes to activity style, the Indian economy can be divided into two sections or sectors: the unorganised sector and the organised sector. Again, the Indian economy can be divided into two sections or sectors in terms of proprietorship or ownership: the private sector and the public sector.

*****

2. Primary Sector

The **primary sector of the economy** uses **natural resources** directly for its livelihood. For e.g. **Agriculture, forestry, and fishing, as well as mining and oil and gas extraction etc.** The secondary sector, which produces manufactured and other processed commodities, and the tertiary sector, which produces services, are in contrast. The UPSC Indian Economic Syllabus includes Primary Sector which is described in this article.

2.1 Primary Sector of the Economy

- The primary sector will comprise the majority of the economy in less developed countries. Increased laborproductivity allows workers to quit the agriculture sector and shift to other sectors such as manufacturing and services as an economy develops.
- Agricultural production employs roughly 3% of the workforce in the United Kingdom.
- Agriculture, mining, and extractive sectors make for about 12% of GDP in the United Kingdom.
- Manufacturing accounts for around 10% of GDP, while the service sector accounts for 78%. (Weighted GDP statistics for the United Kingdom)
- Activities in the primary sector of the economy are carried out by utilising natural resources directly. Agriculture, mining, fishing, forestry, dairy, and other industries fall into this category.
- It is thus named because it serves as the foundation for all other items. It is also known as the **Agriculture and Allied Sector** since agriculture, dairy, forestry, and fishing provide the majority of the natural items we consume.
- Due to the nature of their profession, people who engage in primary activities are referred to as **red-collar employees.**

Examples of Primary Sector

1. Farming
2. Fishing
3. Coal mining
4. Forestry and logging
5. Oil extraction
6. Diamond mining

2.2 Advantages

- Many developing economies' main comparative advantage will be in primary product production.
- The industry grows to be a significant source of economic growth, employment, tax revenue, and export earnings.
- Countries would suffer if primary products were not available.
- In developing economies, there is a **large and flexible supply of labour** willing and able to work in these industries.
- It does not necessitate costly investment or borrowing to finance investment. Local workers can manage the industries.
- Developing economies that have attempted to transition to manufacturing have not always been successful due to a lack of infrastructure, education, and human capital.
- It is an important source of **foreign currency** and **export revenue.**
- **Foreign direct investment** may be attracted. China has been investing in Central Africa to improve raw material access.
- This has included the construction of roads and railways – infrastructure that will benefit the economy in ways other than exporting primary products.
- Primary product industries can serve as a springboard for economic development if export earnings are reinvested in various aspects of economic infrastructure.

2.3 Issues

2.3.1 Export Revenue

- Natural resources can be used to generate income and export money for a country's economy.
- Many developing economies have benefited from the sale of oil, gas, and other natural resources, allowing them to obtain funds to invest in public services.
- Qatar, Saudi Arabia, and Norway, for example, have successfully utilised the boost in revenue to save for the future.

2.3.2 Monopoly power

- One issue with relying on the primary sector is that wealth is frequently distributed unequally.
- For example, a small number of companies establish monopoly power over the manufacturing of raw materials and pay their employees only a small portion of the profit.

- Despite having abundant raw supplies, many African developing countries have remained impoverished. A substantial primary sector is insufficient to drive economic development on its own.

2.3.3 Volatility

- Primary products are prone to price and output volatility. Oil and consumables, for example, can see substantial price changes.
- Demand tends to be quite price inelastic. If prices decline, countries that rely on a single industry may face a significant drop in revenue, producing problems.
- The EU continues to provide major subsidies and price assistance to EU agriculture.

2.3.4 Deindustrialization

We have witnessed a drop in primary sectors in developed economies, and as they take a lower percentage of the economy, this can lead to structural unemployment for a period of time.

2.3.5 Dutch Disease

- If primary products are highly profitable, resources will be diverted from other manufacturing industries and concentrated solely on primary industries.
- The issue is that when raw materials become scarce or the industry declines, the economy lacks broad diversification.
- This is referred to as the **"Dutch disease"** or **"resource curse."**

2.4 Conclusion

Primary activities are directly dependent on the environment since they involve the use of natural resources such as land, water, vegetation, construction materials, and minerals. Hunting and gathering, pastoral activities, fishing, forestry, agriculture, and mining and quarrying are all included in this category. Due to the nature of their profession, people who engage in primary activities are referred to as red-collar employees.

*****

3. Secondary Sector

The **secondary sector** of the economy comprises businesses that produce a finished, useful product and depend on primary sector companies for raw materials. **Mining, manufacturing, and construction** are all part of this industry. The secondary sector contributes **24% of the share** in the Indian economy. The UPSC Indian Economic Syllabus includes the Secondary Sector which is described in this article.

3.1 What is the Secondary Sector?

- The manufacture of finished items is a function of the secondary sector of the economy.
- This sector encompasses **all manufacturing, processing, and building operations**. Metalworking, vehicle manufacture, textile production, shipbuilding, and other activities are all part of this industry.
- Most economies go through a middle period of development during which the secondary sector overtakes the primary sector in terms of production and employment, while the primary sector declines in prominence.
- India, on the other hand, is an exception in that we have jumped right into developing the services industry without first enhancing our industrial capabilities.
- Manufacturing is the process of creating items from raw materials. Manufacturing literally means "to produce by hand," but it now also refers to the production of goods by machines.
- Specialization of skills and techniques of production, mechanisation, technical innovation, organisational structure, and uneven geographical distribution, with the majority of manufacturing units concentrated in a few regions, are all significant elements of modern large-scale manufacturing.

3.2 Classification of Industries

Manufacturing industries are classified on the basis of their output/products, ownership, size and inputs/raw materials.

3.2.1 Industries Based on Size

3.2.1.1 Household Industries or Cottage Manufacturing

- It is the smallest unit of production. The artisans manufacture everyday things in their homes with the support of family members or part-time labour, using local raw materials and modest tools.
- The finished products may be used in the same household, sold in local (village) marketplaces, or bartered.
- Because this sort of production has a limited commercial significance and most of the tools are designed locally, capital and transportation have little influence.

3.2.1.2 Small Scale Manufacturing

- Small-scale manufacturing differs from household businesses in terms of production processes and location (a workshop outside the producer's home/cottage).
- Local raw materials, simple power-driven machines, and semi-skilled labour are used in this sort of manufacturing.
- It creates jobs and boosts the purchasing power of the local community.
- As a result, countries such as India, China, Indonesia, and Brazil have established labour-intensive small-scale manufacturing to offer jobs for their citizens.

3.2.1.3 Large Scale Manufacturing

- A large market, different raw materials, enormous energy, specialised labour, modern technology, assembly-line mass production, and large capital are all involved in large-scale manufacturing.

3.2.1 Industries Based on Inputs/Raw Materials

3.2.1.1 Agro-based Industries

- The processing of raw resources from the field and farm into finished products for rural and urban markets is known as **agro-processing**.
- Food processing, sugar, pickles, fruits juices, beverages (tea, coffee, and chocolate), spices and oils, fats and textiles (cotton, jute, silk), rubber, and other agro-processing businesses are among the most important.

3.2.1.2 Mineral-based Industries

- Minerals are used as a raw material in these industries.
- Some businesses, such as the iron and steel industries, employ ferrous metallic minerals that contain ferrous (iron), whereas others, such as the aluminium, copper, and jewellery industries, use non-ferrous metallic minerals.
- Non-metallic minerals are used in a variety of industries, including cement and ceramics.

3.2.1.3 Chemical-based Industries

- Natural chemical minerals are employed in these industries, such as mineral-oil (petroleum) in the petrochemical industry.
- Natural minerals are also used in the salt, sulphur, and potash industries.
- Wood and coal are also used as raw materials in the chemical industry.
- Chemical-based businesses include synthetic fibre, plastic, and others.

3.2.1.4 Forest-based Raw Material using Industries

- Many big and small goods that are used as raw materials can be found in the forests.

- Forests provide timber for the furniture industry, wood, bamboo, and grass for the paper industry, and lac for the lac industries.

3.2.1.5 Animal-based Industries

- Animals provide leather for the leather industry and wool for woollen goods.

3.2.2 Industries Based on Ownership

- Governments own and oversee the **public sector industries**. There are a number of Public Sector Undertakings in India **(PSUs)**.
- Many state-owned industries exist in socialist countries. Both public and private sector businesses exist in mixed economies.
- Individual investors own the **private sector industries**. Private organisations are in charge of these. The majority of industries in capitalist countries are privately owned.
- **Joint Sector Industries** are controlled by joint-stock corporations, or the private and public sectors collaborate to create and operate them.

3.3 Factors Affecting Industrial Locations

Modern manufacturing has flourished in a small number of locations that account for less than ten percent of the worldwide geographical area. Because corporations' goals are to maximise profits, industry locations are frequently chosen in such a way that production expenses are kept to a minimum. The following are the factors that determine industrial location:

3.3.1 Access to Market

- The most essential factor in the location of industries is the existence of a market for manufactured goods.
- People who have a demand for these things and also have the purchasing power (ability to buy) to buy from the vendors at a location are referred to as **"market."**
- Small markets can be found in remote places where only a few people live.

3.3.2 Access to Raw Material

- Industries should employ low-cost, easy-to-transport raw materials.
- Steel, sugar, and cement businesses, for example, are dependent on inexpensive, bulky, and weight-losing material (ores) and are located near raw material sources.

3.3.3 Access to Labour Supply

- Industry location is influenced by the availability of labour. Some manufacturing processes still require expert labour.
- Industrial processes have become more mechanised, automated, and flexible as a result of increased mechanisation, automation, and flexibility.

3.3.4 Access to Sources of Energy

- Industries that consume more energy, such as the aluminium sector, are placed near the source of energy.
- Although coal was once the primary source of energy, hydroelectricity and petroleum are now key sources of energy for a variety of businesses.

3.3.5 Access to Transportation and Communication Facilities

- For the development of industries, quick and effective transportation infrastructure are required to deliver raw materials to the plant and finished items to the market.
- The cost of transportation has a significant impact on where industrial units are located.

3.3.6 Government Policy

- Governments implement regional policies in order to foster 'balanced' economic development and, as a result, establish industries in specific areas.

3.3.7 Access to Agglomeration Economies/ Links between Industries

- Nearness to a leader-industry and other industries benefits several industries. **Agglomeration economies** are the name given to these advantages.
- Savings are obtained through the interconnections that exist between various sectors.

3.4 Advantages

- Secondary industries have contributed to the creation of job opportunities. After farming, it employs the greatest number of people.
- The finished products in our homes are the result of this sector's manufacturing and production processes. These items have aided in making our lives easier.
- Secondary industries have contributed to a country's growth and prosperity. People are more likely to pay more taxes when they have enough. The government spends this amount on the well-being of its citizens.
- Industrialization is the result of secondary industries, and it has resulted in fewer imports and an increase in exports. This promotes higher income through foreign exchange, making the country more prosperous.
- It aids countries in benefiting and specialising from economies of sale.

3.5 Disadvantages

- The most serious disadvantage of secondary industries is that they have increased pollution to unimaginable levels.
- The poisonous gas emitted over time has been a major contributor to global warming. Our rivers are being polluted by waste materials.
- Secondary industries typically attract workers due to job opportunities and higher pay.

- Workers' base has shifted from rural to urban areas, which can lead to issues such as a lack of proper housing, basic amenities, and a variety of health issues.
- Workers prefer to work in the secondary sector rather than the primary sector because the money and opportunities are greater in the secondary sector.
- This is causing a void that may result in a labour shortage in the agricultural sector.
- The vast disparity between rich and poor is attributed to secondary industries, which make rich people richer and poor people poorer.

3.6 Conclusion

- The manufacture of a final, usable product is the responsibility of India's secondary sector. For the procurement of raw materials for use in the product development process, this sector is heavily reliant on the primary sector.
- The available natural raw materials are exploited to generate goods and services for consumption.
- The numerous government policies and plans are designed to promote the economy's industries with the goal of reaching production self-sufficiency.
- Production self-sufficiency is critical because it protects the economy from international competition.

*****

4. Tertiary Sector

The **Tertiary sector**, which includes the **service industry,** is the most important of all sectors. The tertiary sector of the economy is responsible for providing services to both businesses and final consumers. Services can include the **transportation, distribution, and sale of commodities from a producer to a customer, as in wholesaling and retailing**, or providing of a service, as in pest treatment or entertainment. The UPSC Indian Economic Syllabus includes Tertiary Sector which is described in this article.

4.1 What is the Tertiary Sector?

- The tertiary sector makes the **most contribution to India's GDP** (more than 50percent).
- Because it provides services to all current firms and final consumers, the tertiary sector is often known as the **service industry**.
- Distribution, transportation, and the selling of goods from producers to consumers are all examples of services, as are retailing, wholesaling, and even information technology, insurance, finance, transportation, and entertainment.
- The tertiary sector gains considerably from higher production in the first two sectors.
- This industry is critical because individuals demand specific services to live a pleasant and high-quality existence.

TERTIARY SECTOR

4.2 More about the Tertiary Sector of the Indian Economy

- Medical amenities, transportation facilities, financial facilities, technical facilities, communication facilities, and so on are always in demand.
- The tertiary sector's productivity is primarily reliant on creative innovations and scientific research.
- More than 80% of the population in industrialized economies is employed in the service industry.
- The IT business is booming as a result of the abundant supply of highly skilled English-speaking people who can be hired at a low cost.

The tertiary sector is made of;

- The **market services sector** (trade, transportation, financial operations, business services, personal services, accommodation, and food service activities, real estate, and information and communication);
- The **non-market services sector** (public administration, education, human health, social work activities).

Examples of Tertiary Sector;

1. Trade, Hotels, and Restaurants
2. Real estate and Business services
3. Transport, Storage, and Communication
4. Financial services such as Banking, Insurance, etc.
5. Real estate and Business services
6. Public Administration
7. Other services.

4.3 Advantages

- One of the primary benefits of the tertiary sector is that it has a much lower barrier to entry than starting a physical product-based business.
- They often do not have inventory and do not need to worry about manufacturing products.
- It enables local marketing and one does not have to compete with the retail industry's franchises and corporations.
- They can respond to changing customer needs much faster than product-based businesses.
- In times of economic crisis or downturn, it can provide faster and more flexible adjustment.
- It reduces environmental damage caused by heavy industry.
- It allows for more rapid economic development than the traditional pattern.
- It reduces the use of materials and energy.
- It aids in knowledge advancement.
- More customer-focused products to ensure their satisfaction.

4.4 Disadvantages

- More reliance on other countries for goods.
- The trade deficit has grown as a result of increased imports and decreased exports of goods.
- Product outsourcing has resulted in the loss of manufacturing jobs.
- More skilled workers and employees are required.

4.5 Conclusion

- A country's economy cannot be entirely based on services. However, a service economy is a sign of the country's economic growth and development, and it demonstrates the economy's strength.
- From commerce to administration, transportation, financial and real estate activities, business and personal services, education, health, and social work, the tertiary sector includes a wide range of activities.

*****

5. Quaternary and Quinary Sector

The **Quaternary sector** includes all industries that are concerned with the creation and distribution of knowledge. This sector emerged a few years ago as an additional tertiary sector distinction. For example, **research and development, education**, and so on.

The **Quinary sector** is the segment of the economy that **makes the highest-level decisions.** This includes the **government**, which is in charge of enacting legislation. It also includes the most powerful decision-makers in industry, trade, and education.

The UPSC Indian Economic Syllabus includes the Quaternary Sector and Quinary Sector which is described in this article.

5.1 What is the Quaternary Sector?

- The **intellectual side of the economy** is said to be represented by the **quaternary sector.** It encompasses **education, training, technological advancement, and research and development.**
- It is the process that allows entrepreneurs to improve manufacturing processes and the quality of services provided in the economy by innovating better manufacturing processes.
- Economic progress would be slow or non-existent without the advancement of technology and knowledge.
- It is also known as the **knowledge economy**, which refers to the part of the economy that is reliant on human capital, such as information technology, knowledge, and education.
- It's mostly about the service industry, but it's also about the high-tech component of manufacturing.
- This category includes employees who work in office buildings, elementary schools, and university classrooms, hospitals and doctors' offices, theatres, accounting, and brokerage firms.

5.1.1 Advantages

- It enables a specialized space in which entrepreneurial thinking is essential. This area is used by individuals to identify and develop new products.
- This sector allows countries to focus on developing new ways to support the other sectors.
- The specialised sector allows the workforce to advance their skills to a higher level. It enables consultants, for example, to work in a higher knowledge field while also supporting existing structures.
- The Quaternary Industry devotes a significant amount of time to improving existing knowledge systems in the information technology environment.
- Large-scale corporations typically make significant investments to ensure the development of the Quaternary Industry.

5.1.2 Disadvantages

- It remains a highly specialized environment that tends to decline during economic downturns.
    - That is, it does not provide you with food but rather focuses indirectly on new methods of planting seeds more successfully.
- This industry employs highly skilled individuals and necessitates significant investment to compensate these specialized individuals.
- The Quaternary Industry is a **white-collar field** with a limited number of job opportunities.

5.2 What is the Quinary Sector?

- Some economists say that the quinary sector of the industry includes **health, education, culture, research, police, fire service, and other government-run businesses** that are **not intended to generate a profit.**
- These businesses are usually found in the tertiary or quaternary sectors. Despite the inference, it is not a direct replacement for the quarternary industry, as it only requires a population base and the taxation of other profitable business sectors.
- These are services that concentrate on the production, reorganisation, and interpretation of new and existing ideas, as well as data interpretation and the use and evaluation of new technology.
- Senior business executives, government officials, research scientists, financial and legal consultants, and other professionals in this category are often referred to as **"gold collar" professionals.**
- They are a subset of the tertiary sector that represent special and highly compensated skills of senior business executives, government officials, research scientists, financial and legal consultants, and others.
- Their importance in the structure of advanced economies far outweighs their numbers.

5.2.1 Importance

- The workers' importance in the structure of advanced economies far outweighs their numbers.
- The fact that the term is not used to evaluate **profit vs. economic basis** is an important feature of the Quinary economic sector.
- Not for profit, but to categorise industries based on the application of knowledge, thereby measuring innovation policies and systems.
- This sector is expected to grow primarily, but not entirely, through public investments.

5.3 Conclusion

These are specialized tertiary activities in the **'Knowledge Sector'** which demands a separate classification. The intellectual side of the economy is the quaternary sector. It is the procedure that allows entrepreneurs to innovate and increase the economy's service quality.

Quinary activities are services that centre on the production, reorganisation, and interpretation of new and existing ideas, as well as data interpretation and the use and evaluation of new technology. Quinary actions are carried out by the highest level of decision-maker or policymakers.

*****

6. Economic System

An **economic system** is a tool that the government uses to plan and distribute accessible services, resources, and commodities across the country. Economic systems combine wealth, labour, physical resources, and business personnel to handle production factors. Many organisations, agencies, products, models, and decision-making methods make up an economic system. The UPSC Indian Economic Syllabus includes the Economic System which is described in this article.

6.1 Types of Economic Systems

6.1.1 Capitalist economy

- In a capitalist society, **items are distributed among individuals based on purchasing power,** which is the ability to buy goods and services, rather than on what they want.
- This implies that a person must have sufficient funds to purchase products and services.
- Low-cost housing for the poor is desperately needed, yet there will be little demand in the market because the poor lack the purchasing ability to support it.
- As a result, the goods will not be produced and distributed according to market forces.

6.1.2 Socialist economy

- In a socialist society, the **government decides what products will be made** to meet the society's needs.
- It is assumed that the government is aware of what is appropriate for the country's population. As a result, individual purchasers' passions aren't given much consideration.
- The government makes decisions about how items are made and how they are disposed of.
- In theory, sharing under socialism is based on what each individual requires rather than what they can afford.
- Because everything is controlled by the government in a socialist regime, there is no separate estate.

6.1.3 Mixed economy

- The characteristics of both the **socialist and capitalist economic systems** can be found in mixed systems.
- Mixed economic systems are also called **dual economic systems** for this reason.
- A genuine approach for determining a mixed system, on the other hand, does not exist.

- In some parts of the economy, the term can refer to a market system that is subject to rigorous administrative regulation.

6.2 Central Problem of Economy

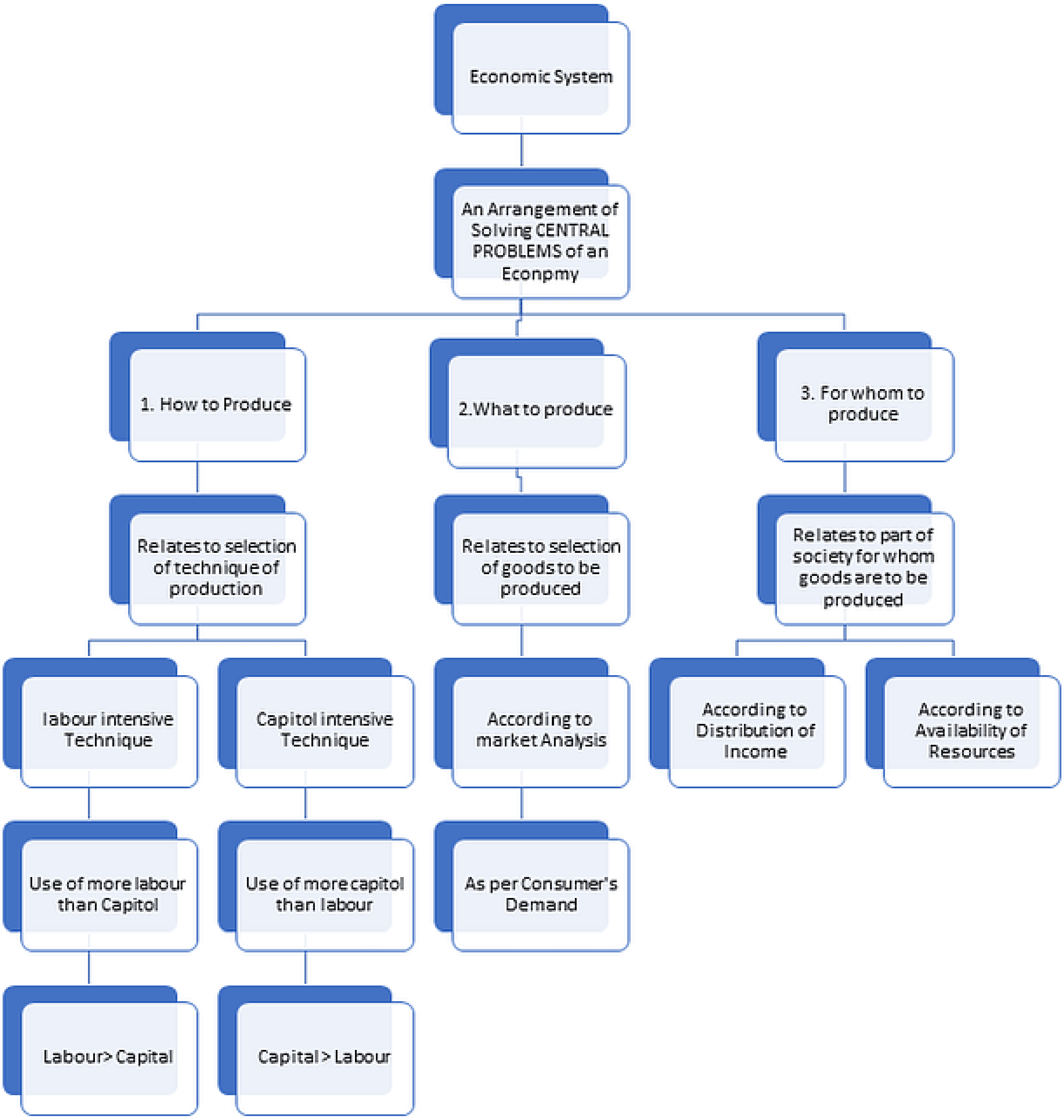


Table 6.1: Differences between Capitalist, Socialist, and Mixed Economies

Parameters	Capitalist economy	Socialist economy	Mixed economy
Ownership of property	Private ownership	Public ownership	Both private and public ownerships
Price determination	Prices are determined by the market forces of demand and supply.	The central planning authority determines prices.	The central planning authority, as well as demand and supply, determine prices.
Motive of production	Profit motive	Social welfare	In the private sector, profit is the motivating factor, while in the public sector, welfare is the motivating factor.
Role of government	No role	Complete role	Full role in the public sector and limited role in the private sector
Competition	Exists	No competition	Exists only in the private sector
Distribution of income	Very unequal	Quite equal	Considerable inequalities exist

6.3 Conclusion

Economies are classified into three models based on the responsibility and structure of the production and distribution network as capitalist, socialist, and mixed economies. Many countries have chosen different models of economic system based on their socio-political systems.

*****

7. Capitalist Economy

In a **capitalist economy,** capital assets, like mines, factories, and railroads, can be privately owned and controlled, labour can be bought for money salaries, capital profits accrue to private owners, and prices allocate capital and labour between competing uses. It is defined as a system characterised by private ownership and the profit-making utilisation of both artificial and natural capital.

Because the **free market decides demand, supply, and price,** the capitalist economy is referred to as a **liberal economy**. The government has no active involvement in this sector. The UPSC Indian Economic Syllabus includes the Capitalist Economy which is described in this article.

7.1 What is Capitalism?

- **Capitalism,** often known as the capitalist economy, is an economic system in which private firms control and govern the factors of production such as **capital goods, labour, natural resources, and entrepreneurship.**
- The production of all commodities and services in a capitalist economy is based on **demand and supply in the market**, often known as a **market economy.**
- It differs from the central planning system, which is also referred to as a **command or planned economy.**
- The primary feature of a capitalist economy is the desire to make money. The presence of open markets and the government's lack of involvement in corporate regulation are also characteristics of the capitalist economy.
- The origins of capitalism may be traced back to 18th century England, which was in the midst of the industrial revolution. This form of economy is also known as a **free-market economy** because there is no government intervention.

7.2 Features of Capitalism

Let us look at some of the key characteristics of capitalism and the capitalist economy.

- **Private property**: Private property is one of the most essential elements of capitalism, as private persons or organisations can possess private properties such as factories, machinery, and equipment.
- **Individual liberty:** Under this system, each person has the freedom to make their own economic decisions without interference. Both consumers and producers can benefit from this.
- **Profit motive:** One of the most significant motivations of a capitalist economy is the desire to make money. In this system, all businesses strive to maximise profits by producing and selling their goods to consumers.
- **Price mechanism:** In this system, market demand and supply decide the volume of production and, as a result, the price is established for the products, with no interference from the government.

- **Customer sovereignty:** In this arrangement, the market is dictated by consumer wants. It governs the degree of production carried out by businesses, although the consumer is free to choose which things to buy.
- **Free trade:** In this system, low tariff barriers exist that promote international trade.
- **Government interference:** In a capitalist economy, the government is not involved in the day-to-day operations of the firm. Customers and producers are free to make their own choices when it comes to products and services.
- **Flexibility in labour markets:** Capitalism allows for a degree of flexibility in the hiring and firing of employees.
- **Ownership freedom:** Under this system, an individual can amass any amount of property and use it as he sees fit. By right of inheritance, the same property is passed on to his successors after his death.

7.3 Advantages of Capitalist Economy

The following are some of capitalism's benefits.

- Economic liberty **promotes political liberty**. When governments own the means of production and set prices, it invariably results in a powerful state and a large bureaucracy that may spread into other areas of life.
- Firms in a capitalist society face **incentives to be efficient and produce in-demand goods.** These incentives put pressure on businesses to cut costs and eliminate waste.
- Capitalism is characterised by a **dynamic** in which entrepreneurs and businesses strive to create and develop profitable products. As a result, they will not remain stagnant, but will instead invest in new products that may be popular with consumers.
- With incentives for firms and individuals to be innovative and work hard, a climate of innovation and economic expansion is created. This contributes to higher real GDP and higher living standards.
- The capitalist economy is more efficient because things are manufactured in response to consumer demand.
- There is less government intrusion and bureaucratic interference.
- As corporations seek to capture a large portion of the market with their goods, there is more room for innovation.
- It prohibits discrimination of any kind so that trade between two parties can proceed without hindrance.

7.4 Disadvantages of Capitalist Economy

- Private capital ownership allows firms to gain monopoly power in product and labour markets. **Monopolistic firms** can use their position to charge higher prices.
- Firms with **monopsony power** pay lower wages to their employees. In capitalist societies, there is frequently a large disparity between those who own capital and those who work for businesses.
- Social benefits are often overlooked.
- A profit-seeking capitalist firm is likely to disregard negative externalities, such as pollution from production, which can harm living standards.

- Similarly, in a free-market economy, goods with positive externalities, such as health, public transportation, and education, will be under-provided.
- Inequality in income is a result of capitalism. Inequitable societies breed resentment and social division.
- A capitalist society argues that it is good for people to be able to earn more money, which leads to income and wealth inequality. This, however, ignores the **diminishing marginal utility of wealth.**
- Firms can gain a monopoly on workers and consumers under capitalism.
- A capitalist economy's high-profit motive is to utilise resources in such a way that it causes environmental concerns by disrupting the natural balance.

Examples of Capitalist Economies

1. Canada
2. Switzerland
3. United Kingdom
4. United States
5. Ireland
6. Hong Kong
7. United Arab Emirates
8. Singapore
9. New Zealand
10. Australia

7.5 Conclusion

- Capitalism is an economic system that relies on a free market to find the most effective resource allocation and price setting based on supply and demand.
- Socialism is frequently portrayed as the polar opposite of capitalism, in which there is no free market and resource distribution is regulated by a central body.
- A two-class structure, private ownership, a profit motive, little government interference, and competition are just a few of capitalism's distinguishing characteristics.

*****

8. Mixed Economy

A mixed economy is an economic system in which **both the government and the private sector exercise control over the economy**. It is the middle path between the capitalistic and socialistic economic systems. A mixed economic system protects private property and allows for some economic freedom in the use of capital, but it also allows governments to intervene in economic activities to achieve social goals. Some of the countries practicing mixed economy are **the United States, the United Kingdom, Iceland, India, and Sweden** among many countries. In this article, we will discuss the mixed economy that is important for the UPSC examination.

8.1 What is a Mixed Economy?

- A mixed economy, as the name implies, is a winning **mixture of a command and a market economy**. As a result, it adheres to both the pricing mechanism and central economic planning and supervision.
- Both private corporations and governmental or state-owned enterprises own the means of production. While market forces determine **pricing, demand, supply**, and other factors, the government maintains some control to avoid **monopolization** and discrimination.
- The goal of a Mixed Economy is to address the flaws of both a capitalist and a socialist economy in order to create a unique system. It values the principle of private property and resource ownership as well as the freedom that comes with it.
- At the same time, it recognizes the dangers of unchecked capitalism. As a result, it advocates government control and economic planning to ensure that the poorest citizens are not discriminated against.

8.2 Features of Mixed Economy

- **Coexistence of All Sectors:** In a mixed economy, all three sectors, namely the private, public, and joint sectors, coexist in peace. The government and private enterprises administer the joint sector together, with the government owning at least 51 percent of the company.
- **Cooperative Sector**: Another sector exists in a mixed economy i.e., the cooperative sector. The primary goal of forming this sector is for the government to offer financial aid to cooperative societies in the warehouse, agricultural, and dairy industries, among other industries.
- Individuals have the **freedom to generate goods and services,** own property, pick their career, and choose or demand the products/services they desire. However, the state retains some supervision over monopolistic behaviors and discrimination against the poorer classes.
- **Economic Planning:** We have a central planning body in a mixed economy. To reach various aims and goals, all sectors of the economy follow the state's economic plan. The plan is not set in stone, but rather serves as a basic guideline for the country's economic progress and prosperity.

- **Social Welfare:** Social welfare is one of the fundamental goals of a mixed economy. Its goal is to close the wealth gap in the country and combat societal inequities. Poverty and unemployment are to be reduced. Simultaneously, increase social security, public health care, and the public education system, among other things.

8.3 Mixed Economy - Benefits

- **Private Sector Encouragement:** The most essential benefit of a mixed economy is that it encourages the private sector and gives it the opportunity to flourish. It causes the country's capital creation to rise.
- **Freedom:** In a mixed economy, as in a capitalist system, there is both economic and occupational freedom. Every individual has the freedom to pursue any employment he or she chooses. Similarly, each producer has the ability to make judgments about production and consumption.
- **Optimal Resource Utilization:** In this system, both the commercial and public sectors collaborate to make the most effective use of resources possible. The public sector works for the common good, whereas the private sector makes the best use of these resources in order to maximize profit.
- **Economic Planning Benefits:** In a mixed economy, economic planning has all of its benefits. The government takes steps to address economic instabilities and other economic ills.
- **Lower Economic Disparities:** Capitalism exacerbates economic inequalities, but in a mixed economy, inequalities are more easily addressed by government initiatives.
- **Rivalry and Efficient Production:** The degree of efficiency stays high due to competition between the private and governmental sectors. In the prospect of profit, the components of production operate efficiently.
- **Social Welfare:** Under this system, social welfare is given top priority through sound economic planning. The government has complete authority over the private sector. The private sector's production and pricing practices are geared toward maximizing societal welfare.
- **Economic Development:** Under this system, the government and the private sector work together to construct socio-economic infrastructures. In addition, the government enacts several legislative measures to protect the interests of the poor and vulnerable. As a result, for any developing country, a mixed economy is the best option.

8.4 Mixed Economy - Demerits

- **Instability:** According to some economists, mixed economies are the most unstable in nature. The public sector reaps the greatest rewards, while the private sector is kept under check.
- **Sector Inefficiency:** Under this arrangement, both sectors are inefficient. The private sector does not have complete independence, and as a result, it is rendered ineffectual. As a result, the public sector becomes ineffectual. Both industries are, in a way, not just competitive, but also complimentary.

- **Ineffective Planning:** In a mixed economy, there is no such thing as comprehensive planning. As a result, the government has no authority over a significant portion of the economy.
- **Efficiencies are lacking in this system**, and both sectors suffer as a result. In the public sector, this is because government personnel does not carry out their responsibilities responsibly, but in the private sector, efficiency suffers because the government imposes too many limitations in the form of controls, permissions, and licenses, among other things.
- **Delays in Economic Choices:** In a mixed economy, certain decisions are usually delayed, especially in the public sector. This sort of lag always creates a significant impediment to the economy's proper operation.
- **Resource Waste:** Another issue with the mixed economic system is resource waste. A portion of the funding given to various public-sector programs ends up in the pockets of middlemen. As a result, resources are squandered.
- **Corruption and Black Marketing:** This system is rife with corruption and black marketing. Political parties and self-interested individuals benefit unduly from the public sector. As a result, numerous evils develop, such as black money, bribes, tax evasion, and other illicit acts. All of these things add to the system's red tape.

8.5 Why India Adopted Mixed Economy?

- After independence, India's **socioeconomic situation made it difficult for either the public or private sectors to shoulder the burden** of development alone.
- To deal with issues such as per capita income, a large portion of the population working in the primary sector, a high birth rate, severe unemployment, and low capital formation, unequal wealth distribution, illiteracy, a lack of technical knowledge, poor human resource quality, and so on, it became critical to adopt an economic system that could bring about the growth that was conducive to or in relation to the prevailing environment. Thus, India adopted a mixed economy.

8.6 Conclusion

A mixed economic system protects private property and permits some economic freedom in capital allocation, but it also allows governments to intervene in economic activity to achieve social goals. Thus, it is one of the most important economic systems existing in the world.

*****

9. Capitalist and Socialist Economic Systems

Capitalist Economy and **Socialist Economy** are two types of economic systems prevailing in the world. **Capitalism,** often known as the capitalist economy, is an economic system in which private firms control and govern the factors of production such as capital goods, labor, natural resources, and entrepreneurship. The setup of a socialist economy is diametrically opposed to that of a capitalist one. The factors of production in such an economy are all held by the government. This article covers the **difference between Capitalist and Socialist Economies**, which will be useful for UPSC IAS Exam preparation.

9.1 What is a Capitalist Economy?

- A capitalist economy is one in which **private companies** own and controls the means of production.
- Capital goods, natural resources, labor, and other elements of production are among them.
- **Demand and supply** govern the production and consumption of products and services in this economy.
- The capitalist economy is dictated by these **market forces**. In this economy, the primary motivation for manufacturing is to make a profit.
- In a capitalist economy, the government also has a significant lack of engagement. Because each sector/industry has several enterprises, there is a fierce rivalry between them in the economic system.

9.2 What is a Socialist Economy?

- The government is the dominant entity in a socialist economy, and it selects what products and services are created to **meet society's needs**.
- They also have total control over the production elements. In this economy, the primary motivation for **providing goods and services is societal welfare** rather than profit, therefore the requirements and desires of individual buyers are unimportant.
- The **price of goods is controlled by the government** in this form of economy.
- There is no competition in this economic system since the government controls every sector/industry.

Table 9.1: Difference between Capitalist and Socialist Economic Systems

Criteria	**Capitalist Economy**	**Socialist Economy**
Definition	A capitalist economy is one in which private firms control key production components such as labor, natural resources, and capital goods.	A socialist economy is one in which the government controls the elements of production such as labor, natural resources, and capital

		goods.
Determination of Price	Demand and supply forces determine the pricing of products and services in a capitalist economy.	The pricing of products and services is regulated and controlled by the government in a socialist economy.
Motive of Production	In a capitalist economy, the primary motivation for producing products and services is to make money.	In a socialist economy, the wellbeing of the general population is the primary motivation for creating commodities and services.
Role of Government	When it comes to the production and distribution of goods and services, the government plays a minimal or non-existent role in a capitalist economy.	The government has total control over the production and distribution of goods and services in a socialist economy.
Role of Private Sector	In a capitalist economy, the private sector totally controls the production and distribution of commodities and services.	In a socialist economy, the private sector has no involvement in the production and distribution of products and services.
Competition	In a capitalist economy, competition between different enterprises is a necessary component.	In a socialist economy, the government has no competitors.
Distribution of Income	In a capitalist economy, income distribution is uneven.	In a socialist economy, income distribution is more or less equal.

9.3 Conclusion

There are significant distinctions between a capitalist and a socialist economic system, and they both operate differently. Both of these systems, however, have advantages and disadvantages, and it is up to each country to choose between them.

*****

10. National Income Accounting

National income accounting is a bookkeeping method used by governments to track the level of economic activity in their country through time. Total revenues made by domestic firms, wages given to foreign and domestic workers, and the amount spent on sales and income taxes by corporations and individuals resident in the nation are all examples of accounting records of this type. Here we will discuss in detail National Income Accounting which will be helpful for UPSC Civil Service preparations.

10.1 What is National Income?

- **National Income:** After depreciation, the total worth of final products and services generated by normal residents throughout an accounting year is called the national income.
    - It is **Net National Product (NNP)** At **Factor Cost (FC).**
    - Taxes, depreciation, and non-factor inputs are not included (raw materials).
- **Domestic Income** - After depreciation, the total worth of final products and services generated inside a domestic area within an accounting year is called domestic income.
    - It is **NDP (National Domestic Product)** at Factor Cost.
    - NNP and NDP may be calculated using either constant prices (real income) or market prices (nominal income).
- **Domestic income plus net factor income from abroad (NFIA)** equals national income.

10.2 National Income Accounting

- Although national income accounting is not an exact science, it does give important information about **how well an economy is performing and where money is created and spent**.
- Data on per capita income and growth may be evaluated across time when paired with statistics on the corresponding population.
- The **gross domestic product (GDP), gross national product (GNP), and gross national income (GNI)** are some of the indicators computed using national income accounting.
- The GDP is a frequently used metric for domestic economic research, and it reflects the total market value of goods and services produced in a certain country during a given period of time.

10.3 National Income Accounting in India

The National Economic Growth Rate is determined by computing the National Income Accounting, which may be done in a variety of ways:

10.3.1 Income Method

- This technique is concerned with the creation of products and services using capital, land, labour, and other resources.
- Interest, profit, rent, salaries, and other sources of income are all used to create income.
- Mixed-income, which is earned by businessmen and self-employed professionals, is another factor to consider.

Therefore, National Income = Interest + Profit + Rent + Wages + Mixed Income

Example: Calculate the National Income of country X and identify which of the following is not considered while calculating National Income using the Income Method?

- Rent accrued – Rs. 10000
- Salaries – Rs. 20000
- Sale from secondhand goods – Rs. 10000
- Interest earned on Loan – Rs. 20000

Answer: National Income = Interest + Profit + Rent + Wages + Mixed Income

= 10000+20000+20000

= 50000

Here the sale of second-hand goods will not be counted because it's not an income generated from land and labour.

10.3.2 Expenditure Method

This strategy takes into account purchases made by governments, residents, businesses, and other entities. The elements are as follows:

- C = Consumer goods and service expenditures by residents and households
- G = Government expenditures on goods and services
- I = Business Organizations' Capital Goods and Stocks Expenses
- NX stands for net exports, which is defined as exports minus imports.

As a result, **national income = C+G+I+NX**

10.3.3 Value Added Method/ Production Method

The economy is separated into several industries using this strategy, such as transportation, communication, agriculture, and so on.

- The Net Value Added at Factor Cost (NVAFC), which is the value-added at each step, is used to determine National Income. We must deduct the following when calculating the same for each industry:
    - Net Indirect Taxes
    - Capital Consumption

    - Raw Material Consumption
- Now NVAFC becomes the value after the deduction of the above things.
- When the NVAFC of industries is summed, the net domestic product at factor cost (NDPFC) is calculated.
- Finally, foreign states' net income should be included.
- Thus, in India,
    - National income = NDPFC + Net factor income from overseas.

10.4 Conclusion

The quantitative data gathered through national income accounting may be used to assess the impact of various economic initiatives. National income accounting, which is considered an aggregate of a country's economic activity, provides economists and statisticians with specific information that can be used to track an economy's health and estimate future growth and development. The data may be used to guide inflation policy, which is especially valuable in developing countries' changing economies, as well as information on output levels as they relate to moving labour forces.

*****

11. Circular Flow of Income

The continual flow of products and services production, revenue, and spending in an economy is referred to as the **circular flow of income.** It depicts the circular transfer of income between the manufacturing unit and households. Here we will discuss in detail the circular flow of income, which will be useful for UPSC Civil Service Exam preparation.

11.1 What is Circular Flow of Income?

- The circular flow model depicts how **money circulates throughout society**. Money moves from producers to employees as wages, then back to producers as product payment. In a nutshell, an economy is a never-ending circle of money.
- Although this is the most basic version of the concept, actual money flows are more complex.
- Economists have included extra variables to properly reflect today's complicated economy. These elements make up a country's gross domestic product (GDP) or national income.
- The concept is also known as the circular flow of income model because of this.

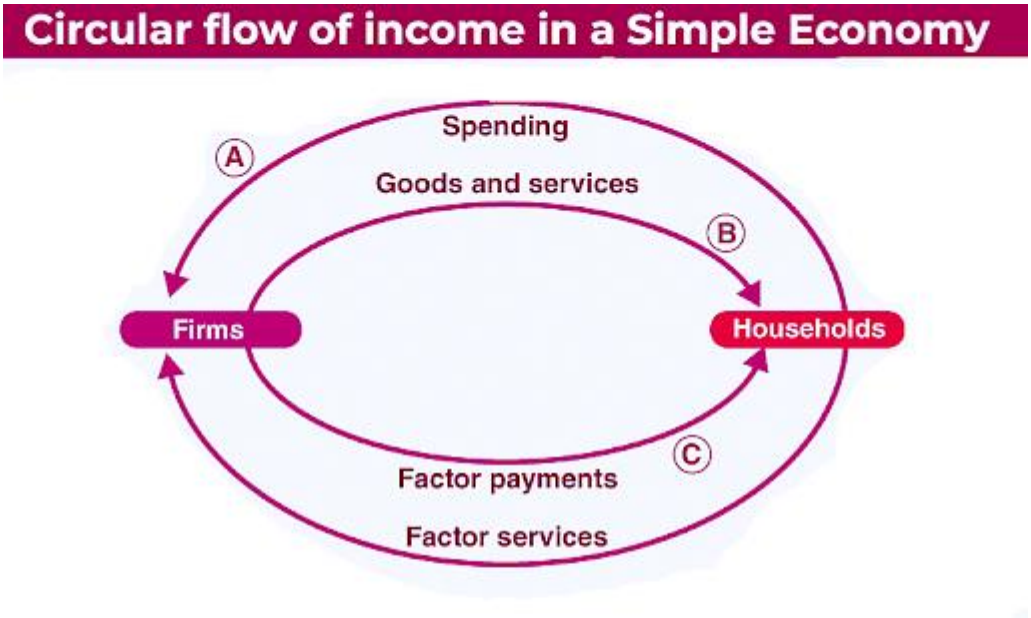
11.2 Concept

- The circular flow in an economy refers to the continuous movement of goods and services production, earning, and expenditure.
- It represents the cyclical revenue transfer between the production unit and the households.
- **Land, labor, capital, and entrepreneurship** are the four factors of production:
    - **Rent** is a payment given in exchange for the contribution produced by fixed natural resources (often known as land).
    - **Wage** is the monetary compensation for a human worker's contribution.
    - **Interest** is the payment provided in exchange for the capital contribution.
    - **Profit** is the monetary reward for entrepreneurship's contribution.

11.3 Case of Two-Sector Economy

It is described as the exchange of payments and receipts for products, services, and factor services between households and businesses.

- The diagram's lower portion depicts the flow of factor services from homes to businesses, as well as the equivalent flow of factor payments from businesses to consumers (C).
- The upper portion depicts the movement of goods and services from businesses to consumers (B), as well as the flow of consumer spending (A) from consumers to businesses.



11.4 Conclusion

The economic model depicting the circular movement of money between firms/producers and households is known as the circular flow of income. Because it only covers two sectors, households and businesses, this model is often known as a **two-sector economy.** Many other actors, including the government, national revenue, and overseas markets, are taken into consideration in the real world. The intricacy rises dramatically, yet the final outcome is still a cyclical flow of wealth.

*****