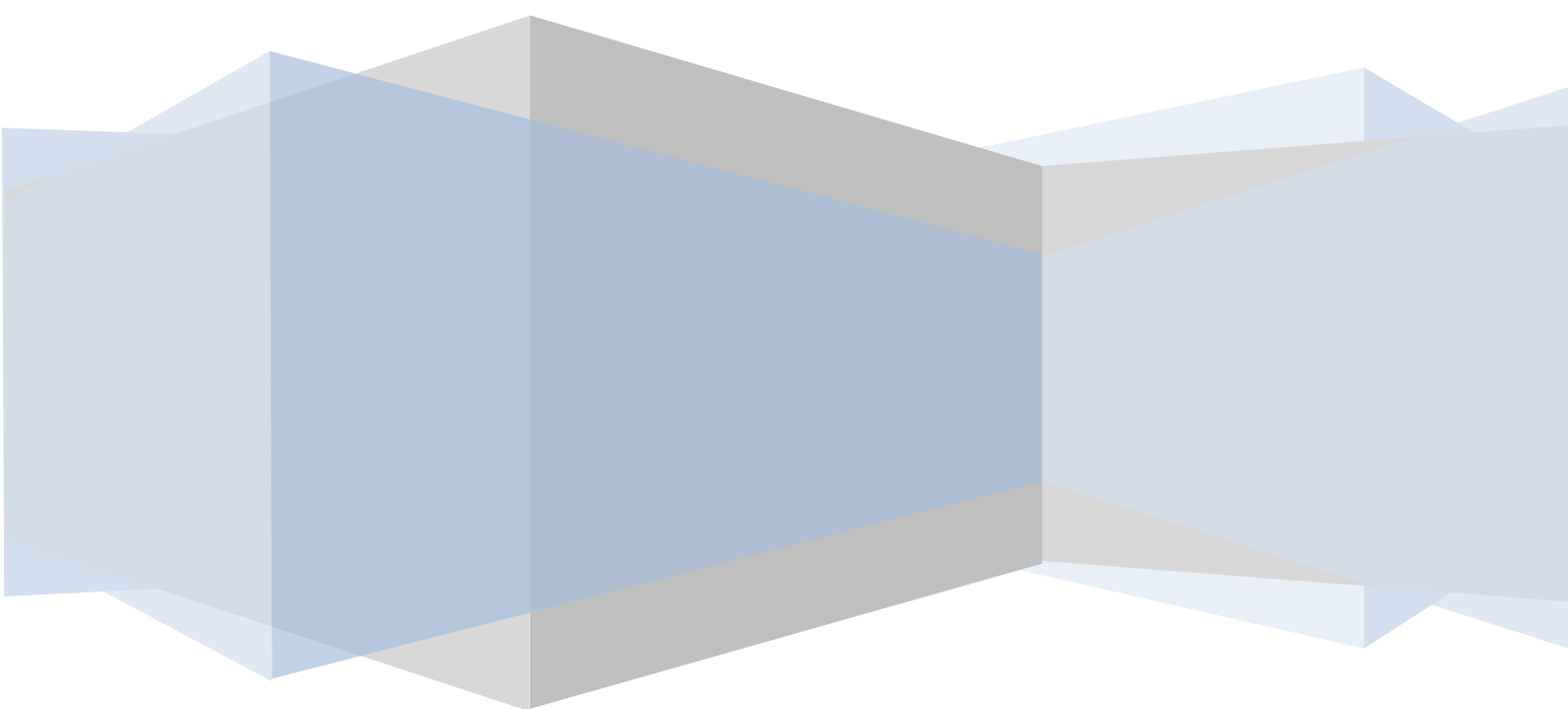


Chapter 1: Basics of Macroeconomics

Short Answers

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

Compiled by Prof. Ashok Vishandass



This chapter contains:

- **Microeconomics and Macroeconomics**
- **Aggregate Demand**
- **Aggregate Supply**
- **Types of Goods**
- **Final Goods**
- **Unemployment**
- **Unemployment Rate**
- **Labor Force Participation Rate (LFPR)**

Contents

1. Microeconomics and Macroeconomics	1
1.1 What is Microeconomics?	1
1.2 What is Macroeconomics?	2
1.3 Conclusion	3
2. Aggregate Demand	4
2.1 Concept	4
2.2 Components of Aggregate Demand	4
2.3 Calculating Aggregate Demand	5
2.4 Aggregate Demand Curve	6
2.5 Factors Influencing Aggregate Demand	6
2.6 Changes in Aggregate Demand	7
2.7 Significance	8
2.8 Drawbacks	8
2.9 Conclusion	9
3. Aggregate Supply	10
3.1 Concept	10
3.2 Types of Aggregate Supply Curves	10
3.3 Input Prices	13
3.4 Economic Growth	14
3.5 Significance	14
3.6 Drawbacks	14
3.7 Conclusion	15
4. Types of Goods	16
4.1 Consumption Goods	16
4.2 Capital Goods	17
4.3 Intermediate Goods	19
4.4 Speciality Goods	21
4.5 Inferior Goods	21
4.6 Normal Goods	21
4.7 Luxury Goods	21
4.8 Complementary Goods	21
4.9 Substitute Goods	21
4.10 Giffen Good	22

4.11	Veblen / Snob Good	22
4.12	Free Goods	22
4.13	Basic Goods	22
4.14	Intermediate Goods	22
4.15	Finished Goods.....	22
4.16	Capital Goods.....	22
4.17	Producer Good.....	23
4.18	Consumer Goods.....	23
4.19	Convenience Goods	23
4.20	Shopping Goods	23
4.21	Public Goods	24
4.22	Merit Goods	24
4.23	Demerit Goods.....	24
5.	Final Goods.....	25
6.	Unemployment	27
6.1	Types of Unemployment.....	27
6.1.1	Frictional Unemployment	27
6.1.2	Cyclical Unemployment	27
6.1.3	Voluntary unemployment.....	27
6.1.4	Involuntary unemployment	28
6.1.5	Structural unemployment.....	28
6.1.6	Seasonal unemployment	28
6.1.7	Open unemployment.....	29
6.1.8	Under-employment.....	29
6.1.9	Disguised Unemployment.....	29
6.1.10	Vulnerable Employment	30
6.1.11	Technological Unemployment	30
6.2	Conclusion.....	30
7.	Unemployment Rate.....	31
7.1	What is the Unemployment Rate?.....	31
7.2	Recent Trends in Unemployment Rate (January 2022)	31
7.3	COVID impact on Unemployment Rate	31
7.4	Conclusion.....	32
8.	Labor Force Participation Rate (LFPR).....	33

8.1	What is the Labor Force Participation Rate?	33
8.2	Significance	33
8.3	Recent Trends	33
8.4	Conclusion.....	34

1. Microeconomics and Macroeconomics

Microeconomics is the study of the economic activity of an economic unit or a part of the economy or a small group of more than one unit. **Macroeconomics** is the branch of economics that deals with the economic aggregates of a country as a whole. Although microeconomics and macroeconomics are two different aspects of economics, they are not mutually exclusive.

The concepts of microeconomics and macroeconomics are very important for the UPSC IAS Exam. In this article, let us see what microeconomics and macroeconomics are and the differences between them.

1.1 What is Microeconomics?

Microeconomics is concerned with the decisions made by individuals and businesses in response to the shifting cost of products and services in an economy. Microeconomics encompasses a variety of subjects, including

- The **Supply and Demand** of items in different markets.
- Consumer behaviour, either individually or collectively.
- Individual labour markets, demand, and determinants such as an employee's wage are all factors that influence service and labour demand.

One of the most distinguishing characteristics of microeconomics is that it focuses on casual scenarios in which a marketplace's present conditions alter. To analyse the economy, it demands a bottom-up strategy.

1.1.1 Concepts covered under Microeconomics

Microeconomics involves the study of several key concepts such as:

- **Incentives and behaviours** - How people react to situations, whether as individuals or in organisations.
- **Utility theory** - It states that consumers will choose a combination of goods that will maximise their happiness or "utility," subject to the constraint of how much income they have available to spend.
- **Production theory** - It is the study of production—or the process of converting inputs into outputs. In order to maximise profits, producers seek to select the combination of inputs and methods of combining them that will result in minimizing the cost.
- **Price theory** - The interaction of utility and production theory results in the theory of supply and demand, which determines prices in a competitive market.
- In a perfectly competitive market, the price demanded by consumers is the same as the price supplied by producers. As a result, economic equilibrium is achieved.

1.1.2 Significance

- Microeconomics can be used in a positive or normative sense.
- **Positive microeconomics** explains economic behaviour and what to expect when certain conditions change. For example,
 - If a car manufacturer raises the price of its vehicles, positive microeconomics predicts that consumers will buy fewer vehicles than before.
 - When a major copper mine in South America collapses, the price of copper tends to rise because supply is limited.
 - Positive microeconomics may assist an investor in understanding why Apple Inc. stock prices may fall if consumers purchase fewer iPhones.
- These positive microeconomic explanations, conclusions, and predictions can then be used normatively to prescribe what people, businesses, and governments should do in order to achieve the most valuable or beneficial patterns of production, exchange, and consumption among market participants.
- This extension of microeconomic implications from what is to what ought to be or what people ought to do necessitates at least the implicit application of some sort of ethical or moral theory or principles, which usually means some form of utilitarianism.

1.2 What is Macroeconomics?

Macroeconomics is the study of a country's economic progress and actions. It also covers the examination of policies and other influencing factors that have a broad impact on the economy. Macroeconomics is based on a top-down strategy, using tactics such as –

- A country's overall economic growth.
- Unemployment and inflation influencing factors.
- Fiscal policies that are expected to have an impact on interest rates.
- Effect of Globalisation and international trade
- Reasons for differences in economic growth between countries.

Another characteristic of macroeconomics is that it is concerned with aggregated growth and its economic correlation.

Table 1.1 Difference between Microeconomics and Macroeconomics

Parameter	Microeconomics	Macroeconomics
Scale of Study	Microeconomics relates to the individual economic agents.	Macroeconomics is related to the study of the aggregate.
Field of Study	Microeconomics is concerned with issues and strategies concerning the most efficient use of resources and economic activity, such as pricing	Macroeconomic analysis is concerned with policies affecting income, employment, and resource growth at the broadest level.

	determination.	
Scope	Price determination in the market for products and services is the focus of microeconomic study.	Macroeconomics is concerned with the overall income determination in the economy.
Methods	The method of partial equilibrium analysis, which is focused on significant aspects associated with economic activity, dominates microeconomic research.	The mutual dependency of significant economic aggregates is analysed in macroeconomics, and this is known as Quasi General Equilibrium Analysis.
Analytical Factors	Microeconomics is the study of the behaviour of economic variables when they are in a state of equilibrium.	The study of the behaviour of economic aggregates under a state of disequilibrium is known as macroeconomic analysis.
Limitations	It is based on implausible assumptions, such as the assumption of full employment in the community in microeconomics, which is not at all realistic.	It has been examined that the 'misconception of composition' includes, which occasionally fails to be accurate because what is true for the aggregate may not be true for individuals.

1.3 Conclusion

Macroeconomics and microeconomics are inextricably linked. All microeconomic studies can aid in the comprehension and analysis of macroeconomic factors. Both economic analysis branches are complementary and supplementary to one another. These have practical applications in the realms of economics and commerce.

2. Aggregate Demand

Aggregate demand is the total amount of demand for all finished goods and services produced in a given economy. The total amount of money exchanged for those goods and services at a specific price level and point in time is referred to as aggregate demand.

The **aggregate demand curve** depicts the total amount of goods (and services) demanded by the economy at various price levels. The price level of all final goods and services is represented by the vertical axis. The horizontal axis represents the real quantity of all goods and services purchased as measured by real GDP. The **aggregate demand curve (AD)**, is downward sloping, as are the demand curves for individual goods, implying that there is an inverse relationship between the price level and the quantity demanded of real GDP.

2.1 Concept

- Aggregate demand is a macroeconomic term that refers to the total demand for goods and services in a given period at any given price level.
- Since the two metrics are calculated in the same way, aggregate demand over time equals **gross domestic product (GDP)**.
- GDP is the total amount of goods and services produced in an economy, whereas aggregate demand is the desire or demand for those goods.
- The aggregate demand and GDP increase or decrease together as a result of the same calculation methods.

2.2 Components of Aggregate Demand

2.2.1 Government Spending (G)

- The total amount spent by the government on infrastructure, investments, defense and military equipment, public sector facilities, healthcare services, and government employees is referred to as government spending.
- It does not include spending on transfer payments, such as pension plans, subsidies, and aid transfers to needy countries.

2.2.2 Consumption spending (C)

- It is the largest component of aggregate demand in an economy, and it refers to the total amount spent by individuals and households on goods and services in the economy.
- Consumption spending is influenced by a number of factors, including disposable income, per capita income, debt, consumer expectations of future economic conditions, and interest rates.
- It is important to note that consumption spending excludes spending on residential structures, which is included in the investment spending component.

2.2.3 Investment Spending (I)

- The total expenditure on new capital goods and services such as machinery, equipment, inventory changes, investments in non-residential structures, and residential structures is referred to as investment spending.
- Investment spending is influenced by factors such as interest rates (which determine the cost of borrowing), economic forecasts, and government incentives (such as tax benefits or subsidies for investing in renewable energy).

Net Exports (X-M)

- Exports are products manufactured by domestic producers and sold abroad, whereas imports are products manufactured abroad and imported for domestic consumption.
- It is important to remember that aggregate demand is the total demand for goods and services produced domestically; thus, exports are added to aggregate demand while imports are subtracted.
- Net Exports is a measure of exports minus imports that is an important determinant of aggregate demand.

2.3 Calculating Aggregate Demand

The aggregate demand equation includes consumer spending, private investment, government spending, and the net of exports and imports. The formula is shown below:

$$\text{Aggregate Demand} = C + I + G + Nx$$

where,

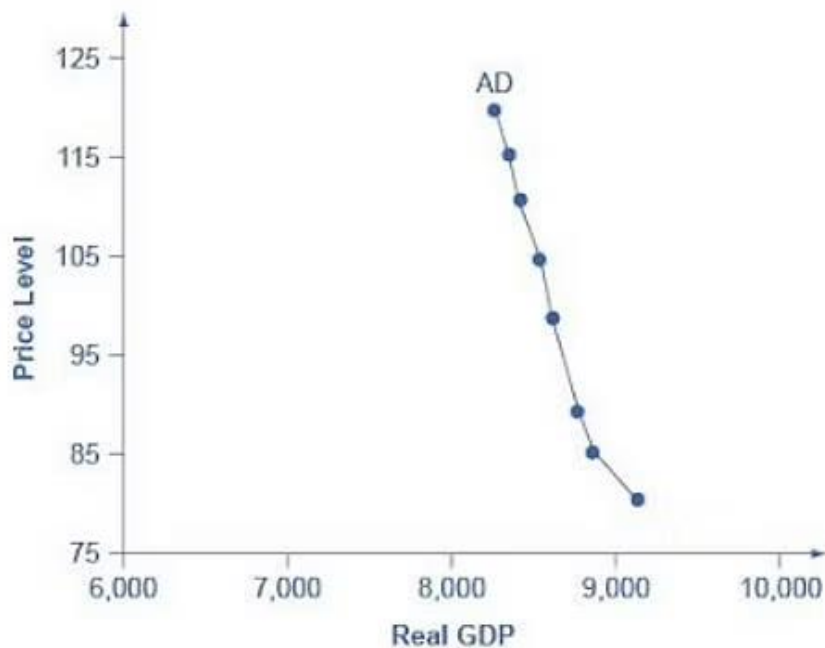
C = Consumer spending on goods and services

I = Private investment and corporate spending on non-final capital goods (factories, equipment, etc.)

G = Government spending on public goods and social services (infrastructure, medicare, etc.)

Nx = Net exports (exports minus imports)

2.4 Aggregate Demand Curve



- If aggregate demand were represented graphically, the total amount of goods and services demanded would be on the horizontal X-axis, and the overall price level of the entire basket of goods and services would be on the vertical Y-axis.
- Like most typical demand curves, the aggregate demand curve slopes downward from left to right. As the price of goods and services rises or falls, demand rises or falls along the curve.
- Furthermore, the curve can shift due to changes in the money supply or tax rate increases and decreases.
- The downward slope of the AD curve indicates that increases in the price level of an output result in less amount of total spending.
- To fully comprehend why price increases lead to lower spending, we must first comprehend how price changes affect the various components of aggregate demand.

2.5 Factors Influencing Aggregate Demand

2.5.1 Pigou's Wealth Effect

- According to Pigou's Wealth Effect, consumers are wealthier at lower price levels (assuming that wages are constant).
- At lower price levels, disposable income is higher, allowing consumers to spend more on goods and services, increasing demand for output.
- As the price level rises, the purchasing power of savings held in bank accounts and other assets decreases, being eaten away to some extent by inflation.

- Consumption spending will fall as the price level rises because an increase in the price level reduces people's wealth.

2.5.2 Interest Rate Effect

- The interest rate effect explains why, as outputs rise, the same purchases require more money or credit.
- Interest rates will rise as a result of the increased demand for money and credit.
- Higher interest rates, in turn, will reduce borrowing by businesses for investment purposes as well as borrowing by households for homes and automobiles, thus lowering both consumption and investment spending.

2.5.3 Exchange Rate Effect

- When the value of a country's currency falls in relation to other currencies, domestic goods become more affordable to foreigners while imports become more expensive.
- As a result, at lower price levels, when domestic goods are cheaper than imported goods, demand for exports rises, resulting in an increase in aggregate demand.

2.6 Changes in Aggregate Demand

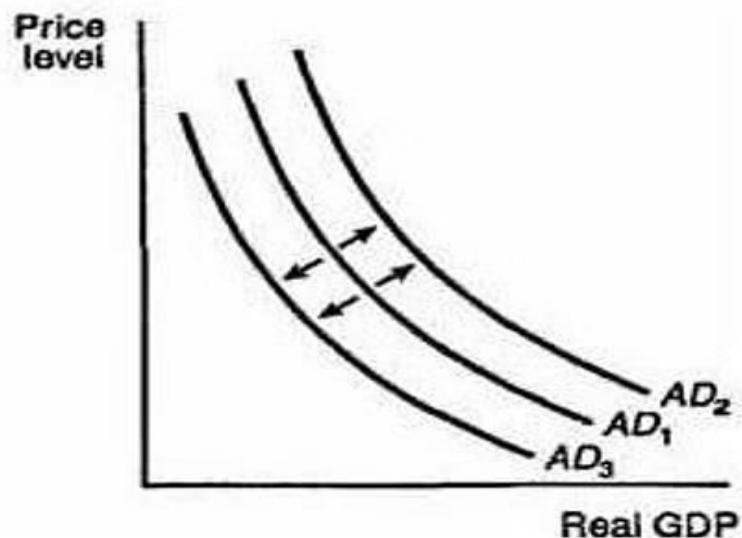


Figure 2 Shifts of the aggregate demand curve

- Shifts in the aggregate demand curve represent changes in aggregate demand.
- Below is an illustration of the two ways in which the aggregate demand curve can shift.

- A shift to the right of the aggregate demand curve, from AD 1 to AD 2, indicates that the quantity demanded of real GDP has increased at the same price levels.
- A shift to the left of the aggregate demand curve, from AD 1 to AD 3, indicates that the quantity demanded of real GDP has decreased at the same price levels.
- Changes in the price level do not cause changes in aggregate demand.
- Changes in demand for any of the components of real GDP cause them instead. For example,
 - Assume that consumers reduce their spending on all goods and services, possibly as a result of a recession. The aggregate demand curve would shift to the left as a result.
 - Assume interest rates fall and investors increase their investment spending; the aggregate demand curve shifts to the right.
 - The aggregate demand curve would shift to the left if the government cut spending to reduce the budget deficit.
 - If foreigners' incomes rose, allowing them to purchase more domestic goods, net exports would rise and aggregate demand would shift to the right.
 - These are just a few of the many possible shifts in the aggregate demand curve. However, none of these explanations have anything to do with price changes.

2.7 Significance

- It is a method of examining the total demand for goods and services in any economy.
- It is a macroeconomic tool used to help determine or predict overall economic strength within a country over a given time period, usually a year.
- It is a useful tool for assessing economic health and the factors that can influence it.
- It enables one to see how a country progresses from a slowdown to a recession, or how a country can recover from a recession.
- A country's trade position can also be deduced from aggregate demand. If the value of imports exceeds the value of exports, the country has a trade deficit with the countries from which it imports goods.
- According to Keynes' theory, the level of employment is determined by the level of aggregate demand rather than the price of labour, as classical economics proposed.
- Aggregate demand is also useful for estimating the impact of prices on productivity.

2.8 Drawbacks

- Since aggregate demand is measured by market values, it only represents total output at a given price level and does not always reflect a society's quality of life or standard of living.
- Furthermore, aggregate demand measures a wide range of economic transactions involving millions of people and for a variety of purposes.
 - As a result, determining the causality of demand and running a regression analysis, which is used to determine how many variables or factors influence demand and to what extent, can become difficult.

- The relationship between growth and aggregate demand has been the subject of major debates in economic theory for many years.

2.9 Conclusion

- All consumer goods, capital goods, exports, imports, and government spending programs are included in aggregate demand.
- As long as the variables trade at the same market value, they are all considered equal.
- An increase in any of the aggregate demand components – consumption spending, investment spending, government spending, and net exports shifts the aggregate demand curve to the right, while a decrease in any of these components shifts the aggregate demand curve to the left.

3. Aggregate Supply

Aggregate supply, also known as **total output**, is the total supply of goods and services produced within an economy in a given period at a given overall price. The **aggregate supply curve (AS)** describes the relationship between price levels and the quantity of output that firms are willing to provide. Generally, aggregate supply and the price level have a positive relationship.

Aggregate supply is usually calculated over a year since the changes in supply tend to lag changes in demand.

3.1 Concept

- Rising prices are usually an indication that businesses should increase production to meet increased aggregate demand.
- When demand rises in the face of constant supply, consumers compete for the goods available and, as a result, pay higher prices.
- Due to this dynamic, the firms are induced to increase output in order to sell more goods.
- As a result of the increased supply, prices normalize while output remains elevated.

3.2 Types of Aggregate Supply Curves

Short-run Aggregate Supply Curve (SRAS)

- The short-run aggregate supply curve (SRAS) is considered a valid description of the economy's supply schedule only in the short run.
- The short-run is defined as the period that begins immediately after a price increase and ends when input prices have increased in proportion to the price increase.
- The prices paid to providers of input goods and services are referred to as input prices.
- Wages paid to employees, interest paid to capital providers, rent paid to landowners, and prices paid to suppliers of intermediate goods are all examples of input prices.
- The SRAS curve is based on the assumption that input providers do not or cannot immediately account for increases in the general price level, so it takes some time—referred to as the short run—for input prices to fully reflect changes in the price level for final goods.
- In the short run, sellers of finished goods receive higher prices for their goods without a proportional increase in the cost of their inputs.
- The higher the price level, the more willing these sellers will be to supply.

- The SRAS curve, depicted in the below figure is thus upward sloping, reflecting the positive relationship that exists in the short run between the price level and the quantity of goods supplied.

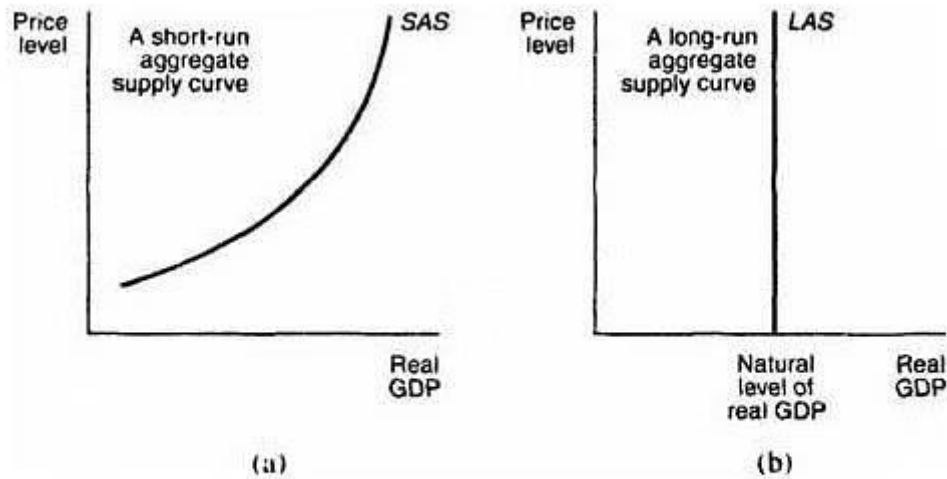


Figure 1 The aggregate supply curve

Long-run Aggregate Supply Curve (LRAS)

- The **long-run aggregate supply (LRAS) curve** describes the economy's supply schedule in the long run.
- The long-run is defined as the time period during which input prices have completely adjusted to changes in the price level of final goods.
- In the long run, the increase in prices received by sellers for their finished goods is completely offset by the proportional increase in prices paid by sellers for inputs.
- As a result, the amount of real GDP supplied by all sellers in the economy is unaffected by changes in the price level.
- The LRAS curve, depicted in the figure below, is a vertical line, indicating that changes in the price level have no effect on long-run aggregate supply.
- It's worth noting that the LAS curve is vertical at the point labeled "natural level of real GDP."
- The natural level of real GDP is defined as the level of real GDP that occurs when all of the economy's available input resources are fully utilized.

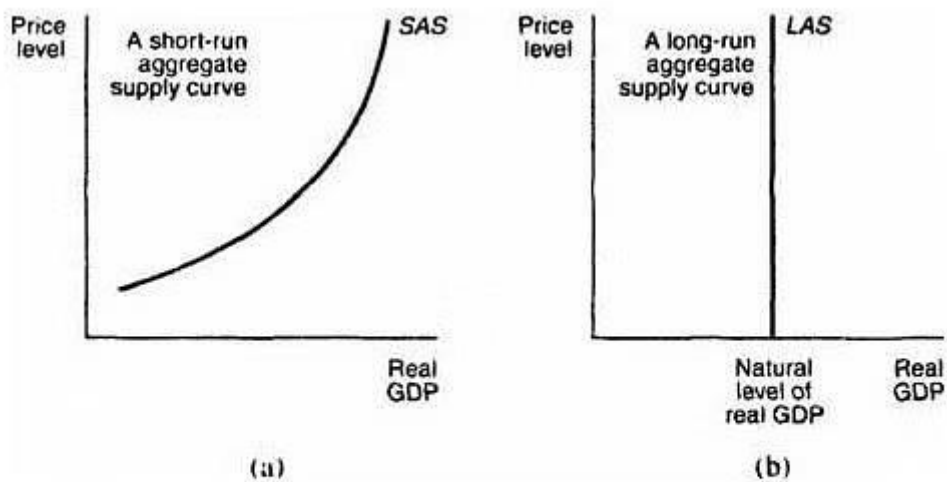
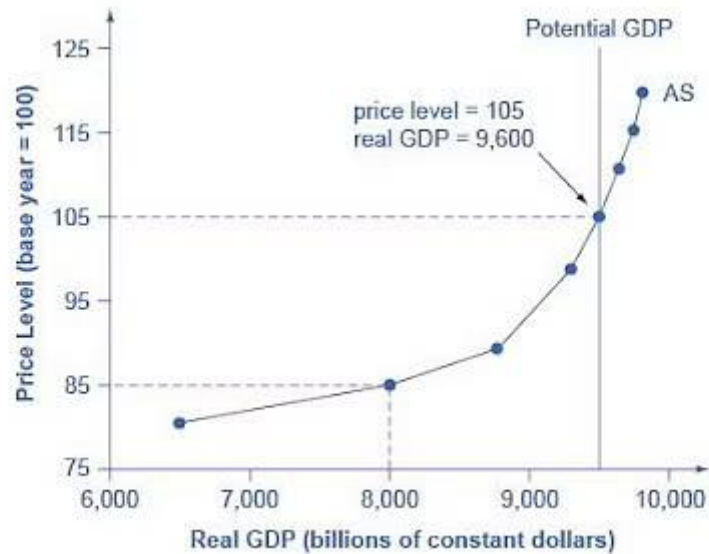


Figure 1 The aggregate supply curve

Aggregate Supply Curve (AS)



- The horizontal axis of the diagram represents real GDP or GDP adjusted for inflation. The price level is depicted on the vertical axis.
- The average price of all goods and services produced in the economy is referred to as the price level. It is an index number, similar to the GDP deflator.
- The vertical axis shows the price level for final goods or outputs purchased in the economy, not the price level for intermediate goods and services that are inputs to production.
- The AS curve describes how suppliers will respond to higher prices for final outputs of goods and services while input prices such as labour and energy remain constant.

- If firms across the economy face a situation in which the price level of what they produce and sell rises while their production costs remain constant, the lure of higher profits will induce them to expand production.

Changes in Aggregate Supply Curve

- Shifts in the aggregate supply curve represent changes in aggregate supply.
- The figure given below depicts the various ways in which the SRAS and LRAS curves can shift.

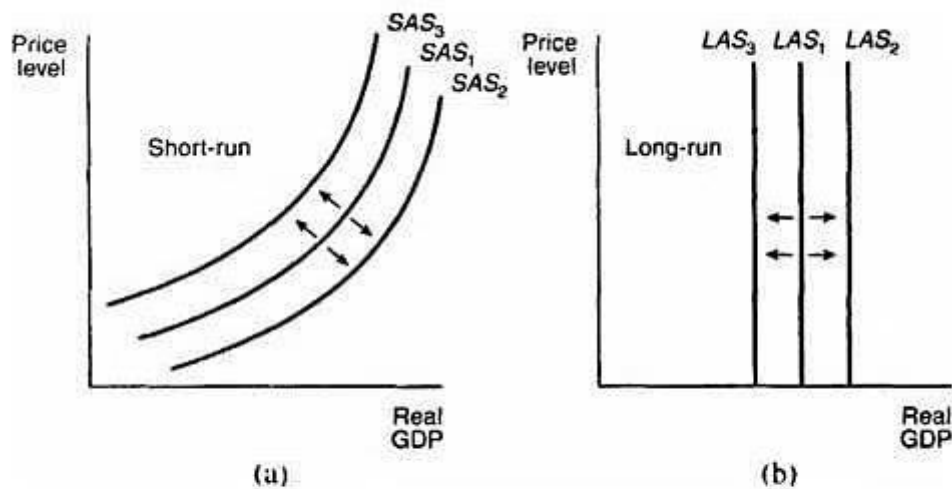


Figure 2 Shifts of the aggregate supply curve

- A shift to the right of the SRAS curve from SRAS 1 to SRAS 2 or of the LRAS curve from LRAS 1 to LRAS 2 indicates that the quantity supplied of real GDP has increased at the same price levels.
- A shift to the left of the SRAS curve from SRAS 1 to SRAS 3 or of the LRAS curve from LRAS 1 to LRAS 3 indicates that the quantity supplied of real GDP has decreased at the same price levels.
- Changes in aggregate supply, like changes in aggregate demand, are not caused by changes in the price level.
- They are instead primarily caused by changes in the following two factors:

3.3 Input Prices

- Since the SRAS curve is drawn under the assumption that input prices remain constant, the decrease in aggregate supply caused by an increase in input prices is represented by a shift to the left of the SRAS curve.

- A shift to the right of the SRAS curve represents an increase in aggregate supply as a result of lower input prices.
- For example, the price of oil, an input good, rose dramatically in the 1970s as a result of efforts by oil-producing countries to limit the amount of oil sold.
- Oil or oil products are used as inputs in many final goods and services. Due to rising costs, suppliers of these final goods and services were forced to reduce their supply at all price levels.

3.4 Economic Growth

- Positive economic growth occurs as a result of an increase in productive resources such as labour and capital.
- With more resources, it is possible to produce more final goods and services, resulting in an increase in the natural level of real GDP.
- Positive economic growth is thus characterized by a shift to the right of the LRAS curve.
- Negative economic growth, on the other hand, reduces the natural level of real GDP, causing the LRAS curve to shift to the left.

3.5 Significance

- The importance of aggregate supply was discovered in the 1970s.
- A reduction in oil supply orchestrated by Saudi Arabia late in 1973 resulted in rising unemployment and inflation in the United States.
- Higher unemployment, according to the Phillips Curve, should have resulted in lower inflation.
- To explain the anomaly, economists coined the phrase "**adverse supply shock.**"

3.6 Drawbacks

- Changes in aggregate supply are a reaction to changes in aggregate demand, which are manifested as price changes.
- However, because many prices are sticky and economic agents take time to recognize changes in price levels, there is a difference between aggregate supply in the short run and aggregate supply in the long run.
- Keynes argued that since prices are sticky in the short run, they do not decline enough to stimulate aggregate demand which can return real GDP to its natural level.
- The only way to increase aggregate supply is to raise prices, which reduces aggregate demand. As a result, firms cut back on production.
- Input prices can also be affected by inflation expectations.
- For example, if union workers anticipate higher inflation, they will demand higher wages when their labour contract is renewed

- Factors that reduce productivity, such as increased regulations, strikes, or, depending on the industry, bad weather, can also cause the SRAS curve to shift to the left.

3.7 Conclusion

The goods and services produced by an economy are referred to as aggregate supply. It is propelled by four production factors: labour, capital goods, natural resources, and entrepreneurship. The availability of financial capital augments these factors.

4. Types of Goods

Goods are items and resources that meet people's needs and desires. A good can be a physical item, a service, or a combination of the two. Almost anything is good if it provides some sort of benefit to consumers. Since goods are diverse, they're categorized into distinct groups with unique characteristics that determine their value.

Learning about the various **types of goods** can assist you in determining how they affect the economy and your own life. In this article, we will define goods and identify various types using examples.

Types of Goods

4.1 Consumption Goods

Consumption goods are those items that are directly employed to satisfy human needs. These aren't used in the manufacture of any other products. Consumption goods are final items that are meant to be consumed. **Households, for example, ice cream and Chocolate.** The UPSC Indian Economic Syllabus includes the Consumption Goods which is described in this article.

4.1.1 What is Consumption Goods?

- Consumer goods are items purchased by the average person for personal consumption.
- Consumer goods, also known as final goods, are the end product of production and manufacturing and are what a customer will see on the store shelf. Consumer goods include things like clothing, food, and jewelry.
- Because basic or raw minerals, such as copper, must be processed into usable items, they are not considered consumer goods.



Examples of Consumption good

1. Food
2. Clothing
3. Vehicles
4. Electronics
5. Appliances

4.1.2 Conclusion

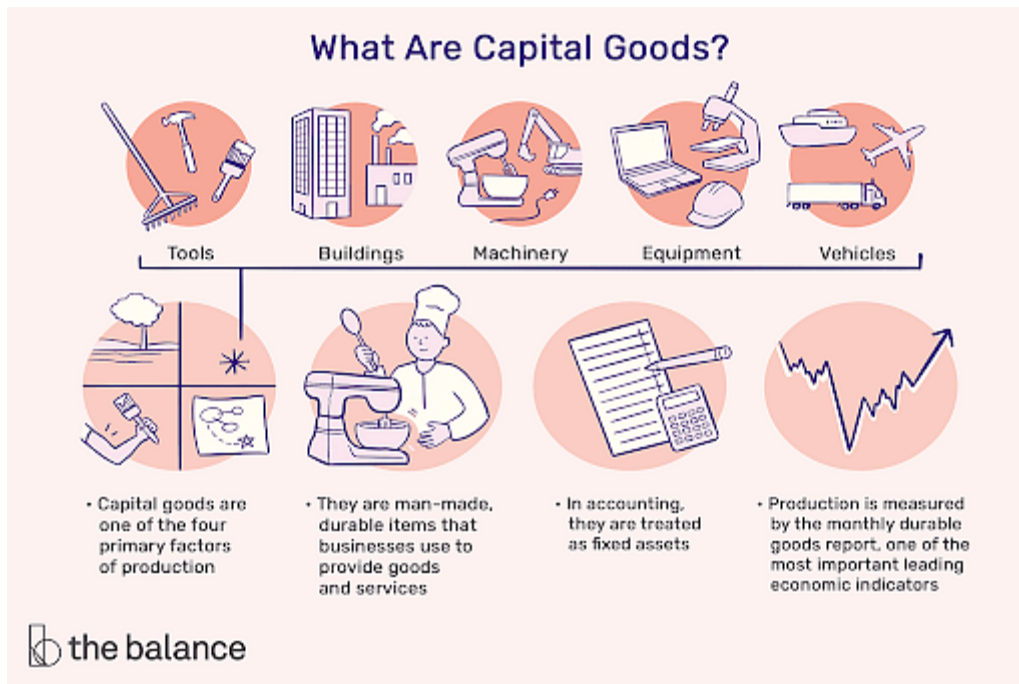
- Consumer goods, often known as final goods, are goods supplied to consumers for their personal use or enjoyment rather than as a way of generating additional economic activity.
- Consumer goods can be classed as durable (useful for more than three years), nondurable (useful for less than three years), or pure services from an economic standpoint (consumed instantaneously as they are produced).
- Consumer goods can be divided into distinct categories for marketing purposes depending on consumer behavior, how customers shop for them, and how frequently they shop for them.

4.2 Capital Goods

Any tangible assets that an organization uses to generate goods or services, such as office buildings, equipment, and machinery, are referred to as **capital goods**. The UPSC Indian Economic Syllabus includes the Capital Goods which is described in this article.

4.2.1 Capital Goods

- Fixed or tangible assets purchased by a business to generate completed products or consumer goods are referred to as capital goods. Capital goods are difficult to convert into cash. They are long-lasting and do not rapidly wear out.
- Equipment, machinery, buildings, computers, and other capital items are some of the most common examples. Capital goods are most typically employed in macroeconomics to determine capital formation and output capability.



- Capital goods, land, labor, and entrepreneurship are all necessary components in the production of commodities. The fundamental factors of production are these four factors taken together.
- The goods that can be used to increase production are referred to as capital goods. Plant, property, and equipment are the three most common types of capital goods. The producer needs to invest a significant quantity of money to purchase capital goods. As a result, in accounting, the acquisition of a capital good is referred to as a capital expense.
- Capital goods are depreciated to the extent of their useful life using depreciation procedures in accounting because they are not used in a year.

4.2.2 Importance of Capital Goods in the Economy

- Capital goods are products that require significant investment and play a vital role in the economy.
- They operate as a barrier to entry for new businesses that do not have the financial resources to purchase such equipment.
- A company cannot compete in the market if it is unable to create items owing to a lack of equipment.
- Capital goods play a critical role in increasing long-term goods production capacity, or in other words, increasing the capacity to produce products and services.

Table 4.1: Capital Goods vs. Consumer Goods

BASIS FOR COMPARISON	CONSUMER GOODS	CAPITAL GOODS
Meaning	Consumer goods are goods that are utilized for consumption by the end-	Capital goods are goods that are used to manufacture consumer

	user.	goods.
Marketing	Business to Consumer	Business to Business
Purpose	Purchased for personal use only.	Purchased to be used in the production of other products.
Buyer	Consumer	Manufacturers
Demand	Direct Demand	Derived Demand
Price determination	By suppliers	By companies
Meant for	Final Consumption	Final Investment

4.2.3 Conclusion

- Businesses use capital goods, which are man-made, long-lasting commodities, to generate goods and services. Capital items include tools, machinery, buildings, automobiles, computers, and construction equipment.
- One of the four major economic elements is capital goods. An increase in capital goods orders and shipments indicates that firms anticipate more demand and that the economy will expand.

4.3 Intermediate Goods

Intermediate goods are things that are used in the manufacturing of other commodities that are eventually sold to customers. In most cases, intermediate goods are utilised directly by a producer, sold to another company to build another intermediary good, or sold to another company to make a completed product. The UPSC Indian Economic Syllabus includes the Intermediate Goods which is described in this article.

4.3.1 What are Intermediate Goods?

- Goods used by businesses to **produce goods or services** are referred to as intermediate goods. Producer goods are another name for these items.
- To put it another way, intermediate goods are used to make final or consumer goods. They can also be described as inputs into other goods and as ingredients in the end goods.
- Intermediate products can be created by a company for use in the manufacture of final goods or finished goods, or they can be sold to another company that produces final goods.
- **Semi-finished goods** are another term for these items. Intermediate goods can be utilised in the following three ways:
 1. Producing and utilizing for personal gain
 2. Producing and selling intermediate goods to other firms
 3. Companies buy them for a specific purpose or to make other intermediate items.

Intermediate goods can **either form part of the final product or be altered beyond recognition** during the manufacturing process to create completed goods.

4.3.2 Intermediate Goods and Gross Domestic Product

- The GDP of a country is not calculated using intermediate goods. The reason for not adding them in the GDP is that doing so would result in the value of the items being counted twice, although the standard is to only calculate the price of finished goods once.

4.3.3 Classify Goods

How to Classify Goods as Intermediate and Final Goods

- The best way to identify things as intermediate or final goods is based on the product's intended purpose rather than the product itself.
- Any commodity can be classed as a final good or an intermediate good depending on its intended purpose.
- With the help of an example, this can be better understood.
- Salt is used in the baking of bread as well as for direct eating. Salt serves as an illustration of how an intermediate item can also serve as a final good.
- Salt used in bread making is categorized as an intermediate good, whereas salt consumed directly is classified as a final good.

Intermediate Goods (example)



The cost of the intermediate goods is included in the cost of the final good. **\$1.75 ea.**

Few more illustrations

- Car engines are an example of a good that is created and then used as inputs into final goods by the producer.
- Some vehicle manufacturers will build their own unique car engines, which will then be used as inputs into autos that will be sold to consumers once they are done.
- Steel, which is used in the completion of buildings, bridges, cars, and trains; wood, which is used in the construction of homes, furniture, and hardwood flooring; precious metals such as gold and silver, which are used in the production of jewellery; and glass, which is used in the production of windows, ornaments, wine

bottles, and photo frames, are just a few examples of goods that are produced and then sold in their partially completed form to other companies.

4.3.4 Conclusion

- An intermediate good, also known as a consumer good, is a product that is utilised to make a final good or finished product. Because salt is consumed directly by consumers and utilised by producers to make other food products, it can be considered a finished product.
- Intermediate goods are traded between industries for resale or for use in the manufacture of other items. Because they are utilised as inputs to form part of the finished product, these commodities are also known as semi-finished products.

4.4 Speciality Goods

- Specialty goods have unique characteristics (and prices) and necessitate special purchasing efforts.
- **Rare art collectibles, antiques,** and fashion items are examples of specialty goods.

4.5 Inferior Goods

- An inferior good is one in which an increase in income causes a decrease in demand. It has a **negative elasticity of demand**.
- For example, as your income grows, you buy less low-value bread and more high-quality, organic bread.

4.6 Normal Goods

- An increase in income leads to an increase in demand. It has a **positive elasticity of demand**.
- It is important to note that a normal good can be either income elastic or income inelastic.

4.7 Luxury Goods

- A luxury good is one in which an increase in income causes a greater percentage of increase in demand. This indicates that the **elasticity of demand is greater than one**.
- High-Definition televisions, for example, would be considered a luxury item.
- People spend a greater proportion of their income on luxury goods as their income rises.
- It should be noted that a luxury good is also a normal good, but a normal good is not always a luxury good.

4.8 Complementary Goods

- Items that are used together. For example, a television and a DVD player.

4.9 Substitute Goods

- Products that are alternatives, such as Pepsi and Coca-Cola.

4.10 Giffen Good

- A rare type of good in which a price increase leads to an increase in demand.
- Since you can't afford more expensive goods, the income effect of a price increase causes you to buy more of this cheap good.
- For example, if the price of wheat rises, a poor peasant may no longer be able to afford meat and thus must purchase more wheat.

4.11 Veblen / Snob Good

- A good whose price increase encourages people to buy more of it. This is because they believe that more expensive goods are superior.

4.12 Free Goods

- If one does not need to pay anything for a good, it is called “free good”.
- **Air – which we breathe** – is the best example of a free good. It has utility, but it is so abundant in nature that we don't have to pay a price for both its production and use.
- However, a free good sold for promotion is not a free good in the economic sense.

4.13 Basic Goods

- A basic good is one that does not have utility in and of itself but is derived from another good that does.
- For example, **cotton or textile** is a basic good because clothing made from it is useful.
- In another sense, basic goods are bulk or raw material products used in the production of new items in agriculture, manufacturing, or construction.

4.14 Intermediate Goods

- Intermediate goods are unfinished goods that are used as input for further processing.
- Thus, intermediate goods are found in the production chain between raw materials and finished goods.
- For example, **Sugarcane** is an intermediate good in the manufacture of Sugar.

4.15 Finished Goods

- A finished product has completed the necessary manufacturing and is ready to be used. Finished goods are ready for consumption or distribution.
- The electronics we use such as **TV, smart phones** are examples of finished goods.

4.16 Capital Goods

- **Plants, machinery, and other assets** used in the conversion of basic goods to finished goods are referred to as capital goods.
- Except for wear and depreciation, Capital Good provides service without losing its essential functional characteristic, form, or shape.
- Furthermore, a Capital Good is a finished good because it does not require any further processing.

4.17 Producer Good

- A producer is any good that is used to manufacture other goods or services.
- As a result, all basic goods, intermediate goods, and capital goods are Producer goods because they are used in the production of other goods.
- The basic and intermediate goods are raw materials, but NOT capital goods.

4.18 Consumer Goods

- While producer goods are used to make other goods, consumer goods are used for personal consumption.
- Consumer goods are generally, but not always, "Finished Goods" because they are ready to use without further processing or changes.
- Some consumer goods may require additional processing – for example, **cloth that must be sent to a tailor** is both a consumer good and an intermediate good.
- Consumer goods are classified into two types: consumer durable goods and consumer non-durable goods.

Consumer Durable Goods (aka. Consumer Durables)

- Non-perishable goods, such as electronics, are classified as consumer durables.
- Such items do not need to be purchased on a regular basis because they are designed to last for at least three years.
- They are generally more expensive than non-durables.

Consumer Non-durable Goods (aka. Consumer Non-durables)

- Consumer non-durables are perishable goods such as fruits, vegetables, cosmetics, food items, and so on that we must purchase on a regular basis.

4.19 Convenience Goods

- Convenience goods are items that are purchased frequently, quickly, and with minimal effort.
- These include **candy, ice cream, cold drinks, cigarettes, magazines**, and medicines, among other things.

4.20 Shopping Goods

- Shopping goods are those purchased after selecting, purchasing, and comparing various goods.

- In general, shopping goods are long-lasting items such as **furniture, dresses, electronic** items and appliances, and so on.

4.21 Public Goods

- Goods with non-rivalry and non-excludability characteristics, such as national defence.

4.22 Merit Goods

- Goods whose benefits people may underestimate and may have positive externalities, such as education.

4.23 Demerit Goods

- Goods in which the consumption cost may be underestimated and it may often have negative externalities, such as smoking and drugs.

5. Final Goods

Final goods are finished goods that are sold in the market for consumption or investment. Since these are finished goods that do not require further processing, they are produced for their own sake. Final goods meet the needs of producers or consumers, or both.

The value of these goods constitutes the **Gross Domestic Product (GDP)**. Only newly produced goods and services are considered final goods when calculating GDP. It is done to avoid counting goods that have already been counted.

5.1 Classification of Final Goods

Final goods are divided into two groups: **Consumption Goods and Capital Goods**.

Consumption Goods

- **Consumption goods** are those that directly satisfy the desires of consumers.
- For example, Bread, butter, shirts, pens, televisions, furniture, and so on.

Consumption goods are further sub-divided into following categories:

- **Durable goods:** It refers to items that can be used repeatedly over an extended period of time. For example, televisions, refrigerators, and so on.
- **Semi-durable goods:** Semi-durable goods are those that can only be used for a limited time. These items have a one-year shelf life. For example, clothing, crockery, shoes, and so on.
- **Non-durable goods:** These goods are those that are consumed in a single act of consumption. These items can only be used once. For example, milk, bread, cereal grains, paper, and so on.
- **Services:** Services are non-material goods that directly satisfy human desires. They are intangible activities, which cannot be seen or touched. For example, the service of teachers, doctors, and banks.

Capital Goods

- **Capital goods** are finished goods that aid in the production of other goods and services. For example, plant and machinery, equipment, and so on.
- They will be used for productive purposes in the future and have a life expectancy of several years.
- They do not lose their identity during the manufacturing process, i.e., they do not become merged during the manufacturing process.
- They will require repairs or replacement over time as they depreciate.
- They have derived demand because their demand is derived from the demand for other goods that they contribute to the production of.

Examples;

- All goods (durable or non-durable) purchased by consumer households. For example TV, fridge, vegetables, electricity, food, etc.
- Goods purchased by production units (producer) for investment (for capital formation). For example machinery, furniture, etc.
- There is no clear dividing line between consumption and capital goods. The same good can be both consumption and a capital good. It is determined by the ultimate use of the good.
- A machine purchased by a household is consumption good, whereas a machine purchased by a firm for use in the business is a capital good.

6. Unemployment

Unemployment is a circumstance in which a person who is actively looking for a job is unable to find work. Unemployment is seen as a significant indicator of the economy's health. **Types of Unemployment** are Frictional, cyclical, structural, voluntary, seasonal, disguised, and open and underemployment. This article discusses the types of unemployment that are essential for UPSC aspirants.

6.1 Types of Unemployment

Unemployment can be grouped into various types based on the nature of work, the structure of the economy, the nature of the seasons, technological advancements in an economy, etc. Various types of unemployment are discussed below.

6.1.1 Frictional Unemployment

- It is when there is the least amount of unemployment prevailing in an economy due to workers quitting their previous jobs and searching for new jobs.
- One of the major causes of occurrence of frictional unemployment is **lack of information about the availability of jobs and non-willingness of mobility** on the part of workers (it means workers are not willing to travel to a distant place or a new state for employment).
- A frictionally unemployed person remains unemployed for a **very brief period of time**.

6.1.2 Cyclical Unemployment

- It occurs during the **cyclical trends of booms and recessions** of a business cycle.
- This type of unemployment occurs mainly **due to either deficiency or fall in effective demand from consumers** which in turn leads to a fall in production and low demand for labor.
- This type of unemployment occurs for a long period of time and workers remain unemployed during the entire phase of slowdown.
- The unemployment crisis due to the 2008 financial crisis is an example of

6.1.3 Voluntary unemployment

- It is when workers are **either not seeking work or are in transition** from one job to another.
- Voluntary unemployment is present all the time in an economy.
- As there will always be some workers, who quit their previous jobs in search of new ones

6.1.4 Involuntary unemployment

- It is when **workers are actively seeking employment and are willing to work but are unable to get work.**
- Involuntary unemployment happens in an economy during the **time of depression** and decreases in aggregate demand for goods and services.

6.1.5 Structural unemployment

- It refers to a situation that arises as a result of a **change in the structure** of the economy.
- For instance, when an economy transforms itself from a **labor-intensive to a capital-intensive economy**, structural unemployment happens due to the mismatch of skills.
- As a result, workers who do not know how to operate the new and advanced technologies will be removed.
- This type of unemployment happens as the current workers do not have the skills required by their employers.

6.1.6 Seasonal unemployment

- This happens **during specific seasons of the year**. It is more prevalent in sectors and occupations such as agriculture, holiday resorts etc., where production activities take place only in some seasons.
- Therefore, they offer employment for only a certain period of time in a year.
- People **engaged in seasonal activities** may remain unemployed during the off-season

6.1.6.1 Reasons for Prevalence of Seasonal Unemployment

- In India, agriculture is the most common occupation taken up by the people. Agriculture in India is mainly **dependent on monsoons**, due to which agricultural **labor has no work to do in the non-monsoon season**.
- Therefore, this implies that the labor has **no wages as well in the offseason**.
- They remain **unemployed for the rest of the year** when they don't have work. As the word itself indicates, seasonal unemployment in India is majorly caused by the change in seasons.

6.1.6.2 Impact of Seasonal Employment

- When the labor is unemployed for a part of the year, it becomes **difficult to cover up the expenses** incurred during the off-season such as periodical payment of rent and other bills, etc.
- Savings is not possible due to already **meager wages**.
- In a few places, people take up **various other jobs during the off-season**. This can help them build their skills and try out new things.

- It can cause **migration in search of work**, however, in the case of permanent migration, it could lead to **drainage of human resources**, which could have been tapped and used otherwise.

6.1.7 Open unemployment

- It is a condition where **people have no work to do**. It is also known as **naked unemployment**.
- Here individuals are able to work and are also willing to work but there is no work for them.
- It is frequently found in larger cities and is less frequent in villages. Most of such individuals come from villages in search of jobs or might originate in cities themselves.
- Such employment can be seen and counted in terms of the number of such persons. Hence it is called open unemployment..

6.1.8 Under-employment

- It is a scenario where employed people are **contributing to production less than they are capable of**.
- It can be estimated in terms of time, which is visible under-employment or type of work, which is invisible under-employment. Part-time workers come under this category.

6.1.9 Disguised Unemployment

- It occurs when a person is the **one who seems to be employed but actually, he is not. His/Her contribution to the total output is either zero or negligible**.
- When more individuals are engaged in a job than the number actually required it leads to a state of disguised unemployment.
- It is mostly seen in rural areas such as in agricultural activities

6.1.9.1 Reasons for Prevalence of Disguised Unemployment

- According to the census 2011 India, being the second-most-populous country has almost **70% of its total population in rural areas**.
- High population growth leads to **surplus labor**, especially in the rural areas however, employment in such areas **mostly remains seasonal**, thus creating disguised unemployment.
- **Poverty** results in limited capital in hands of the individual causes inability to purchase land and thus people have access to limited capital.
- **Limited availability of capital** increases the **dependency** of more people on limited resources.
- In labor-intensive economies with a high population, **labor is available at cheaper rates**, therefore more people are easily employed for a particular work, which could be done by a much lesser number of individuals

- At a time when the majority of India's population lives in rural areas with limited means, **people lack proper skills that need to be recruited at better places.**

6.1.9.2 Measures to Prevent Disguised Unemployment

- **Population control measures** to control the increase of the population.
- Increase in various measures that can provide easy availability of **credit to the people for self-employment.**
- Providing **skill development** and entrepreneurship programs.
- Encouraging **mobility of the workforce** from rural to urban areas.

6.1.10 Vulnerable Employment

This means, people, **working informally, without proper job contracts** and thus gets deprived of any legal protection. These persons are regarded as unemployed since records of their work are never maintained. It is one of the main types of unemployment in India.

6.1.11 Technological Unemployment

- It is unemployment that occurs as a **result of the loss of jobs due to changes in technological developments.**
- According to World Bank data, the proportion of jobs threatened by automation in India is 69% on a year-on-year basis.

6.2 Conclusion

Unemployment can be caused by various reasons ranging from changes in seasons, the structure of the economy to changing technological advancements. Unemployment caused due to seasonal nature can be temporary and have less impact on the economy, however, unemployment caused due to the structural nature of the economy can have a more permanent character.

7. Unemployment Rate

Unemployment happens when a person who is **actively searching for a job is unable to find work**. Rising unemployment indicates the **health and the growth potential** of the economy. **The unemployment rate** is the ratio of unemployed workers to the total labor force. According to the Centre for Monitoring Indian Economy (**CMIE**), the unemployment rate in India is **6.57% in Jan 2022**. It can be measured by various metrics, one of which is the unemployment rate which would be discussed in this article from the perspective of UPSC aspirants.

7.1 What is the Unemployment Rate?

- The unemployment rate is the most **frequent measure of unemployment**.
- The unemployment rate is the number of people unemployed divided by the working population/people working in the labor force.
- It is represented in the following manner.
 - **Unemployment rate = (Unemployed Workers / Total labor force) × 100**

7.2 Recent Trends in Unemployment Rate (January 2022)

- According to the Center for Monitoring Indian Economy (CMIE) unemployment rate in India in **January 2022 fell sharply to 6.57%**, the lowest rate recorded since March 2021.
- The lowest unemployment rate in January was recorded by Telangana at 0.7%.
- The unemployment rate in Gujarat was at 1.2%, in Meghalaya at 1.5%, in Odisha at 1.8%, and 2.9% in Karnataka.
- The highest unemployment rate was recorded in Haryana at 23.4% in January 2022.
- Also, a high rate of unemployment was seen in Rajasthan (18.9%), Tripura (17.1%), Jammu & Kashmir (15%), and Delhi (14.1%).
- Rural unemployment declined in January 2022 to 5.84% as against 7.28% in December 2021.
- **Urban unemployment was recorded at 8.16% compared to 9.30% in December 2021.**

7.3 COVID impact on Unemployment Rate

- Unemployment across the country was significantly impacted by the pandemic. For instance, the restriction was imposed in various parts of the country such as in **Delhi the gyms, shopping malls, schools, and cinemas were closed**.
- States such as Haryana and West Bengal restricted public gatherings and imposed other similar curbs. These events impacted the economic output and **increased the unemployment rate**.

7.4 Conclusion

Unemployment is an evil that greatly impacts economies such as India with high demographic potential. If left unattended it can spiral from demographic dividend to demographic burden. This can be measured by various metrics, one being the unemployment rate, which tells about the percentage of unemployed individuals in an economy among individuals currently in the labor force.

8. Labor Force Participation Rate (LFPR)

Labor Force Participation Rate (LFPR) is known as the section of the working population in the age group of 16-64 in the economy currently **employed or either seeking employment**. According to the **Quarterly Bulletin (Oct-Dec 2020)** of the Periodic Labour Force Survey (PLFS), the **LFPR in urban areas was 73.6% and 20.6% for men and women respectively**. This article highlights the topic of labor force participation rate that is important for aspirants preparing for the UPSC examination.

8.1 What is the Labor Force Participation Rate?

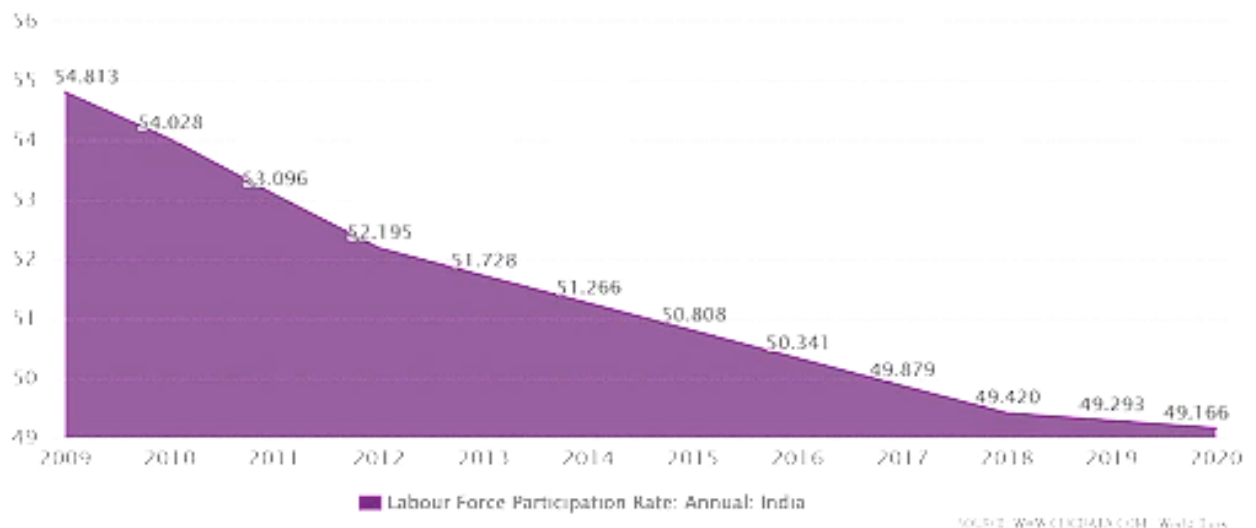
- It is an important metric when the **economy is not growing or witnessing recession**.
- The labor force participation rate (LFPR) is a measure undertaken to evaluate the working-age population in an economy.
- The participation rate estimates the total number of people who are currently employed or are in the search of a job.
- People who are **not looking for a job such as full-time students, homemakers, individuals above the age of 64, etc** are not a part of this data set.

8.2 Significance

- During a recession, the labor force participation rate mostly decreases.
- During the time of recession, the economic activity is low which results in fewer jobs across the country.
- When jobs are less, people do not take extra efforts to focus on employment which eventually leads to a lower participation rate in the economy.
- The Labour force participation rate helps to **understand the unemployment rate in the economy**. Consistent analysis of the unemployment rate in the economy is essential.
- Higher labor force participation is a good sign for the economy whereas if it is on the lower side, it can also act as a warning sign for any economy.

8.3 Recent Trends

- Data for India's Labor Force Participation rate is provided by CEIC and the annual Periodic Labour Force Survey (PLFS).
- As per the CEIC data, the Labor Force Participation Rate dropped to 46.3 % in December 2020 as compared with 49.3 % in the previous year.
- It is updated every year from December 1990 to December 2020, with an average rate of 57.5%.
- It reached an all-time high of 58.4% in December 1990 and a record low of 46.3 % in December 2020.
- The Unemployment Rate of India increased to 7.1 % in Dec 2020.



Labor Force Participation Rate in India

8.4 Conclusion

Labor Force Participation Rate is one of the important indicators of labor market measure because it represents the relative amount of labor resources available for the production of goods and services. This metric helps the policymakers to provide conducive welfare measures that boost the participation of the labor force in the economy, thereby increasing the economic output.
