LATEST EDITION

CBSE

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POWER PRACTICE

INDIAN ECONOMIC DEVELOPMENT

CONTENTS

Chapter 1

INDIAN ECONOMY ON THE EVE OF INDEPENDENCE

LEARNING OBJECTIVES

- Know the state of India's economy in 1947.
- Understand colonial rule's impact on agriculture and industry.
- Learn about low literacy, poor health, and infrastructure issues.
- Identify the features of backward economy (low output, poverty).
- Recognize economic challenges India faced after independence.

When India got independence in 1947, it inherited an economy that was very much underdeveloped, stagnant, and heavily exploited by nearly 200 years of British colonial rule. The colonial government had structured India's economic system to serve British interests, not to develop India's economy. As a result, the Indian economy faced both serious structural and developmental challenges.

Colonial Impact on the Economy

The British used India primarily as a source of raw materials only for their industries and as a market for their finished products. This led to the downfall of indigenous industries, especially traditional handicrafts, and the drain of India's wealth through unfair trade practices. The colonial rulers made no significant attempts to modernize or industrialize the Indian economy.

Agriculture: The Backbone, Yet Broken

- Agriculture was the main occupation for the majority of Indians, but it suffered from low productivity and primitive methods of cultivation.
- Zamindari and landlord systems caused big exploitation of farmers.
- There was little to no investment in irrigation, tools, or seeds.
- Frequent famines, food shortages, and high rural poverty marked the agricultural sector.

Industry: Minimal and Controlled

- Indian industries were deliberately suppressed to promote British imports.
- Traditional handicrafts and cottage industries fall down due to cheap British machine-made goods.
- A few modern industries (like jute, cotton textiles, iron & steel) emerged, but their growth was slow and largely controlled by the British or foreign capitalists.
- There was no industrial policy for national development.

Foreign Trade: Unbalanced and Exploitative

- India was forced into an unequal trading relationship where it exported raw materials and imported expensive British goods.
- This resulted in a massive outflow of wealth from India to Britain—often referred to as the economic drain.
- Trade lacked diversity and India's own manufacturing capabilities were never developed.

Infrastructure: Built, But Not for People

- Infrastructure like railways, ports, and roads was developed during British rule, but mainly for economic and administrative control, not for connecting or uplifting the Indian population.
- Communication systems (post, telegraph) also served military and governance needs rather than public benefit.
- Rural and agricultural infrastructure remained neglected.

Demographic Conditions: Poor and Depressing

- Life expectancy was very low (around 44 years) due to poor health facilities, high infant mortality, and widespread disease.
- The literacy rate was extremely low, with very limited access to education.
- Population growth was high, driven by high birth and death rates.
- Standard of living was extremely poor for most Indians.

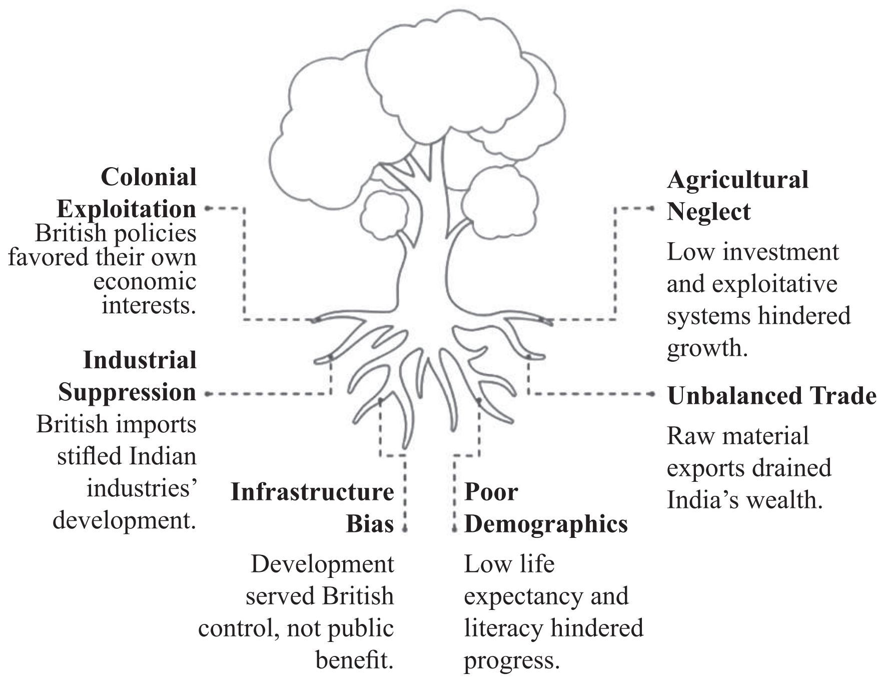
Occupational Structure: Skewed and Unequal

- A large portion of the workforce was engaged in the primary sector (mainly agriculture).
- The secondary (industrial) and tertiary (services) sectors were grossly underdeveloped.
- Employment was regionally imbalanced and heavily concentrated in rural areas.

Conclusion

On the eve of independence, India's economy was exploited, underutilized, and deeply underdeveloped. The country faced major challenges such as poverty, unemployment, poor health, low industrial output, and an unbalanced trade structure. This grim economic inheritance highlighted the urgent need for planned economic development and structural reforms, which became the focus of India's economic planning in the post-independence era.

Underdeveloped Indian Economy in 1947 due to British Colonial Rule



CONCEPT MAP-1

INDIAN ECONOMY ON THE EVE OF INDEPENDENCE

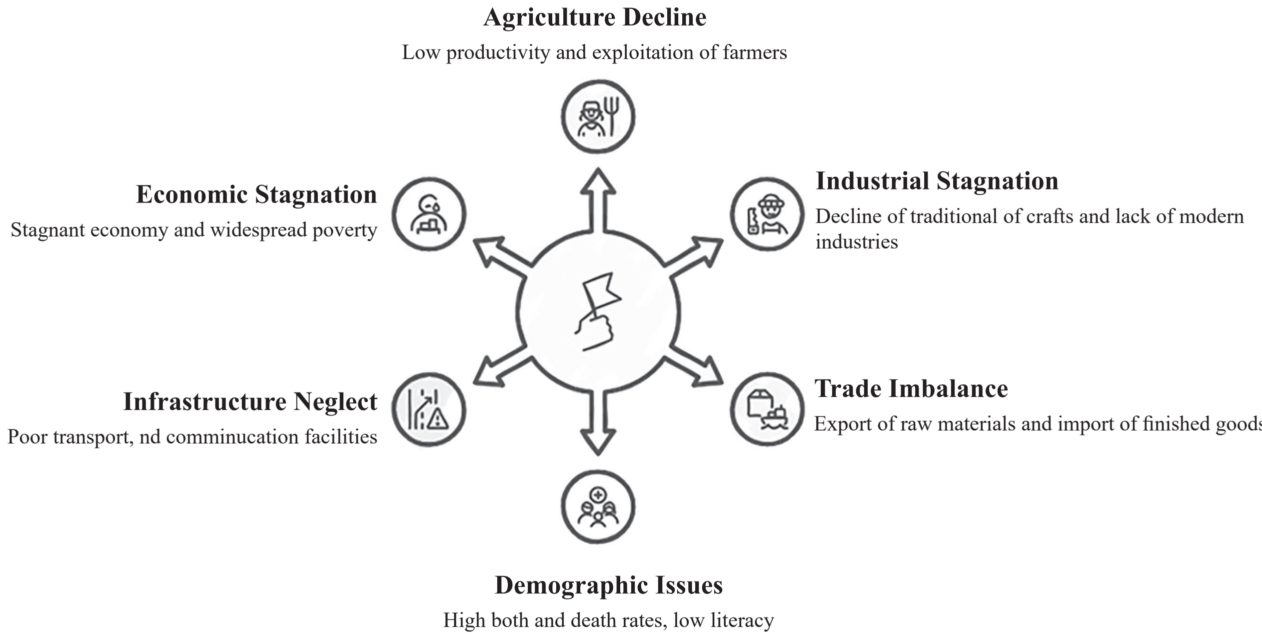
Colonial Rule Impact
- British policies aimed at economic exploitation
- Focus on raw material extraction & market for British goods
- No industrial development encouraged

Introduction
- Snapshot of the Indian economy in 1947
- Primarily agrarian
- Stagnant and backward

Agriculture
- Dominant sector, employing the majority
- Low productivity and outdated techniques
- Zamindari system exploited peasants
- Frequent famines and food insecurity

Industry
- Handicrafts destroyed by British imports
- No support for modern industries
- Few modern industries in jute, textiles, iron, and steel
- Public sector presence negligible

Economic Challenges in Colonial India



Bonus Mnemonic for Quick Recall !!!

Write "LAID FLAT" on top of your notes. It'll help recall all the major points quickly during revision or exams.Each letter stands for a major aspect of the economy at independence:

- L – Low Level of Agricultural Productivity
  Agriculture was backward, with poor tools, no irrigation, and exploitative systems like Zamindari.
  A – Absence of Industrialisation
- Traditional industries declined due to British deindustrialisation policy.
  I – Infrastructure Built for Colonial Gain
- Railways, ports, and roads were developed mainly to exploit resources, not for Indian development.
  D – Decline of Handicrafts
- Indian handicrafts collapsed under competition from British machine-made goods.
  F – Foreign Trade Pattern was Unfavourable
  India exported raw materials and imported British goods, leading to a drain of wealth.
- L – Low Literacy Rate
  Less than 20% literacy reflected poor education systems.
- A – Adverse Demographic Conditions
  Life expectancy was around 32 years; health conditions were poor.
- T – Third-World Economy at Independence
  India was left poor, underdevelop

Topic-Wise Exam Analysis

Topic	Marks Allotted	Years
Stagnant Economy	3M, 5M	2021, 2019, 2017, 2025
Agricultural Condition	3M, 5M	2020, 2018
Industrial Backwardness	3M, 5M	2021, 2019, 2018
Foreign Trade	3M, 5M	2020, 2017
Infrastructure	3M	2019, 2018
Demographic Profile	1M, 3M	2021, 2020
Occupational Structure	3M, 5M	2018, 2017
Positive Contributions of British Rule	3M, 5M	2021, 2019, 2018

EXAM BASED QUESTIONS

Multiple Choice Questions

Structure of the Economy

1. Out of the following, which sector dominated the Indian economy on the eve of independence?

(*a*) Industrial sector
(*b*) Agricultural sector
(*c*) Service sector
(*d*) Manufacturing sector

Ans. (*b*) At the time of independence, nearly 70-75% of India's population was engaged in agriculture. However, the sector was marked by low productivity, outdated techniques, and heavy dependence on monsoon.

2. The Indian economy on the eve of independence was characterized as:

(*a*) Modern and industrial
(*b*) Underdeveloped and stagnant
(*c*) Self-sufficient and growing
(*d*) Fully globalized

Ans.(*b*) The Indian economy was under British control and was structured to serve colonial interests. There was minimal growth in key sectors, with a stagnant per capita income and underutilized resources.

3. Among the following, which option best describes the nature of Indian agriculture at the time of independence?

(*a*) Mechanized and productive
(*b*) Commercial and export-oriented
(*c*) Subsistence and backward
(*d*) Fully irrigated and efficient

Ans. (*c*) Agriculture was mostly for self-consumption (subsistence), lacked modern inputs, and was technologically backward. It suffered from low yields and frequent famines.

British Policies and Impact

4. The major target of British colonial policies in India was to:

(*a*) Develop Indian industry
(*b*) Improve the welfare of Indians
(*c*) Promote self-sufficiency
(*d*) Serve British economic interests

Ans. (*d*) British policies focused on exploiting India's resources and raw materials to benefit British industries and markets. The Indian economy was molded to complement Britain's needs.

5. Which sector was systematically deindustrialized during Colonial rule?

(*a*) Agriculture
(*b*) Handicraft
(*c*) Mining
(*d*) Banking

Ans. (*b*) Traditional Indian handicrafts suffered due to competition from machine-made British goods and lack of state support. This led to deindustrialization and unemployment in this sector.

6. This term "drain of wealth" is associated with:

(*a*) Migration of Indians to other countries
(*b*) Investment in foreign lands
(*c*) Transfer of Indian resources to Britain
(*d*) Deficit financing

Ans. (*c*) The "Drain of Wealth" theory, proposed by Dadabhai Naoroji, described how Britain extracted wealth from India through trade, salaries, and pensions, without adequate returns to India.

7. Which policy of the British resulted in the decline of Indian handicrafts?

(*a*) Protection of local artisans
(*b*) Heavy import duties on British goods
(*c*) Free trade policy
(*d*) Promotion of indigenous industries

Ans. (*c*) The British imposed free trade policies that allowed British goods to enter Indian markets without tariffs, but Indian goods were taxed in Britain, leading to the decline of local industries.

Agricultural Sector

8. Which land revenue system was introduced by the British in Bengal?

(*a*) Ryotwari
(*b*) Mahalwari
(*c*) Zamindari
(*d*) Jagirdari

Ans. (*c*) Under the Zamindari system, zamindars collected land taxes from peasants on behalf of the British, often resulting in exploitation and absentee landlordism, worsening the condition of peasants.

9. Under the Colonial rule, agriculture was mainly used to produce:
(*a*) Food crops for local use
(*b*) Industrial crops for Indian industries
(*c*) Cash crops for export
(*d*) Forest produce

Ans. (*c*) The British encouraged the cultivation of cash crops such as indigo, opium, cotton, and jute for export, often at the cost of food crops, leading to food shortages and famines.

10. Out of these what was not a feature of agriculture during colonial rule?
(*a*) Low productivity
(*b*) Dependence on monsoon
(*c*) Institutional credit support
(*d*) Fragmented landholdings

Ans. (*c*) Farmers had no access to organized credit and depended on moneylenders who charged high interest, trapping farmers in debt.

Industrial Sector

11. Which industry saw some development under British rule?
(*a*) Automobile
(*b*) Steel
(*c*) Shipbuilding
(*d*) Textile

Ans. (*d*) While most industries were underdeveloped, the textile industry, especially cotton textiles in Bombay and jute in Bengal, saw some growth due to local entrepreneurial efforts and demand.

12. The development of modern industries under British rule was:
(*a*) Balanced across sectors
(*b*) Limited and region-specific
(*c*) Strong and nationwide
(*d*) Self-reliant and indigenous

Ans. (*b*) Industrial development was mostly concentrated in port cities like Bombay, Calcutta, and Madras. It was limited to a few industries and lacked diversification.

13. Who was a major player in Indian industries during colonial rule?
(*a*) Government of India
(*b*) Indian farmers
(*c*) British capitalists
(*d*) Indian cooperative societies

Ans. (*c*) British companies and individuals invested in railways, plantations, and mines in India. Indian industrialists had limited presence due to discriminatory policies.

Foreign Trade

14. India's foreign trade during colonial rule was:
(*a*) Favorable to Indian producers
(*b*) Encouraged for national development
(*c*) Biased to serve British interests
(*d*) Directed by Indian entrepreneurs

Ans. (*c*) Trade was structured to export raw materials from India and import British manufactured goods, ensuring profits for Britain and deindustrialization of India.

15. The main export items from India under colonial rule were:
(*a*) Machinery and electronics
(*b*) Finished goods and garments
(*c*) Raw materials and food grains
(*d*) Oil and chemicals

Ans. (*c*) India was used as a source of raw materials like cotton, jute, and spices for British industries. Even food grains were exported during famines.

16. Major import into India during British rule was:
(*a*) Agricultural tools
(*b*) British manufactured goods
(*c*) Indian handmade goods
(*d*) Food grains

Ans. (*b*) British goods were dumped in Indian markets duty-free, destroying local crafts and industries, making India a market for British products.

Demographic Conditions

17. The literacy rate in India at the time of independence was around:
(*a*) 12%
(*b*) 50%
(*c*) 35%
(*d*) 80%

Ans. (*a*) Due to the neglect of education by the colonial government, especially for the masses and rural areas, literacy rates remained extremely low.

28. Which Indian leader strongly condemned the economic policies of the British?

(*a*) Lord Curzon
(*b*) Jawaharlal Nehru
(*c*) Rabindranath Tagore
(*d*) Dadabhai Naoroji

Ans. (*d*) He is known for his "Drain Theory," where he argued that Britain was draining India of its wealth through unfair trade and taxation.

29. What was the general condition of capital formation in India under colonial rule?

(*a*) Very high
(*b*) Satisfactory
(*c*) Inadequate
(*d*) Rapidly increasing

Ans. (*c*) Very little capital was invested back into the Indian economy. Most profits were sent back to Britain, resulting in poor infrastructure and industrial base.

30. Which of the following best expresses the state of the Indian economy in 1947?

(*a*) Industrially self-sufficient
(*b*) Dependent and underdeveloped
(*c*) Globally competitive
(*d*) Socialist and planned

Ans. (*b*) India lacked modern industries, had poor infrastructure, and was heavily dependent on agriculture and British markets.

Exam Based Subjective Questions

1. Describe any three main features of the Indian economy on the eve of independence.

Ans.
- **Stagnant Agriculture:** Indian agriculture was stagnant and inefficient due to low productivity, lack of irrigation, and outdated technology.
- **Deindustrialization:** Traditional industries like handicrafts declined sharply due to British policies and competition from imported goods.
- **Poor Infrastructure:** Infrastructure like railways and roads existed but was built primarily to serve colonial economic interests.

2. State how the British rule led to the deindustrialization of India.

Ans.
- The British allowed **duty-free imports of machine-made goods,** which outcompeted Indian handmade products.
- **Lack of protection** to Indian industries further weakened local manufacturers.
- Craftsmen and artisans lost their traditional livelihoods, leading to unemployment and migration to agriculture.

3. Mention three adverse impacts of colonial rule on Indian agriculture.

Ans.
- **Forced cultivation of cash crops** (like indigo and opium) reduced food grain production.
- **High land revenue demands** led to farmer indebtedness and landlessness.
- **Neglect of irrigation and technology** kept agricultural productivity low and dependent on the monsoon.

4. What was the 'Drain of Wealth'? Give any two methods by which it occurred.

Ans.
- The **Drain of Wealth** refers to the economic exploitation and outflow of India's resources to Britain without any economic return.
- It occurred through:
  (*a*) **Home charges:** payments made by India to Britain for pensions, salaries, etc.
  (*b*) **Export surplus:** exporting goods without receiving proper payment or investment in return.

5. How did the foreign trade of India reflect the colonial pattern of the economy?

Ans.
- India exported **raw materials** (like cotton, jute, indigo) and **imported finished** goods from Britain.
- Trade was **oriented towards British needs,** not India's development.
- There was no diversification, and India had a **negative balance of development** from trade.

Assertion & Reason Based Questions

Instructions: *For each question, choose the correct option:*

(*a*) *Both Assertion (A) and Reason (R) are true, and (R) is the correct explanation of (A).*

(*b*) *Both (A) and (R) are true, but (R) is not the correct explanation of (A).*

(*c*) *(A) is true, but (R) is false.*

(*d*) *(A) is false, but (R) is true.*

1. **Assertion (A):** Indian handicraft industries declined sharply during British rule.
   Reason (R): British policies favored the import of machine-made goods and imposed high duties on Indian products.

Ans. (*a*)

2. **Assertion (A):** The Indian economy on the eve of independence was mainly agrarian.
   Reason (R): The British developed large-scale industries extensively in India.

Ans. (*c*) A is true (India was agrarian), but R is false—industrial development was limited and not widespread.

3. **Assertion (A):** India's foreign trade under the British was beneficial to Indian development.
   Reason (R): India had a large export surplus under colonial rule.

Ans. (*c*) A is false (trade benefited Britain), but R is true—India had export surplus but gained little from it.

4. **Assertion (A):** The British introduced railways in India primarily to promote Indian trade and development.
   Reason (R): Railways were constructed to transport raw materials to ports for British industries.

Ans. (*d*) A is false (not for Indian benefit), but R is true (railways served British economic interests).

5. **Assertion (A):** The literacy rate in India was very low at the time of independence.
   Reason (R): British colonial policies gave low priority to mass education.

Ans. (*a*) Assertion and Reason are both true, and the Reason correctly explains the Assertion.
The literacy rate was low at independence because British policies neglected mass education and focused only on producing a small educated class for administration.

Two Statements Based Questions

Instructions: *Read both statements carefully and choose the correct option:*

(*a*) *Both statements are true, and Statement II is the correct explanation of Statement I.*
(*b*) *Both statements are true, but Statement II is not the correct explanation of Statement I.*
(*c*) *Statement I is true, but Statement II is false.*
(*d*) *Statement I is false, but Statement II is true.*

1. **Statement I:** The Indian economy on the eve of independence was characterized by a stagnant agricultural sector.
   Statement II: The British introduced modern irrigation and agricultural technology widely across rural India.

Ans. (*c*) Statement I is true, but II is false — the British did not invest in modernizing Indian agriculture on a large scale.

2. **Statement I:** India had an export surplus in foreign trade during the colonial period.
   Statement II: The surplus earnings from trade were invested in the development of Indian infrastructure and industries.

Ans. (*c*) Statement I is true — India did export more than it imported. However, Statement II is false — the earnings were mostly used for British interests, not Indian development.

Long Answer Type Questions

1. Discuss five major features of the Indian economy on the eve of independence.

Ans.
- **Agrarian Dominance:** About 70-75% of the population depended on agriculture, which was stagnant and lacked modernization.
- **Low Level of Industrialization:** India had very few industries, mostly limited to textiles and jute, with little diversification.
- **Colonial Pattern of Trade:** India exported raw materials and imported British goods, benefiting Britain, not India.
- **Underdeveloped Infrastructure:** Infrastructure like railways and ports existed mainly to serve colonial interests, not national development.
- **Low Standard of Living:** High poverty, illiteracy (~12%), low life expectancy (~35 years), and poor health and education indicators.

2. Explain the state of Indian agriculture at the time of independence.

Ans.
- **Backward and Stagnant:** Agricultural practices were traditional, with minimal use of modern inputs like fertilizers and irrigation.
- **Land Tenure Systems:** Systems like Zamindari exploited farmers, leading to insecurity and indebtedness.
- **Low Productivity:** Per hectare yields were among the lowest in the world due to lack of mechanization and technology.
- **Cash Crop Focus:** British policies promoted cash crops (indigo, jute, cotton) over food crops, contributing to famines.
- **Peasant Exploitation:** Farmers faced high taxes, unpredictable weather, and no institutional credit.

3. What were the main causes of the decline of Indian handicrafts under British rule?

Ans.
- **Import of British Goods:** Duty-free imports of machine-made goods wiped out domestic markets for handmade products.
- **Lack of Protection:** Indian crafts received no tariff protection, while British products were protected in their own markets.
- **Poor Infrastructure for Artisans:** No state support, training, or capital for artisans to compete with industrial goods.
- **Changing Tastes:** Urban and colonial elites preferred British goods, further reducing demand for indigenous products.
- **Drain of Wealth:** Economic policies diverted resources away from native industries.

4. Describe the structure and impact of colonial trade policies in India.

Ans.
- **Export-Oriented:** India exported primary products like cotton, jute, and indigo, and imported finished goods.
- **No Domestic Benefit:** The export surplus did not benefit India; it financed British administration and wars.
- **Decline of Local Industries:** Trade policies led to deindustrialization and loss of livelihood for artisans.
- **Dependence on Britain:** India became dependent on Britain for essential goods and capital.
- **Lack of Diversification:** Trade was restricted and failed to stimulate industrial or agricultural modernization.

5. Discuss the demographic conditions in India on the eve of independence.

Ans.
- **High Birth and Death Rates:** Both were around 40 per 1,000, indicating poor public health conditions.
- **Low Life Expectancy:** Average life expectancy was around 32–35 years due to disease and malnutrition.
- **High Infant Mortality Rate:** Many children died before the age of five, due to poor maternal and child healthcare.
- **Low Literacy Rate:** Only about 12% of the population was literate, with worse conditions in rural areas and among women.
- **Poor Medical Facilities:** Inadequate hospitals and healthcare services, especially in rural areas.

Case Based Questions

When India gained independence in 1947, it inherited an economy that had been systematically exploited under British colonial rule. The structure of the Indian economy was largely agrarian, with nearly 85% of the population dependent on agriculture. However, agriculture was marked by low productivity, outdated technology, and an exploitative land revenue system, such as the Zamindari system, which prioritized the interests of landlords over those of actual cultivators.

Indian handicraft industries, once renowned globally, declined sharply under British rule due to the deliberate policy of deindustrialisation. Cheap and mass-produced goods from Britain flooded Indian markets, displacing local artisans and creating widespread unemployment.

Although the British introduced railways, telegraphs, ports, and roads, the primary objective was to facilitate resource extraction and trade for Britain's benefit. The infrastructure served colonial interests, not the development of India's domestic economy.

The social indicators at the time also reflected severe underdevelopment. The literacy rate was abysmally low—less than 20%, life expectancy hovered around 32 years, and public health and education facilities were scarce. India's foreign trade was heavily skewed toward the export of raw materials and the import of finished goods, resulting in no real capital accumulation or industrial growth.

1. Explain the impact of British land revenue systems on Indian agriculture and farmers.

Ans. British land systems like Zamindari forced farmers to pay high taxes, regardless of crop output. This led to poverty, debt, and low agricultural productivity.

2. How did British policies lead to the decline of Indian handicraft industries during the colonial period?

Ans. British imports of cheap machine-made goods replaced Indian handicrafts. Artisans lost their livelihood due to lack of demand and unfair trade policies.

3. Mention two major indicators that reflect the backwardness of the Indian economy on the eve of independence and briefly explain them.

Ans. **Low literacy rate:** below 20%.

Low life expectancy: around 32 years due to poor health conditions.

Past Year Questions (PYQs)

Very Short Answer Type

1. What was the literacy rate in India at the time of independence? **(1 M) (CBSE 2017)**

Ans. Around 12%

2. Name the economist who estimated India's per capita income during British rule. **(1 M) (CBSE 2019)**

Ans. Dadabhai Naoroji or William Digby

3. The given statement "India followed unbalanced growth during the colonial rule." is of True/False type. **(2 M) (CBSE 2020)**

Ans. True: Because during colonial rule, development was highly imbalanced — some sectors like railways, plantations, and ports were developed to serve British interests, while industries, agriculture modernization, and social infrastructure were neglected. cbse 2025

Short Answer Type

4. Explain any three features of Indian agriculture at the time of independence. **(3 M) (CBSE 2018)**

Ans:
- Traditional and backward techniques.
- Exploitative land tenure systems (like Zamindari).
- Low productivity and frequent famines.

5. What do you understand about the drain of wealth? Mention any two ways it occurred. **(3 M) (CBSE 2019)**

Ans:
- The term refers to the outflow of Indian wealth to Britain without adequate return.
- It occurred through:
  - Remittances to Britain by British officials.
  - Payment of home charges.

6. Why is the period before independence referred to as a period of de-industrialisation? **(3 M) (CBSE 2017)**

Ans:
- Decline of traditional Indian industries like handicrafts.
- Unfair trade policies that favored British goods.
- Lack of government support and capital for indigenous industries.

OR

During the colonial period, the occupational structure showed lopsided movements. Do you agree with the given statement? Justify your answer with valid arguments. **(4 M) (CBSE 2020)**

Ans: Yes, the occupational structure during the colonial period was highly lopsided.
- **Dominance of Agriculture:** Nearly 70–75% of India's workforce was engaged in agriculture, but productivity was very low due to outdated methods.
- **Negligible Growth of Industries:** Only a very small proportion of the workforce was employed in manufacturing and modern industries, as British policies discouraged industrialisation.
- **Regional Imbalances:** Some regions like Madras, Bengal, and Bombay had slightly higher participation in industries and services, while most other areas remained overwhelmingly dependent on agriculture.

Thus, instead of balanced growth, the occupational structure reflected heavy dependence on agriculture and very limited opportunities in other sectors, proving it was indeed lopsided.

Long Answer Type

7. Describe the occupational structure of India on the eve of independence. What were its main features? **(5 M) (CBSE 2018)**

Ans:
- Majority employed in agriculture (~70-75%).
- Very few in secondary and tertiary sectors.
- Regional and gender disparities.
- Stagnant employment pattern with minimal structural transformation.

8. Explain any five major features of the Indian economy on the eve of independence. **(5 M) (CBSE 2017, 2019)**

Ans:
- Predominantly agrarian economy.
- Low level of industrialization.
- Colonial pattern of trade.
- Poor infrastructure development.
- Low literacy and health standards.

9. How did British rule impact Indian industries and trade? **(5 M) (CBSE 2016)**

Ans:
- Led to de-industrialisation.
- Focus on raw material exports and finished goods imports.
- No diversification or modernization.
- Policies favored British manufacturers.

Assertion-Reason (MCQ)

10. **Assertion:** India had a high export surplus during colonial rule.

Reason: The British invested the entire export surplus in the development of Indian infrastructure. **(5 M) (CBSE 2020)**

(*a*) Both Assertion and Reason are true, and Reason is the correct explanation of Assertion.

(*b*) Both Assertion and Reason are true, but Reason is not the correct explanation of Assertion.

(*c*) Assertion is true, but Reason is false.

(*d*) Assertion is false, but Reason is true.

Ans. (*c*) Assertion is true as India had a high export surplus during colonial rule.

Reason is false because the surplus was drained to Britain, not invested in India's development.

WORD OF ADVICE

"Don't just memorize facts—understand the 'why' behind them."

This chapter isn't only about knowing that India was poor in 1947; it's about **understanding how colonial policies shaped that poverty**. Focus on:

- **Causes and effects:** Know how British policies in trade, agriculture, and industry caused economic stagnation.
- **Patterns:** Recognize how every sector (agriculture, industry, trade) was interconnected and impacted by British interests.
- **Compare and reflect:** Think about how those historical conditions contrast with India's present economy.
- **Prepare answers smartly:** Use bullet points, data (like literacy rate, life expectancy), and cause-effect explanations in long answers.

This approach not only helps you **score well** in exams, but also builds a deeper **understanding of India's economic history—** which is essential for economics, history, and civics alike.

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INTRODUCTORY MACROECONOMICS

CONTENTS

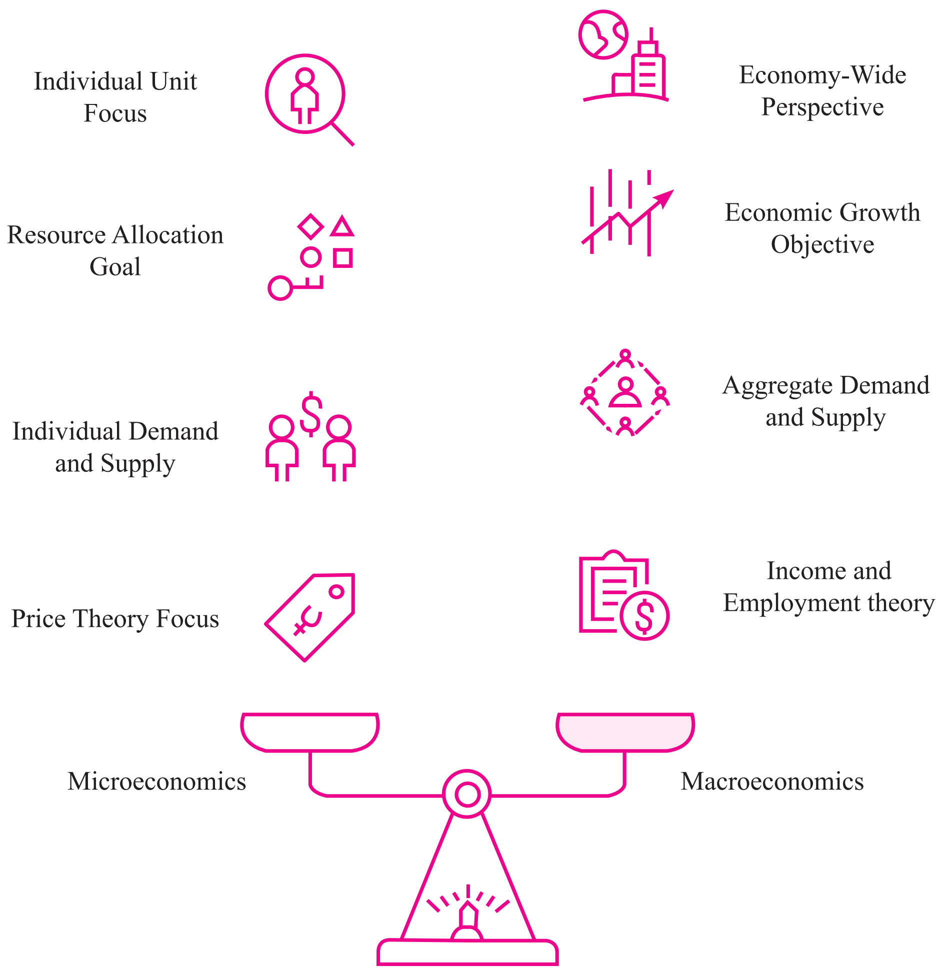
Chapter 1

NATIONAL INCOME

LEARNING OBJECTIVES

- Understand the basic concepts of national income, like GDP, GNP, NNP, domestic income, and factor cost.
- Distinguish between different measures of national income and their interrelationships using formulas.
- Learn methods of calculating national income: value added, income, and expenditure methods.
- Identify the components and precautions involved in national income estimation.
- Analyze the limitations of using GDP as an index of welfare.

1. Difference between Microeconomics and Macroeconomics



2. Difference between Intermediate Goods and Final Goods

Intermediate vs. Final Goods

	Internediate Goods	Final Goods
Use	Further production/resale	Final consumption/ investment
Buyer	Producers	Consumers and producers
Production Boundary	Within	Outside
Role in National Income	Not included	Included

3. Differences between Stock and Flow Variables

Stock vs Flow Variables

Time Reference
Stock variables are measured at a specific point in time, capturing a snapshot. Flow variables are measured over a period, showing change.

Nature
Stock variables are static, representing a fixed quantity. Flow variables are dynamic, reflecting continuous movement.

Time Dimension
Stock variables do not inherently have a time dimension. Flow variables always have a time dimension measured in terms of per second, per minute, per day, per month, etc..

Examples
Examples of stock variables include wealth, capital, and money supply. Examples of flow variables include income, investment, and expenditure.

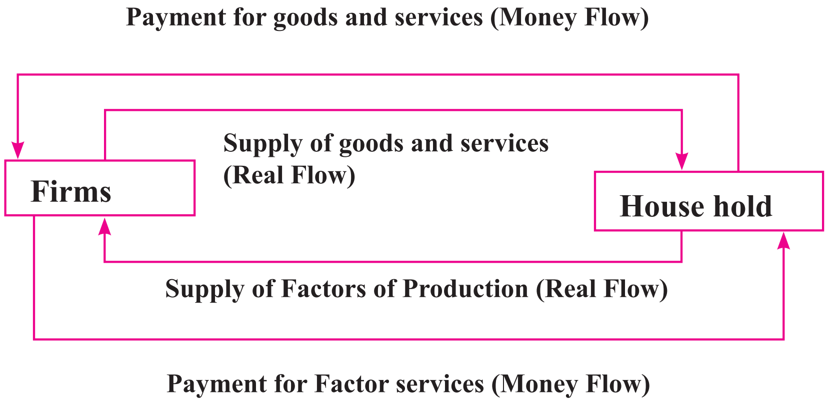
Examples Important for Exams

Component	Stock / Flow	Reason
Income	Flow	Measured over a period of time (e.g., per month or year)
Wealth	Stock	Measured at a particular point in time
Capital	Stock	Refers to the total value of assets at a given time
Investment	Flow	Refers to addition to capital over a time period
Water flow rate	Flow	Measured per second or per minute (time-based measurement)
National Income (NNP_{FC})	Flow	Total income earned in an economy during a year
Bank Balance	Stock	Amount available at a specific date
Production of goods	Flow	Measured over time (e.g., per day/month/year)

Circular Flow of Income

It refers to the continuous movement of money, goods, and services between different sectors of the economy.

There are two types of flows:



4. INVESTMENT

Gross Investment

It refers to the total investment made in the economy on capital goods (like machinery, buildings, and tools) during a year, **including depreciation.**

Net Investment

It refers to the **actual addition** to the capital stock in an economy after deducting depreciation from gross investment.

Formula: Net Investment = Gross Investment – Depreciation

5. National Income (NNP at FC) VS Domestic Income (NDP at FC)

National income refers to the net income earned by the normal residents of a country, both within and outside the country, during an accounting year.

It includes:

- Income earned **within the country**
- Income earned **from abroad by residents**

  Domestic income refers to the net income generated within the domestic (economic) territory of a country, irrespective of who earns it (resident or non-resident), during an accounting year.

It includes:

- Income earned **within the country only**
- By **both residents and non-residents**

Conversion of Domestic Income into National Income

Formula: National Income (NNP at FC) = Domestic Income (NDP at FC) + NFIA

NFIA (Net Factor Income from Abroad)

NFIA refers to the net earnings from factor services (like wages, rent, interest, and profit) received from abroad and paid abroad.

NFIA = Factor Income Received from Abroad – Factor Income Paid to Abroad

6. Factor Cost vs Market Price

- **Factor Cost =** Cost of production paid to factors (like wages, rent, interest, profit)
- **Market Price =** Price paid by consumers, which includes **taxes** and excludes **subsidies.**

To Convert	Formula
Market Price → Factor Cost	**Minus NIT** → Factor Cost = Market Price - NIT
Factor Cost → Market Price	**Add NIT** → Market Price = Factor Cost + NIT

Hints:-

Net	Domestic	Fixed Cost (FC)
(–) D ↑ ↓ (+) D	(–) NFIA ↑ ↓ (+) NFIA	(–) NIT ↑ ↓ (+) NIT
Gross	National	Market Price (MP)

D → Depreciation/Consumption of fixed Asset
NFIA → Net factor income from abroad (Factor Income from Abroad - Factor Income to Abroad)
NIT → Net Indirect Taxes

7. Methods of Calculation of National Income

7.1 Expenditure Method

GDP_{MP}

- Private Final consumption Expenditure
- Goverment Final Consumption Expenditure
- gross Domestic Capital Formation
  - Gross Fixed Capital Formation + Change in stock
    - Change in stock → Closing Stock - Opening Stock
- Net Export [EX-IM]

- **GDP_{MP}** = Government Final Consumption Expenditure + Private Final Consumption Expenditure + Net Exports + Gross Domestic Capital Formation.
- **NNP_{FC} (National Income)** = GDP_{MP} – Consumption of fixed capital (Depreciation) + Net factor income from abroad – Net indirect tax.

7.2 Income Method

$NDPFL_{FC}$

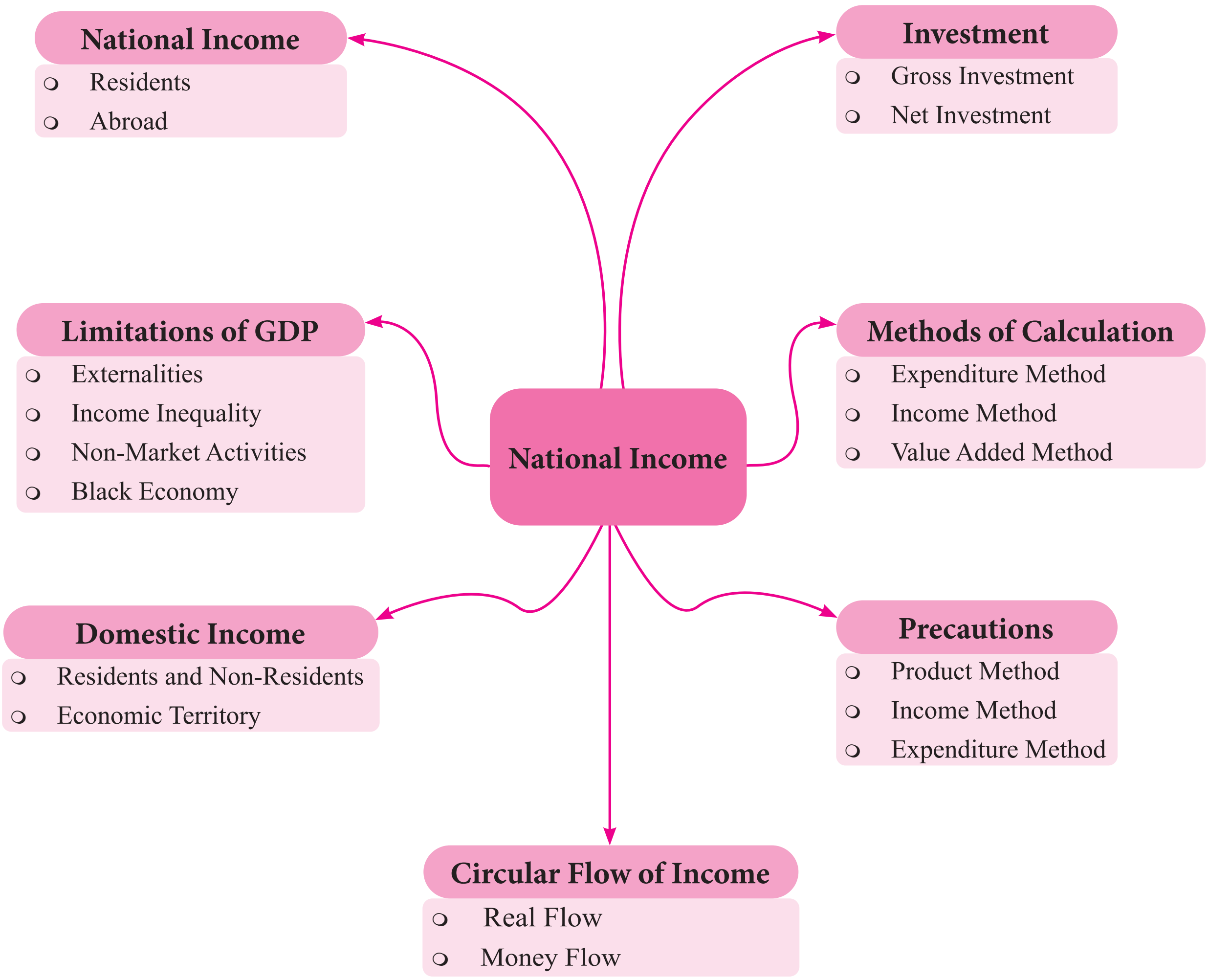
Compensation of employee + Operating Surplus + Mixed Income

- Compensation of employee → Compensation in Cash + Compensation in kind + Social Security ontribution by Employer
- Operating Surplus → Rent + Profit + Royality + Profit
  - Profit → Corporate Tax, Dividend, Corporate Saving / Undistributed Profit

- **NNP_{FC} (National Income) =** NDP_{FC} + Net factor income from abroad

CONCEPT MAP

National Income and Related Concepts



Topic-Wise Exam- Analysis

Topic	Question Types	Year(s)
Basic Concepts (GDP, GNP, FC, MP, etc.)	1M, 3M	2025, 2023, 2021
Domestic vs. National Income	1M, 3M	2024, 2022
Factor Cost vs. Market Price	3M	2024, 2021
Normal Resident	1M	2023
Circular Flow of Income	3M	2025, 2022
Investment (Gross/Net, Domestic/National)	1M, 3M	2024, 2021
Numericals (Conversions & Methods)	3M, 6M	2025–2021
Methods of Measuring NI (VAM, Income, Expenditure)	6M	2025, 2023, 2022, 2021
Precautions in Methods	1M, 3M	2024, 2022, 2021
Treatment of Items (Special Cases)	1M, 3M	2025, 2024, 2023
NFIA (Net Factor Income from Abroad)	1M, 3M	2023, 2021
Concept Differences (e.g., GDPmp vs NDPfc)	1M, 3M	2024, 2022

EXAM BASED QUESTIONS

Multiple Choice Questions

Intermediate Goods vs. Final Goods

1. Which of the following is an intermediate good?
   (*a*) Cotton bought by a textile mill
   (*b*) Laptop used by a student
   (*c*) Car purchased by a consumer
   (*d*) Refrigerator used in a house

Ans: (*a*) Cotton used in textile production is for further processing, so it's intermediate.

2. Goods purchased for final consumption are called:
   (*a*) Intermediate goods
   (*b*) Capital goods
   (*c*) Final goods
   (*d*) Producer goods

Ans: (*c*) Final goods are not meant for further production or resale.

3. Machinery purchased by a firm for production is a:
   (*a*) Final good
   (*b*) Intermediate good
   (*c*) Capital good
   (*d*) Consumer good

Ans: (*c*) Machinery is a capital good—used in production to generate further output.

Stock vs. Flow Variables

4. Wealth, as measured on 31st March, is:
   (*a*) Flow variable
   (*b*) Stock variable
   (*c*) Not an economic variable
   (*d*) Not measurable

Ans: (*b*) Stock variables are measured at a specific point in time.

5. Which of the following is a flow variable?
   (*a*) Capital
   (*b*) National income
   (*c*) Inventory
   (*d*) Foreign exchange reserves

Ans: (*b*) National income is measured over some time—hence a flow.

6. Which of the following pairs are stock-flow pairs?
   (*a*) Income – Saving
   (*b*) Wealth – Interest
   (*c*) Capital – Investment
   (*d*) GDP – Exports

Ans: (*c*) Capital is a stock; investment (change in capital stock) is a flow.

Circular Flow of Income

7. Which of the following represents **real flow** in the circular flow model?
   (*a*) Goods and services
   (*b*) Income payments
   (*c*) Taxes
   (*d*) Profits

Ans: (*a*) Real flow involves actual movement of goods and services between sectors.

8. Households provide factor services and receive:
   (*a*) Goods and services
   (*b*) Factor payments
   (*c*) Intermediate goods
   (*d*) Loans

Ans: (*b*) Households offer land, labor, and capital and Get factor Payment in return.

9. In the money flow, which of the following flows from firms to households?
   (*a*) Factor services
   (*b*) Goods and services
   (*c*) Wages and rent
   (*d*) Raw materials

Ans: (*c*) Firms pay wages, rent, and profit to households for factor services.

Gross vs. Net Investment

10. If Gross Investment = ₹800 crore and Depreciation = ₹200 crore, Net Investment =?

(*a*) ₹1,000 crore (*b*) ₹600 crore

(*c*) ₹800 crore (*d*) ₹200 crore

Ans: (*b*) Net Investment = Gross Investment – Depreciation = ₹800 – ₹200 = ₹600 crore

11. When gross investment = depreciation, it means:

(*a*) Capital stock is increasing (*b*) Net investment = 0

(*c*) The economy is declining (*d*) Capital gains increase

Ans: (*b*) All new investment is replacing old/worn-out capital—net addition to stock is zero.

12. An increase in net investment implies:

(*a*) No capital formation (*b*) Replacement of old capital

(*c*) Increase in capital stock (*d*) Zero depreciation

Ans: (*c*) Positive net investment means new capital formation and economic expansion.

National Income vs Domestic Income

13. Which of the following is included in national income but not in domestic income?

(*a*) Rent paid to a resident by another resident (*b*) Profit earned by an Indian company in the USA

(*c*) Wages paid to foreign workers in India (*d*) Interest earned within Indian territory

Ans: (*b*)National Income = Domestic Income + NFIA. Profit earned abroad by Indian residents is included in national income only.

14. Which of the following is part of domestic income but not national income?

(*a*) Wages paid to Indian embassy workers in the USA (*b*) Rent received from property in the UK

(*c*) Profits earned by a Japanese company in India (*d*) Interest from an Indian bank abroad

Ans: (*c*) It's earned in India (included in domestic income) but goes to foreigners, so it's excluded from national income.

15. A doctor working in the Indian Embassy in the UK is:

(*a*) Included in the Domestic Income of India (*b*) Included in the National Income of the UK

(*c*) Included in the National Income of India (*d*) Excluded from both

Ans: (*c*) Embassies are treated as part of the home country's territory, so this is an Indian economic activity abroad.

Factor Cost vs Market Price

16. If Net Indirect Tax is ₹100 crore and GDP at FC is ₹900 crore, then GDP at MP is:

(*a*) ₹800 crore. (*b*) ₹1,000 crore

(*c*) ₹900 crore (*d*) ₹1,100 crore

Ans: (*b*) $GDP_{MP} = GDP_{FC}$ + NIT = ₹900 + ₹100 = ₹1,000 crore

17. When subsidies exceed indirect taxes, what is the relation between FC and MP?

(*a*) MP > FC (*b*) MP = FC

(*c*) MP < FC (*d*) Can't say

Ans: (*c*) NIT = Indirect Tax – Subsidies

If subsidies > taxes, NIT becomes negative → FC > MP.

18. Market Price includes:

(*a*) Factor payments only (*b*) Factor cost + Net Indirect Taxes

(*c*) Only profit and wages (*d*) Only transfer payments

Ans: (*b*) Market Price = Cost of production (FC) + Taxes – Subsidies (i.e., NIT)

Methods of Calculating National Income

19. Which of the following is **not** included in the income method?

(*a*) Rent (*b*) Interest on productive loans

(*c*) Gifts (*d*) Profit

Ans: (*c*) Gifts are transfer incomes, not earned through production, hence excluded.

Assertion & Reason Based Questions

Instructions *For each question, choose the correct option:*

(*a*) *Both Assertion* (*A*) *and Reason* (*R*) *are true, and Reason* (*R*) *is the correct explanation of Assertion* (*A*).

(*b*) *Both Assertion* (*A*) *and Reason* (*R*) *are true, but Reason* (*R*) *is not the correct explanation of Assertion* (*A*).

(*c*) *Assertion* (*A*) *is true, but Reason* (*R*) *is false.*

(*d*) *Assertion* (*A*) *is false, but Reason* (*R*) *is true.*

1. **Assertion (A):** Gross investment is always greater than net investment.

Reason (R): Gross investment includes depreciation, while net investment does not.

Ans: (*a*) Gross investment = Net investment + Depreciation. Since depreciation is always positive, gross investment is always greater. Hence, both A and R are true, and R correctly explains A.

2. **Assertion (A):** Interest on personal loans is included in national income.

Reason (R): All forms of interest are considered factor income.

Ans: (*d*) Interest on personal loans is **not** included in national income, as it is not earned from productive activity. So, A is false, and R is true but irrelevant.

3. **Assertion (A):** Sale of second-hand goods is excluded while calculating national income.

Reason (R): Secondhand goods are part of intermediate consumption.

Ans: (*c*) Secondhand goods are excluded because they have already been counted earlier. But they are **not** intermediate goods; hence, R is false.

4. **Assertion (A):** Household kitchen work is not included in national income.

Reason (R): It is considered a non-market activity with no monetary transaction.

Ans: (*a*) Household work is unpaid and not traded in the market, so it is excluded. Both A and R are true, and R is the correct reason.

5. **Assertion (A):** Production of military tanks raises GDP.

Reason (R): GDP accounts for all goods and services, regardless of their utility.

Ans: (*a*) GDP includes all final goods/services produced, whether socially useful or not. Hence, both A and R are correct, and R explains A.

6. **Assertion (A):** GDP underestimates economic welfare in a country.

Reason (R): GDP ignores non-market activities and externalities.

Answ (*a*) **Explanation:** GDP doesn't account for unpaid services (e.g., voluntary work) or negative/positive externalities. Hence, both A and R are true, and R explains A.

7. **Assertion (A):** GDP at market price is always more than GDP at factor cost.

Reason (R): Indirect taxes are always more than subsidies.

Ans: (*b*) While GDP at MP = FC + Net Indirect Taxes, the assumption that taxes are always more than subsidies isn't necessarily true. Hence, A and R are true, but R is not the full explanation.

8. **Assertion (A):** Profit earned by a US firm in India is part of India's domestic income.

Reason (R): Domestic income includes all income generated within the domestic territory, regardless of nationality.

Ans: (*a*) Domestic income is based on location, not nationality. So, both A and R are correct, and R explains A.

9. **Assertion (A):** Stocks are measured at a point in time, whereas flows are measured over some time.

Reason (R): National income is a stock variable.

Ans: (*c*) The assertion is correct, but the reason is false. National income is a **flow**, not a stock.

10. **Assertion (A):** Transfer payments are excluded from national income.

Reason (R): They do not represent the production of goods and services.

Ans: (*a*) Transfer payments (like pensions and gifts) are not earned through productive activity. Hence, both A and R are true, and R correctly explains A.

Two Statement Based Questions

1. **Statement-I:** GDP at market price includes depreciation.
   Statement-II: Net Domestic Product at factor cost includes both depreciation and net indirect taxes.

Ans: (*c*) Statement-I is correct because GDP at MP = NDP at MP + depreciation.
Statement-II is incorrect. NDP at FC = NDP at MP – Net Indirect Taxes, and does not include depreciation.

2. **Statement-I:** Intermediate goods are included in the calculation of national income.
   Statement-II: Final goods are those that are used either for consumption or for investment.

Ans: (*d*) Statement-I is incorrect. Intermediate goods are excluded to avoid double counting.
Statement-II is correct. Final goods include consumer goods and capital goods.

3. **Statement-I:** Net exports can be negative if a country imports more than it exports.
   Statement-II: Imports reduce the value of domestic income.

Ans: (*a*) Both statements are **correct**.
Negative net exports (X–M) happen when imports exceed exports.
Imports are a **leakage** in the circular flow of income.

4. **Statement-I:** Consumption of fixed capital refers to depreciation.
   Statement-II: Depreciation is the cost of wear and tear of capital assets during the year.

Ans: (*a*) Both statements are **correct**.
Depreciation = Consumption of Fixed Capital. It accounts for the fall in value of fixed assets.

5. **Statement-I:** Payment of interest by a bank on public deposits is a factor payment.
   Statement-II: Interest on borrowing for consumption is not included in national income.

Ans: (*a*) Interest paid by a bank is for the use of public savings (a factor service).
However, interest paid on **personal loans** is not for production; hence, it is **excluded** from national income.

6. **Statement-I:** Transfer payments are included while calculating national income.
   Statement-II: National income includes only factor incomes.

Ans: (*d*) Statement-I is **incorrect**. Transfer payments (pensions, scholarships) are **not included** in national income.
Statement-II is **correct**—only incomes earned from production (rent, wages, etc.) are included.

7. **Statement-I:** The sale of shares in the stock market is included in national income.
   Statement-II: Commission earned by the broker on the sale of shares is included in national income.

Ans: (*d*) Statement-I is **incorrect**. The sale/purchase of shares is a **financial transaction**, not production.
Statement-II is **correct**. A broker's commission is **payment for a productive service**.

8. **Statement-I:** Production for self-consumption is included in national income.
   Statement-II: Goods produced and consumed by the producer are considered as final goods.

Ans: (*a*) **Both** are **correct.** Self-consumed goods are valued at market price and included in national income. Since no further transformation happens, they are final goods.

Match the Following

1. Match the items in Column-I with those in Column-II and choose the correct pair.

Column-I	Column-II
(a) Income from Property	(i) Rent received on owned house
(b) Income from Entrepreneurship	(ii) Profit
(c) Mixed Income	(iii) Self-employed farmer's earnings
(d) Compensation of Employees	(iv) Salary and Perks

Options:

(*a*) (*a*) – (ii)
(*b*) (*b*) – (iii)
(*c*) (*c*) – (ii)
(*d*) (*d*) – (iv)

Ans: (*d*) (*d*) – (i)

Compensation of employees includes all forms of payments (wages, salaries, perks) made to employees by employers. Salary and perks fall under this category.

2. Match the items in Column-I with those in Column-II and choose the correct pair.

Column-I	Column-II
(a) Transfer Income	(i) Old-age pension
(b) Income from Entrepreneurship	(ii) Operating surplus
(c) Income from Property	(iii) Rent from land
(d) Mixed Income	(iv) Labour and capital income both

Options:

(*a*) (*a*) – (i)
(*b*) (*b*) – (iii)
(*c*) (*c*) – (iv)
(*d*) (*d*) – (ii)

Ans: (*a*) (*a*) – (i)

Old age pension is a transfer income, as it is received without rendering any productive service during the current accounting year.

3. Match the items in Column-I with those in Column-II and choose the correct pair.

Column-I	Column-II
(a) Net Factor Income from Abroad	(i) Difference between NFIA and NIFA
(b) Gross Domestic Product (GDPmp)	(ii) Domestic product at market price
(c) Net National Product (NNPfc)	(iii) National income
(d) Gross National Product (GNPmp)	(iv) GDPmp + NFIA

Options:

(*a*) (*a*) – (iii)
(*b*) (*b*) – (ii)
(*c*) (*c*) – (iv)
(*d*) (*d*) – (i)

Ans: (*b*) (*b*) – (ii)

GDPmp refers to Gross Domestic Product at market prices, i.e., the total value of goods and services produced within the domestic territory at market prices.

4. Match the items in Column-I with those in Column-II and choose the correct pair.

Column-I	Column-II
(a) Net Indirect Taxes	(i) Indirect taxes – subsidies
(b) National Income	(ii) NNPfc
(c) Gross Domestic Product at FC	(iii) GDPmp – NIT
(d) Gross National Product at MP	(iv) NNPfc + Depreciation

Options:

(*a*) (*a*) – (ii)
(*b*) (*b*) – (iii)
(*c*) (*c*) – (iii)
(*d*) (*d*) – (i)

Ans: (*c*) (*c*) – (iii)

GDP at factor cost is obtained by subtracting net indirect taxes from GDP at market prices. So, GDPfc = GDPmp – NIT.

5. Match the items in Column-I with those in Column-II and choose the correct pair.

Column-I	Column-II
(a) Net National Product at FC	(i) National Income
(b) Rent, Interest, Wages, Profit	(ii) Factor incomes
(c) Factor Income from Abroad	(iii) Income received from the rest of the world
(d) Personal Disposable Income	(iv) Personal income – direct taxes

Options:

(*a*) (*a*) – (ii)
(*b*) (*b*) – (i)
(*c*) (*c*) – (iii)
(*d*) (*d*) – (ii)

Ans: (*c*) (*c*) – (iii)

Factor income from abroad includes wages, rent, interest, and profits received by non-residents from the rest of the world.

Short Answer Type Questions

1. Will the services of a housewife be included in the estimation of national income?

Ans: No. The services of a housewife are not included in national income because she is not paid for her work. Although her contribution has value, it does not involve a monetary transaction in the market. National income includes only those goods and services that are economically exchanged and have a market price. Therefore, unpaid household work is excluded.

2. A businessman earns profit from his shop in India. Will this be included in national income?

Ans: Yes. The profit is a factor income (reward for entrepreneurship) earned by a normal resident within the domestic territory. Since the income is both earned inside the country and accrues to a resident, it satisfies the conditions of domestic income and national income, and hence, it is included.

3. A foreign company pays rent for using land in India. Will this rent be part of India's national income?

Ans: Yes. The rent is being paid to an Indian resident for land located within India, meaning the income is generated in the domestic territory and received by a normal resident. Since both conditions for national income are satisfied, it will be included. This is a case where foreign investment leads to income generation for the domestic economy.

4. A student receives a scholarship from the government. Is this counted in national income?

Ans: No. A scholarship is a transfer payment, meaning it is not made in return for any productive service. Since national income includes only those incomes arising out of productive economic activities, scholarships (like pensions, donations, or unemployment benefits) are excluded.

5. A Chinese engineer working on an Indian railway project earns ₹1 lakh per month. Will it be included in India's national income?

Ans: No. Although the income is earned in India (domestic territory), it goes to a non-resident (a Chinese national). National income includes only incomes earned by normal residents, whether earned inside or outside the country. So, this is excluded from national income but included in domestic income.

6. Distinguish between domestic income and national income in one line.

Ans: Domestic income is earned within the country's territory, while national income is earned by residents of the country, regardless of location. Domestic income is based on the location of earnings, while national income is based on the residency of the earner. For example, a Japanese company earning profits in India is part of India's domestic income but not its national income.

7. Will the production of goods for self-consumption be a part of national income? Give a reason.

Ans: Yes. Even though such goods are not sold in the market, they are meant for personal consumption and have value. Their value is imputed (estimated) and included in national income because they represent actual production. For example, a farmer growing wheat for his family is contributing to the economy's output.

8. An Indian artist performs in the UK and earns income. Will it be part of India's national income?

Ans: Yes. The artist is a normal resident of India, and national income includes all factor incomes earned by residents, whether earned inside or outside India. Even though the performance happened in the UK, the income is counted in India's national income.

9. What is meant by factor income?

Ans: Factor income refers to income earned by providing factors of production—land, labor, capital, and entrepreneurship. These include wages (labor), rent (land), interest (capital), and profit (entrepreneurship). National income includes only these types of incomes, as they result from productive activity. It does not include transfer incomes like gifts or pensions.

10. A person receives ₹10,000 as interest from Indian government bonds. Is this included in national income?

Ans: Yes. Interest is a factor of income received on capital provided. If the person receiving interest is a normal resident, it is part of national income. This shows how even government liabilities, when they pay income to residents, become part of productive earnings in the economy.

Long Answer Type Questions

1. (*a*) Differentiate between Gross Domestic Product (GDP) and Gross National Product (GNP) with the help of one example.

Basis	GDP (Gross Domestic Product)	GNP (Gross National Product)
Definition	GDP is the money value of all final goods and services produced within the **domestic territory** of a country in a year.	GNP is the money value of all final goods and services produced by the **normal residents** of a country in a year, regardless of where they are produced.
Scope	Includes income generated **within the country**, both by residents and non-residents.	Includes income earned **by residents only**, whether earned domestically or abroad.

Formula	GDP = GNP - Net Factor Income from Abroad (NFIA)	GNP = GDP + NFIA
Example	Income earned by a German company operating in India is included in India's GDP.	Income earned by an Indian company operating in the USA is included in India's GNP.

(*b*) Explain how Net Factor Income from Abroad (NFIA) helps in converting GDP into GNP.

Ans: Net Factor Income from Abroad (NFIA) refers to the difference between factor income earned by residents from abroad and factor income paid to non-residents within the domestic territory.

To convert GDP to GNP, we adjust for NFIA as follows:

If NFIA is positive (i.e., residents earn more abroad than foreigners earn domestically), then GNP > GDP.

If NFIA is negative, then GNP < GDP.

Formula:

GNP = GDP + NFIA

So, NFIA accounts for international income flows and helps in shifting the focus from location-based production (GDP) to ownership-based income (GNP).

2. (*a*) State two differences between National Income at Market Price and National Income at Factor Cost.

Basis	National Income at Market Price	National Income at Factor Cost
Definition	It is the value of final goods and services **at current market prices**, including indirect taxes and excluding subsidies.	It is the value of final goods and services **received by factors of production**, excluding indirect taxes and including subsidies.
Includes	Indirect taxes (e.g., GST), exclude subsidies	Excludes indirect taxes, includes subsidies
Usefulness	Reflects actual expenditure by consumers	Reflects actual income earned by producers/factors of production

(*b*) What adjustments are required to convert National Income at Market Price into National Income at Factor Cost?

Ans: To convert National Income from Market Price (MP) to Factor Cost (FC), we make the following adjustments:

Subtract indirect taxes (since they increase market price but are not part of factor incomes).

Add subsidies (as they are income support from the government and increase factor income).

Formula:

National Income at FC = National Income at MP − Indirect Taxes + Subsidies

This adjustment helps reflect the **real income earned by the factors of production**, not just the price paid by consumers.

3. (*a*) Distinguish between Domestic Income and National Income with appropriate examples.

Basis	Domestic Income	National Income
Definition	Income generated by all production units **located within the domestic territory** of a country, regardless of ownership.	Income earned by **normal residents** of a country, whether earned domestically or abroad.
Ownership	Includes income of both residents and non-residents operating in the country.	Includes only the income of residents, even if earned abroad.
Formula	Domestic Income = National Income − NFIA	National Income = Domestic Income + NFIA
Example	Profit earned by a foreign company operating in India is part of India's domestic income.	Wages earned by an Indian working in the US are part of India's national income.

(*b*) Classify the following items into domestic income or national income:

(i) Compensation of employees received from abroad

National Income (Because it is earned by a resident of the country from abroad)

(ii) Rent received by an Indian resident from property located in the USA.

National Income. It is earned by a normal resident from abroad, so it is included in national income but not in domestic income.

(iii) Salaries paid to foreign embassy staff working in India.

Not Included in Domestic or National Income. Embassies are considered part of the territory of the respective foreign country. Hence, this is excluded from both.

(iv) Profit earned by a branch of an Indian bank located in Canada.

National Income. It is earned by an Indian resident enterprise from abroad, so it is part of national income but not domestic income.

(v) Wages paid to a foreigner working temporarily in India.

Domestic Income. The income is earned within the domestic territory, even though the person is a non-resident, so it is part of domestic income, not national income.

(vi) Dividends received by an Indian from shares in a U.S. company.

National Income. This is factor income from abroad earned by a resident, included in national income, not in domestic income..

Numericals

1.

Items	(₹ in crore)
1. Gross domestic fixed capital formation	400
2. Private final consumption expenditure	8000
3. Government final consumption expenditure	3000
4. Change in Stock	50
5. Consumption of fixed capital	40
6. Net indirect taxes	100
7. Net exports	– 60
8. Net factor income to abroad	– 80
9. Net current transfers from abroad	100
10. Dividend	100

Gross Domestic Capital Formation = Gross Domestic fixed capital formation + change in stock

Gross Domestic Capital Formation = 400 + 50 = ₹450

GDP at MP = Private Final consumption expenditure + Government Final Consumption Expenditure + Gross domestic capital formation + Net Exports

GDP at MP = 8000 + 3000 + 450 – 60

GDP at MP = ₹11390,

NNP at MP = GDP at MP – consumption of fixed capital + NFIA

NNP at MP = 11390 – 40 – (- 80) = ₹11430

2. Find Net Value Added at Market Price:

Items	(₹ in lakh)
i) Fixed capital goods with a life span of 5 years	15
ii) Raw Materials	6
iii) Sales	25
iv) Net Change in Stock	(–) 2
v) Taxes on production	1

Ans: Value of Output = Sales + Change in Stock

Value of Output = iii) + iv) = 25 + (– 2) = 23

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

GVA at MP = ₹ 23 – ₹ 6 = ₹ 17

Net Value Added at MP = GVA at MP – Consumption of fixed Capital

Consumption of Fixed Capital = Total value of fixed Capital/life span = 15/5 = ₹ 3 lakh

NVA at MP = ₹ 17 – ₹ 3 = ₹ 14

3. Calculate 'Net National Product at Factor Cost from the following:-

Items	(₹ in crore)
1. National debt interest	60
2. Wages and salaries	600
3. Net current transfers to abroad	20
4. Rent	200
5. Transfer payments by the government	70
6. Interest	300
7. Net domestic product at factor cost accruing to the government	400
8. Social security contributions by employers	100
9. Net factor income paid to abroad	50
10. Profits	300

NDP at FC = COE (Wages & Salaries + Social Security contribution of employers) + Mixed Income + Rent + Interest + Profit
NDP at FC = (600 + 100) + 0 + 200 + 300 + 300
NDP at FC = 1500
NNP at FC = NDP at FC – Net factor income paid to abroad
NNP at FC = 1500 – 50
NNP at FC = ₹ 1450 crore

4. From the following data, find out value added by firm X:

S.N	Items	(₹ lakh)
(i)	Sales by Firm Y to Firm X	400
(ii)	Sales by Firm X to households	500
(iii)	Purchases by firm Z from Firm X	300
(iv)	Opening stock of firm X	25
(v)	Closing stock of firm X	75

Value of Output = Sales (Sales by Firm X to households + Purchases by firm Z from firm X) + Change in stock (Closing Stock by firm X – Opening stock of Firm X)
Value of Output = (ii + iii) + (v – iv) = (500 + 300) + (75 – 25) = ₹ 850
Value added by Firm X = Value of Output – Intermediate Consumption (sales by Firm Y to firm X)
Value added by Firm X = 850 – 400 = ₹ 450 lakh

Previous Year Questions

Multiple-choice questions (1 mark)

1. From the items given in Column-I and Column-II, choose the correct pair. **(CBSE 2025)**

Column-I		Column-II	
(a)	Income from Property	(i)	Old age pension
(b)	Income from Entrepreneurship	(ii)	Profit
(c)	Mixed Income	(iii)	Rent free accommodation from an employer
(d)	Compensation of Employees	(iv)	Interest from capital

Options:

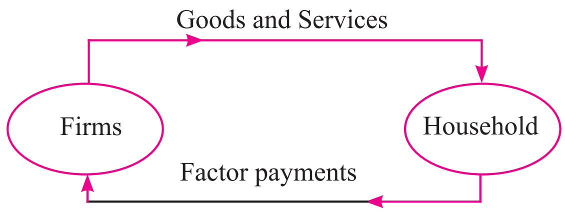
(*a*) (*a*) - (i)
(*b*) (*b*) - (ii)
(*c*) (*c*) - (iii)
(*d*) (*d*) - (iv)

Ans: (*b*)

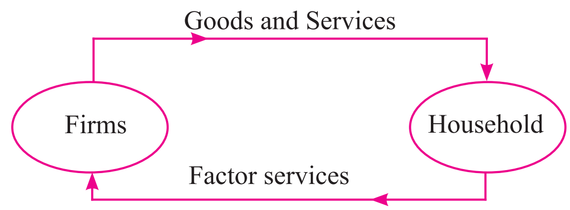
(*a*) Income from Property → Should match with (iv) Interest from capital
(*b*) Income from Entrepreneurship → Correctly matches with (ii) Profit.
(*c*) Mixed Income → Includes all types of income in small businesses, but (iii) Rent-free accommodation is part of Compensation to Employees.
(*d*) Compensation of Employees → Matches with (iii), not (iv).
So, only option (B) gives the correct match: Income from entrepreneurship = profit.

2. Identify which of the following represents only the real flow: **(CBSE 2023)**

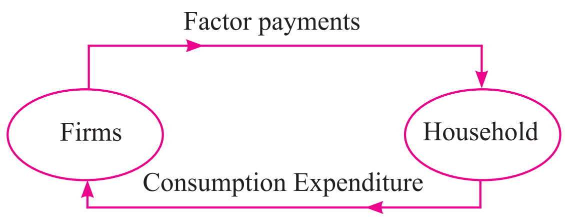
(*a*)



(*b*)



(*c*)



(*d*)

Ans: (*b*) Option (*b*) shows only real flow—i.e., flow of goods & services from firms to households and factor services from households to firms, with no money involved.

3. The difference between National Income at market price and National Income at factor cost is _______. **(CBSE 2023)**
(Choose the correct alternative to fill up the blank.)

(*a*) Net Indirect Taxes
(*b*) Net Factor Income from Abroad
(*c*) Consumption of Fixed Capital
(*d*) Market Price

Ans: (*a*) Net Indirect Taxes

National Income at Market Price – Net Indirect Taxes = National Income at Factor Cost
Net Indirect Taxes = Indirect Taxes – Subsidies
Hence, the difference between MP and FC is due to net indirect taxes.

Subjective Answer Type Questions (3-6 MARKS)

1. (*a*) Calculate the value of Net Value Added at Factor Cost (NVAFC): **3 M (CBSE 2025)**

S. No.	Particulars	Amount (In crore)
(i)	Operating Surplus	3,740
(ii)	Increase in unsold stock	600
(iii)	Sales	10,625
(iv)	Purchase of raw materials	2,625
(v)	Consumption of fixed capital	500
(vi)	Subsidies	400
(vii)	Indirect taxes	1,200

OR

(*b*) Distinguish between Net Factor Income from Abroad (NFIA) and Net Exports (X-M). **3 M**

Ans: (*a*) Gross value of output - Intermediate consumption

= value of output – Sales + change in stock
= 10625 + 600 11,225
= 11,225
GVA_{MP} = 11,225 – 2645 = 8600
$NVA_{FC} = GVA_{MP}$ – Dep – NIT
= 8,600 – 500 – (12,00 – 400)
8,600 – 500 – 800 – 7800
NVA_{FC} = 7300

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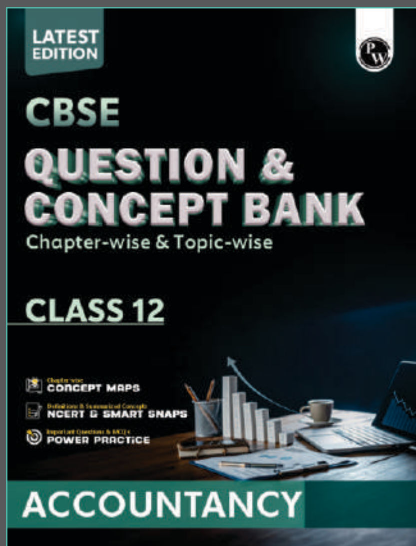

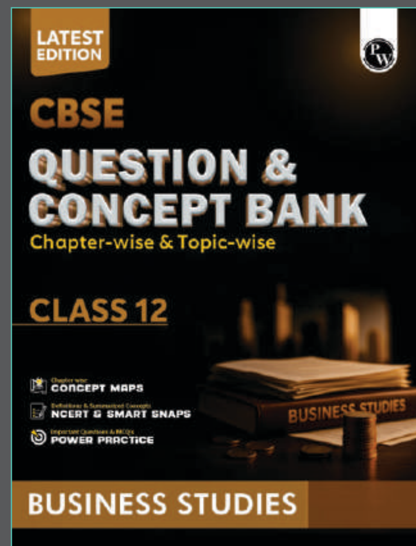

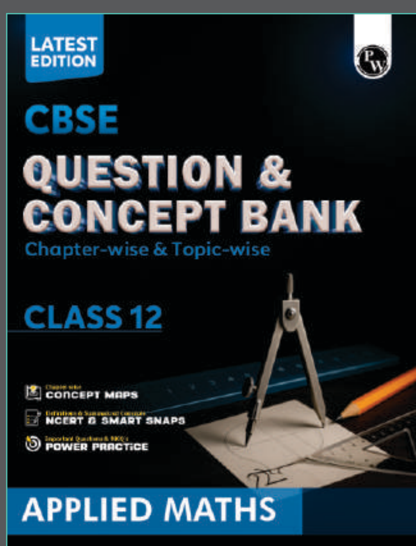

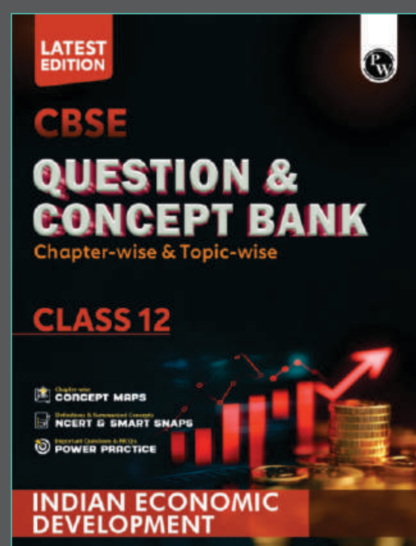

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