

PAPER I - INDIAN ECONOMY & INDIAN FINANCIAL SYSTEM

Module A: INDIAN ECONOMIC ARCHITECTURE

Chapter 1: An overview of Indian Economy

Topics in this chapter

- Evolution of Indian Economy
- Basic Characteristics of Indian Economy
- Indian Economy in Pre-British period
- Economy till 2008 & after 2008
- Structural changes in Indian Economy

1.1 EVOLUTION OF INDIAN ECONOMY

According to historical data from the Angus Maddison database, India and China were the powerhouses of the global economy for centuries.

- In **1000 AD**, India and China together contributed a massive **50.5%** of the world's GDP.
- By **1600 AD**, this figure had risen to **52%**, with China accounting for 29% and India for 23% of global GDP.
- A century later, India's share had risen to **24.4%** of world output.
- However, British colonialism dramatically altered this dynamic. By **1820 AD**, India's share of global GDP had plummeted to **16.1%**.

After centuries of decline, India's economy is once again on the rise. According to the International Monetary Fund (IMF), India's contribution to global GDP reached **7.3% in 2021**. In terms of GDP measured by purchasing power parity (PPP), India is ranked **3rd in the world**, behind only



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the USA and China. Today, India is one of the world's fastest-growing major economies.

India's economic performance during the British Raj was dismal. The policies of the colonial state were significant barriers to the country's growth. The recurring famines and disease outbreaks in the late 19th and early 20th centuries showed the British government's socioeconomic irresponsibility. The pre-independence period was characterized by near-stagnation, with very little change in how production was organized or in productivity levels.

The British East India Company ignored industrialization in the nation. The infrastructure they built was not designed to industrialize India but to exploit its raw materials for Britain's benefit. At the time of independence in 1947, India's economy was in a state of complete distress. The new government faced the significant challenge of systematically organizing and rebuilding the economy from scratch.

1.2 BASIC CHARACTERISTICS OF INDIAN ECONOMY

The World Bank classifies economies into four categories based on per capita income: Low Income, Lower-Middle Income, Upper-Middle Income, and High Income.



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The Indian economy falls into the category of a **lower-middle-income economy**. As of 2019, India's Per Capita Income (PCI) was **\$1,891**. While India is the 3rd largest economy in the world in terms of Purchasing Power Parity (PPP), its rank in terms of per capita income is very low.

This low per capita income is mainly due to high levels of poverty, unemployment, and illiteracy. At the time of its independence, India was a backward nation. The government addressed these developmental issues through a series of **five-year plans**, setting targets and allocating funds for the development of various sectors.

A number of factors influence the nature and characteristics of the Indian economy. Some of these include:

- Low per capita real income.
- Rapid population growth.
- A high rate of unemployment, underemployment, and disguised unemployment.
- Excessive reliance on the primary sector (agriculture).
- A vicious circle of poverty.

The following table of India's macro-economic aggregates from an RBI publication provides an overall view of the economic status of India.

India's Macro-Economic Aggregates (2014-15 to 2024-25) Round Figures

Parameter	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
Population (in Crores)	126.7	128.3	129.9	131.4	132.7	134.1	135.5	136.8	138.3	139.5	140.8
GDP (in ₹ Thousand Crores)	12,468	13,772	15,392	17,090	18,887	20,075	19,830	23,471	26,950	29,536	32,411



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Parameter	2014-15	2015-16	2016-17	2017-18	2018-19	2019-20	2020-21	2021-22	2022-23	2023-24	2024-25
GNI (in ₹ Thousand Crores)	12,321	13,612	15,215	16,905	18,685	19,864	19,645	23,250	26,667	29,231	31,925
NNI (in ₹ Thousand Crores)	10,978	12,162	13,624	15,140	16,705	17,717	17,462	20,813	23,800	26,134	28,495
Gross Capital Formation (in ₹ Thousand Crores)	4,180	4,423	4,918	5,792	6,173	6,551	5,598	7,648	8,678	9,107	N/A
Per Capita GDP (in ₹)	98,000	1,07,000	1,18,000	1,30,000	1,42,000	1,50,000	1,46,000	1,72,000	1,95,000	2,12,000	2,30,000
Per Capita NNI (in ₹)	87,000	95,000	1,05,000	1,15,000	1,26,000	1,32,000	1,29,000	1,52,000	1,72,000	1,87,000	2,02,000

Notes on the Data:

- **Source:** The underlying data is from the National Statistical Office (NSO), Government of India.
- **N/A:** Data for Gross Capital Formation for 2024-25 is not yet available in the advance estimates.

Historically, India was an agricultural economy. In 1950, **agriculture** was the dominant sector, contributing **53.1%** of the GDP. Industry contributed 16.6%, and services contributed 30.3%. After independence, as the planning process



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began, agriculture's share decreased while the shares of industry and services increased. By 1980-81, the **services sector (38% of GDP)** had surpassed agriculture (36.1%) to become the largest contributor to India's GDP.

1.3 INDIAN ECONOMY IN BRITISH PERIOD

During British colonialism, India's commerce, trade, and investment were severely hampered by the **unilateral transfer of capital and raw materials to Britain**. The social sector was neglected, which had a negative impact on the economy's production and productivity. At the time of independence, less than one-sixth of Indians were literate, and the country was plagued by extreme poverty and sharp social divisions.

Dadabhai Naoroji published the first estimates of India's national income in his book "Poverty and Un-British Rule in India" for the year 1867-1868. According to him, the per capita income was just **₹20 per year**. By 1947, the per capita income had risen to only about ₹250 per year.

According to the work of Cambridge economist **Angus Maddison**, India's share of the global economy shrank from **23% in 1600 AD to just 3% by 1947**. Similarly, India's share of global trade fell from 33% to less than 3% in the same period.

British Era: Three Phases of Economic Impact

1. **Early British Period (1600-1757):** The East India Company was founded with two goals: to procure raw materials for their factories in Britain and to find a market for their finished goods in India.
2. **Company Rule (1757-1857):** This period started after the Battle of Plassey. The East India Company pretended to do trade but actually looted wealth. They used unfair land tax systems like Zamindari,



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Mahalwari, and Ryotwari to take money from farmers. Many company officers got rich through dishonest means.

3. **British Crown Period (1858 onward):** After the Sepoy Mutiny of 1857, the British Crown took direct control of India. This period was marked by systematic colonial exploitation through:

- **De-industrialisation:** Ruining India's traditional industries.
- **Commercialisation of Agriculture:** Forcing farmers to grow cash crops for British industries.
- **Wealth Drain:** The unilateral transfer of wealth from India to Britain.
- **Westernisation of Education:** Creating a class of Indians to serve the colonial administration.

The British transportation system, particularly the railways, was developed not to help India but to assist the British in moving raw materials from the hinterlands to the ports and finished goods from the ports to the hinterlands.

The "Wealth Drain"

The wealth drain means India's money and resources were going to Britain, but India got almost nothing in return. This happened in many ways – through money sent by officials, business profits, and "Home Charges."

Home Charges were payments officially sent from India to Britain during British rule (1858-1947). These included:

- Profits (dividends) given to East India Company shareholders.
- Interest on loans that the Government of India took from England.
- Cost of the British army in India.
- Pensions and salaries of retired British officers and the Secretary of State for India.

By the 1930s, these payments were around £40-50 million every year. Early British rulers were extremely greedy. British officers had huge salaries – for



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example, the Viceroy earned £25,000 a year, which was about 60 times more than what an average Indian worker earned.

The following table shows how Britain prospered at India's expense:

Indicator (1600-1947)	India	United Kingdom
Per Capita GDP (1990 int. Dollars)	From 550 to 618 (+12%)	From 974 to 6,361 (+553%)
Population	From 13.5 crore to 41.4 crore	From 61.7 lakhs to 4.95 crore
GDP (Million 1990 int. Dollars)	From 74,250 to 255,852 (x 2.44)	From 6,007 to 314,969 (x 52)

*Source: Data compiled from the historical economic studies of Angus Maddison.

1.4 ECONOMY TILL 2008 & AFTER 2008

1951-1980

During the first three decades after independence, India's growth rate was very slow. In 1978, Professor Raj Krishna famously coined the phrase "**Hindu rate of growth**" to describe this slow annual growth rate, which hovered around **3.5%**, while per capita income growth averaged only 1.3%.

1980-1990

This time is seen as a period when India's economy grew strongly and recovered. In the Sixth Five-Year Plan (1980-1985), India finally moved past the slow growth known as the "Hindu Rate of Growth." This happened because the government spent more money and made it easier to import goods.



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1992 to 2008

This is known as the post-reform period. Following the 1991 economic crisis, India implemented major reforms and adopted **LPG (Liberalisation, Privatisation, Globalisation)** policies. This paved the way for higher GDP growth rates. From 2002-03 to 2006-07, India's GDP grew at an impressive **8.6%** annual rate, making it the world's second-fastest-growing economy after China.

2008 to 2021

The **2008 global financial crisis**, triggered by the Lehman Brothers collapse, had a significant impact on India. To mitigate the effects of the crisis, the government provided three fiscal stimulus packages totaling **₹1.86 lakh crore**, and the RBI injected a massive **₹5.6 lakh crore** of liquidity into the system.

The economy recovered impressively but at the cost of a larger fiscal deficit. In the subsequent decade, revolutionary policies such as the **Goods and Services Tax (GST)**, the **Insolvency and Bankruptcy Code (IBC)**, corporate tax cuts, and **demonetisation** were implemented. Before the COVID-19 pandemic, the economy's average annual growth rate between 2008-09 and 2019-20 was 6.5%. However, growth had already slowed to just **4.0% in 2019-20** due to structural bottlenecks, and this slowdown was made worse by the pandemic.

1.5 STRUCTURAL CHANGES IN INDIAN ECONOMY

Indian Economy Post COVID-19



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The COVID-19 pandemic was the third major shock to the Indian economy in the last four decades, after the 1991 Balance of Payments crisis and the 2008 global financial crisis. The Government of India imposed one of the world's most stringent lockdowns in 2020 to fight the virus. This led to a severe economic impact, with GDP contracting by a massive **23.8%** in the first quarter of 2020-21.

Sectoral Impact of COVID-19

- **Services Sector:** Suffered the most due to the lockdown, as contact-intensive businesses like retail, hotels, and transportation were almost halted.
- **Labour Market:** Suffered a severe decline, with unemployment hitting an all-time high. There was a reverse migration from urban to rural areas, which increased demand for MGNREGS employment.
- **Agriculture:** This sector remained robust and resilient, as agriculture and allied activities were exempt from the lockdown restrictions.
- **Industry:** Manufacturing, mining, and quarrying saw significant drops, but manufacturing led the recovery after the first wave.

The following table shows the recovery pattern of different sectors:

Sector-wise Recovery Pattern

Sector	Pre-Pandemic Growth (2017-20)	Pandemic Period (2020-21)	Status
1. Agriculture, forestry & fishing	5.2%	3.3%	Resilient



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Sector	Pre-Pandemic Growth (2017-20)	Pandemic Period (2020-21)	Status
2. Mining & quarrying	2.4%	-8.6%	Recovering / Need Repair
3. Manufacturing	5.0%	-0.6%	Recovering / Need Repair
6. Trade, hotels, transport	8.1%	-22.4%	Still Suffering
7. Financial, real estate & professional services	5.4%	5.1%	Resilient
8. Public Administration, defence	7.0%	2.3%	Resilient
GVA at basic prices	5.9%	-4.8%	Recovering / Need Repair

(*Source: Analysis based on National Statistical Office (NSO) data, as presented by the office of the Chief Economic Advisor, Government of India (2021).

Economic Recovery Dynamism Post COVID

Despite the severe contraction in Q1 2020-21, the economy began a gradual recovery in the second half of the year. For the full fiscal year 2020-21, the contraction was **6.6%**. The economy recovered impressively in **2021-22**, with an estimated GDP growth of **8.7%**.

The COVID-19 pandemic caused significant permanent damage to the economy. The RBI has predicted that India is expected to overcome the losses caused by the pandemic in about **12 years**, by **2034-35**.



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Structural change refers to the fundamental changes in the critical components of the Indian economy over time. In the long run, the contribution of the primary sector (agriculture) to GDP decreases, while that of the secondary (industry) and tertiary (services) sectors increases. In India, the **services sector** has largely replaced the industrial sector and now dominates the economy.

Agriculture's share of GDP has steadily declined from 26.9% in 1990 to **17.7% in 2019**. The onset of the pandemic temporarily increased the primary sector's contribution because agriculture was the only sector allowed to function smoothly during the lockdown. An empirical examination of the Indian economy reveals that the services sector drives the industry and the overall economy, and its growth is influenced by external factors like foreign direct investment.

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