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INDIAN ECONOMY

CHAPTER 1

Basic Concepts of Economy

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EDITION October 2026

LANGUAGE English

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CHAPTER 1

Basic Concepts of Economy

Economic Systems, Sectors, Goods and Markets

IN THIS CHAPTER

- Economic System
- Sectors of the Economy
- Types of Goods in the Economy
- Market
- Sectors of the Economy by Economic Role

Economic System

An **economic system** is a mechanism through which the government plans and allocates the available services, resources and commodities across the country.

- It manages the factors of production: wealth, labour, physical resources and entrepreneurs.
- It includes many companies, agencies, objects, models and decision-making procedures.

Types of Economic Systems

Type	Controlled by	Also known as	Examples
Capitalist Economy	Market forces of **demand and supply** (not the government)	Free Economy	USA, Canada
Socialist Economy	The **government**	Controlled Economy	Former USSR, China
Mixed Economy	Both market and government (features of both systems)	Dual Economic System	**India**

REMEMBER

- **India** follows the **Mixed Economy** system.
- Capitalist = Free economy; Socialist = Controlled economy; Mixed = Dual economy.

Sectors of the Economy

On the basis of activity, the economy is divided into **three sectors**:

Sector	Also known as	Meaning	Examples
Primary Sector	Agricultural Sector	Depends directly on the environment / natural resources for production	Agriculture, farming, mining, fishing
Secondary Sector	Manufacturing Sector	Raw material is converted into a valuable product	Construction, steel manufacturing
Tertiary Sector	Service Sector	Production and exchange of services	Banking, insurance, hotels, restaurants, transport, communication

Types of Goods in the Economy

Type of Good	Meaning	Example / Note
Normal Good	When income **increases**, demand **increases**	Most everyday goods
Luxury Good	When income increases, demand increases by a **bigger percentage**; people spend a higher share of income on it	Luxury cars, branded goods
Inferior Good	Low-quality goods; when income **increases**, demand **falls**	People buy less low-quality bread and more high-quality bread as income rises
Giffen Good	A rare type of highly inferior good; when price **increases**, demand **increases**, and when price decreases, demand decreases	Exception to the law of demand

EXAM TIP

A **Giffen good** is the most-asked exception to the **law of demand**: price and demand move in the **same** direction.

Market

A **market** is a place where buyers and sellers meet to trade goods and services.

- It can be a **physical** structure (like a retail outlet where buyers and sellers meet face to face) or a **virtual** structure (like an online market).

Types of Market

Market Type	Number of Sellers	Key Features	Example
Perfect Competition	Very many	**Homogeneous** (identical) products; no entry barriers; no single buyer or seller can affect the price; it is **hypothetical**	Agricultural produce markets (closest example)
Monopolistic Competition	Many	Products are similar but **slightly differentiated**; sellers can charge a slightly higher price; the most realistic market type	Soaps, toothpaste, restaurants
Oligopoly	**A few**	A few firms dominate the market; firms may compete or collaborate; entry barriers exist	Automobile industry, telecom (Airtel, Jio)
Monopoly	**Only one**	One seller controls the entire market and sets the price; buyers must pay that price; considered highly undesirable	Indian Railways

Sectors of the Economy by Economic Role

Gross Domestic Product (GDP) expenditure comes from four sectors:

- **Household sector** – consumption expenditure (it consumes)
- **Business / Production sector** – investment expenditure (it produces)
- **Government sector** – government purchases (it regulates, consumes and produces)
- **Foreign / External sector** – net exports (it engages in external activity)

1. Household Sector

The household (consumer) sector is mainly concerned with the consumption of goods and services. Household income is spent on buying goods and services and on paying taxes to the government. Its role is divided into two parts:

- It provides **factor services** (land, labour and capital) to businesses.
- It buys final goods and services from the market, and so **creates market demand**.

It plays a huge role in the economic development of a country. Households:

- are the **primary consumers** of goods and services;
- work as **producers** (as employees in manufacturing);
- **pay taxes** to the government;
- act as **savers** – money left after consumption is saved in banks or financial organisations. These savings are one of India's main sources of **capital formation**.

2. Production Sector

- Responsible for the **creation of goods and services**.
- It pays for household factor services, government taxes and imports of materials.
- The stages that raw materials pass through to become a finished product are called the **manufacturing process**.

3. Government Sector

- Includes both **government services** and **government-owned businesses**.
- The government acts as a **consumer, producer and regulator**.

4. External Sector

- Covers all international economic interactions between residents of the country (private and public sector) and the rest of the world.
- Examples: exports, imports, international investment, external debt, current account, capital account and balance of payments.

QUICK REVISION

1. An economic system plans and allocates resources, services and commodities in a country.
2. **Capitalist** = market controlled (USA, Canada); **Socialist** = government controlled; **Mixed** = both (India).
3. Primary = agriculture; Secondary = manufacturing; Tertiary = services.
4. Normal good: income up, demand up. Inferior good: income up, demand down.
5. **Giffen good**: price up, demand up – an exception to the law of demand.
6. Perfect competition has homogeneous products and is hypothetical.
7. Oligopoly = a few sellers (automobiles); Monopoly = one seller (Indian Railways).
8. GDP expenditure comes from household, business, government and external sectors.
9. Household savings are a primary source of capital formation in India.